

# DEDUCTIBILITY OF EXPENSES PAID WITH PPP LOAN FUNDS

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Typically, businesses can deduct ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business from their otherwise taxable income. Historically, this includes (among other things) expenses like payroll costs consisting of wages and benefits, rent, utilities, and certain interest paid or accrued, including that incurred on a mortgage obligation of a trade or business.

These are also the “covered expenses” for which a PPP loan may be used to qualify for forgiveness. This begs the question: **If loan proceeds are used for “covered expenses” which would normally be deductible, can the deduction still be taken against other business income?**

The IRS addressed this by publishing Notice 2020-32<sup>[1]</sup>, stating that no deduction is allowed for an expense that would otherwise be deductible, if the payment of the expense results in forgiveness of a covered loan pursuant to Section 1106(b) of the CARES Act. The reason is that Section 265(a)(1) of the Internal Revenue Code, along with Section 1.265-1 of the Income Tax Regulations, provides that deductions are not allowed for expenses to the extent the expenses are allocated to income which is exempt from taxes. The IRS has taken the position that the payment of expenses resulting in loan forgiveness is automatically allocated to income exempt from taxes (the forgiven loan proceeds), and deductions related to the use of such proceeds are therefore not allowed.

**In short, the IRS does not want businesses double-dipping on tax benefits under the PPP.**

This makes sense, as it would otherwise allow the taxpayer to use loan proceeds (which are forgiven and untaxed) to pay expenses, and then deduct those expenses against other taxable income, resulting in a “double tax benefit.” To the extent unforgiven loan proceeds are used on expenses which would normally be deductible, those expenses should still be deductible. Notice 2020-32 specifically states that that the exclusion from deductibility applies “to the extent of the resulting covered loan forgiveness (up to the aggregate amount forgiven) because such payment is allocable to tax-exempt income.”

However, commentators including the American Institute of Certified Public Accountants have observed that the IRS’s position contradicts the spirit of the CARES ACT and PPP. <sup>[2]</sup> **Lawmakers may soon override the double-dipping rule, so be sure to check back here for updates.**

If you have questions or concerns about how Notice 2020-32 applies to your PPP loan, please reach out to one of our attorneys today.

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