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Legislative update: Proposal to clarify the deductibility of PPP expenses

Provisions in the pending “Consolidated Appropriations Act, 2021” are intended to clarify the deductibility of Paycheck Protection Program (PPP) expenses.

Background

The Paycheck Protection Program (PPP) was enacted as part of the “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act) in March 2020 and expanded by the “Paycheck Protection Program Flexibility Act” in June 2020. Under the PPP, qualified borrowers could receive loans of up to \$10 million that were guaranteed by the Small Business Administration. Critically, if the PPP loan proceeds were used by borrowers on certain qualified expenses, the CARES Act provided that the loan could be forgiven **and** that such forgiveness would be excluded from gross income for federal income tax purposes.

Almost as soon as lenders began making the first PPP loans in April 2020, questions arose as to the tax treatment of the loans, their associated tax attributes, and the impact of the potential forgiveness on both of those issues.

Notice 2020-32 (May 2020) asserted the IRS position that otherwise deductible expenses should not be deductible for tax purposes if it was expected that the PPP borrower would get forgiveness based on such expenses. Read [TaxNewsFlash](#)

Tax professionals observed that this position came as a surprise to many, including some of the congressional drafters of the PPP provisions. There were bipartisan calls for the IRS to reverse this position, and also talk of clarifying congressional intent in future legislation.

Rather than reversing course, the IRS in November 2020 released Rev. Rul. 2020-27 that amplified the earlier interpretation. The revenue ruling asserted that a PPP borrower that paid eligible expenses in 2020 is not to deduct those expenses for federal tax purposes if it anticipated applying for forgiveness of its PPP loan—regardless of whether the borrower had applied for forgiveness already, and regardless of whether the borrower might apply in 2020 or 2021. Read [TaxNewsFlash](#)
Provisions in pending legislation

In the text of the [bipartisan omnibus bill](#) [PDF 8.43 MB] (5,593 pages), Congress has included language to clarify its original intent and to provide that the PPP-funded expenses of borrowers would be deductible for federal income tax purposes, regardless of the fact that the PPP loan is or will be forgiven.

In addition, while it had been reported that earlier versions of this provision included limitations that could restrict deductibility based on the size of a PPP borrower's loan, the text of the bill does not impose conditions or guardrails on the deductibility of expenses. The language specifies that it would be effective retroactively as of the date of enactment of the PPP in the CARES Act.

The relevant text of a [bill summary](#) [PDF 246 KB], titled "Sec. 276. Clarification of tax treatment of Paycheck Protection Program loans" provides the following:

The provision clarifies that gross income does not include any amount that would otherwise arise from the forgiveness of a Paycheck Protection Program (PPP) loan. This provision also clarifies that deductions are allowed for otherwise deductible expenses paid with the proceeds of a PPP loan that is forgiven, and that the tax basis and other attributes of the borrower's assets will not be reduced as a result of the loan forgiveness. The provision is effective as of the date of enactment of the CARES Act...

KPMG observation

Assuming that this provision remains in the bill and it is enacted, this would be welcome news for PPP borrowers. Recently, as year-end approaches for calendar year taxpayers, numerous questions about the treatment and timing of PPP expenses have arisen. This proposal would seem to answer those questions and simplify matters for PPP borrowers.

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