



Tax Deductions of Expenses Paid by PPP Forgiven Loan Proceeds

The following information was prepared by the Avitus Group Tax & Accounting Department.

On April 30, 2020 the Internal Revenue Service ("IRS") issued Notice 2020-32 which covers guidance for the federal deductibility of expenses paid for Paycheck Protection Program ("PPP") loan proceeds which are forgiven under the CARES Act.

The PPP loan program has provided loans to many small businesses over the last few weeks and one of the main features of the program is the ability of borrowers to receive forgiveness of the loan used for allowed expenses. The CARES Act made no mention of the ability of a borrower to deduct expenses paid for by PPP loan proceeds

The IRS is now stating that, with the silence of the Act with regard to deductibility of these expenses, they are applying a section of the Internal Revenue Code (specifically §265 and the Regulations thereunder) to the issue of deducting expenses that were paid for by forgiven loan amounts borrowed under the PPP.

Under this section, expenses that are allocable to any class of income that is exempt from tax are not allowed as a federal tax deduction. Normally, income includes loans which are forgiven.

There are exceptions in applying this rule, including part of the Act which specifically states that any amount which would otherwise be income because of the forgiveness shall be excluded from gross income. This means that loan forgiveness income becomes tax exempt income.

I'm a business owner who received a PPP loan. How do I plan for any tax implications?

- Accounting for expenses should continue as would usually occur in the normal course of business. Best practices now used by ABS Accounting Services include categorizing all such expenses with a coding that allows for the accumulation of all PPP loan funded expenses into reports to be used in applying for loan forgiveness. In addition, try to set up a separate bank account to deposit the PPP funds so they are not comingled with other accounts. Expenses may also be tracked in a separate spreadsheet should your software not have the capability to assign a class code to the transactions associated with qualifying expenses.
- The estimation of the amount of loan forgiveness does not change. The total of qualified expenses paid during the 8 week period following the funding of the loan will be considered for forgiveness.
- The requirements that such expenses must be part of the types listed in the Act (payroll costs, certain interest payments, rents and utilities), that forgiveness is reduced by any reduction of full-time equivalent employee headcount or more than 25% salary of each employee, and expenses other than payroll costs must not exceed 25% of the total loan forgiveness, have not been altered.
- For income tax planning purposes, no deductions that are directly traceable to the PPP forgiven loan proceeds should be taken into consideration in determining taxable income.
- Expenses allowed by the bank used to document the loan proceeds that are forgiven will be excluded as deductions for income tax purposes. The total of such expenses will be determined with the borrower's bank and will require supporting documentation to be allowed as forgivable expenses.



Sample Calculations

For example, a company applies for and receives a loan under the PPP in the amount of \$100,000. During the 8-week period following the funding of the loan, the company spends \$90,000. \$80,000 is used to pay for payroll costs, \$10,000 is used for rent and utilities, and the remaining \$10,000 is used for allowable expenses but not until week ten and are therefore excluded from the forgiveness calculation.

The company successfully applies for forgiveness of \$90,000 and will not need to repay that portion of the original loan. \$10,000 must be repaid within 2 years of the loan origination with interest of 1% on the balance.

Loan Proceeds	\$100,000
Loan Forgiven.....	<u>(\$90,000)</u>
Remaining loan	\$10,000
Expenses	\$100,000
Allocated to Forgiveness	<u>(\$90,000)</u>
Expenses Deducted	\$10,000

Avitus Group will continue to monitor activity in this area by the IRS as well as Congress. If any significant change occurs we will post another memo on the subject. However, everyone should be mindful that the IRS guidance is now operable and must be used absent substantial authority.

This document is based on the latest information available on 5/5/2020 and subject to change. Additional information can be found on our Avitus Group COVID-19 Resources page at <https://avitusgroup.com/covid-19/>

NOTE: This material is provided for information purposes only. It does not constitute legal advice. We recommend you consult with a licensed attorney before taking any actions based on the materials provided. All copyrights to the materials belong to the authors.