

NEWS & INSIGHTS

IRS issues new guidance on the deductibility of business expenses paid for with PPP funds

INSIGHTSLEGAL UPDATE

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The below information is current as of the publication date listed. Because COVID-19 response measures on all fronts are continually evolving, clients should stay alert to new developments and consult with counsel on any critical questions.

Last week, the Internal Revenue Service (IRS) issued [Revenue Ruling 2020-27](#), providing clarity on the ability of a

Paycheck Protection Program (PPP) loan recipient (i.e. business owner) to deduct business expenses paid for using PPP loan proceeds. The updated ruling reinforces previous guidance issued in May through [Revenue Ruling 2020-32](#) and if not followed, may increase the audit risk of a business owner by potentially understating their total net income (or overstating their potential loss).

Generally, deductions for business expenses paid for using PPP loan proceeds are prohibited if the loan recipient is reasonably expected to receive PPP loan forgiveness (which means that the loan recipient followed all PPP rules regarding fund use during the covered loan period). For example, a business that used its PPP loan proceeds to pay employee wages and rent will not be permitted to deduct either as an ordinary and necessary business expense on its year-end tax return. In the foregoing example and as stated above, if the business does not follow the ruling and deducts the expenses on their year-end tax return, their annual net income may be understated (or loss overstated). This immediately increases the risk that upon audit or otherwise, and a governmental authority may assess additional tax, penalty and interest.

Since the Coronavirus Aid, Relief and Economic Security (CARES) Act that created the PPP loan program was signed into law in March, business owners have been frustrated by the lack of clarity and frequent changes related to PPP loan and loan forgiveness procedures. Given the challenging economic climate and uncertainties created by the pandemic, many hoped that Congress and/or the IRS would give business owners a break and reverse its earlier position on the permissibility of loan recipients to deduct expenses paid for using PPP funds – arguing that the additional tax break was an intended result of the CARES Act. Since the IRS remains firm in its position, we may see court challenges in the near future. However, until the IRS changes its position or Congress changes the law, business owners seeking PPP loan forgiveness should ensure that their accounting books and records are able to separately track expenses paid for using PPP funds.

Saxton & Stump attorney [Rick Calabrese](#) can help you navigate the complex rules related to PPP loans and loan forgiveness and can assist with analyzing the deductibility of certain business expenses under Revenue Ruling 2020-27. In addition, Saxton & Stump is able to assist with other tax and business matters as businesses seek solutions to overcome the impacts of the COVID-19 pandemic.

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