



New IRS Guidance on Forgiven PPP Loans: The Song Remains the Same

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Per our May 5, 2020 eAlert, the IRS in Notice 2020-32 concluded that a taxpayer cannot deduct payroll, rent, utilities and other business expenses funded with a forgiven Paycheck Protection Program (“PPP”) loan. The IRS’s position has gone over like a lead balloon with Congress, tax practitioners and PPP loan recipients struggling to keep their businesses afloat, even while coping with ever-shifting Small Business Association (“SBA”) guidance on when and how they can get the loans forgiven. Unfortunately, they will not be happy with the IRS’s guidance last week (Revenue Ruling 2020-27 and Revenue Procedure 2020-51) which, while the IRS touts as “clarifying,” actually cements the IRS’s unforgiving position and provides relief only in unusual circumstances.

What Revenue Ruling 2020-27 Says

Our May 5, 2020 eAlert discussed IRS Notice 2020-32 in detail and concluded that, while the IRS’s position was bad for PPP loan recipients, it was not unexpected. In fact, the IRS was well-grounded in its application of the relevant Internal Revenue Code provisions and judicial precedent and was in an untenable position anyway after Congress failed to address whether expenses funded by a forgiven PPP loan were still deductible in the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, which created the PPP. Note that when the IRS issued Notice 2020-32, almost everyone expected that a taxpayer – particularly one using a calendar year, here 2020 – would be able to get the PPP loan, pay eligible expenses and apply for and get forgiveness all in the same reporting year. Obviously, that expectation has come to naught because Treasury, the SBA and banks are still working through the paperwork and procedures for PPP loan recipients applying for forgiveness, and the minutiae about what acts or omissions by a PPP loan recipient could bar forgiveness. (See our subsequent eAlerts on May 8, June 8, June 8 again, and October 21, as well as our September 22 webinar on the ins and outs of loan forgiveness.)

Revenue Ruling 2020-27 takes into account this subsequent reality and addresses two calendar-year taxpayers, “A” and “B,” whose dazed and confused situations should by now be familiar to any PPP loan recipient. Taxpayer “A” applies for forgiveness before the end of 2020 and satisfies all the conditions for forgiveness. Taxpayer “B” will apply in 2021, but like “A,” otherwise satisfies all the conditions for forgiveness. Revenue Ruling 2020-27 concludes that neither “A” nor “B” may deduct PPP-funded eligible expenses in 2020. The IRS continued to rely on the same statutes and judicial precedents that it did in Notice 2020-32, but with a slight twist. While the IRS in Notice 2020-32 analyzed a forgiven PPP loan as the equivalent of an outright grant of tax-free money (like a scholarship) on the assumption that the PPP loan and forgiveness would occur in one integrated transaction in one year, the IRS in Revenue Ruling 2020-27 now analyzes the issue as whether “A” or “B” “*reasonably expected*” the PPP loan to be forgiven at the end of 2020. Even a PPP loan recipient who can somehow be sure that every criterion for loan forgiveness was met will, at best, be bemused and, at worst, guffaw at the IRS’s position that the recipient can somehow “reasonably expect” the loan to be forgiven by the end of 2020, given the ever-shifting landscape from Treasury, the SBA and lenders and the unexpected nuances that keep popping up. For PPP loan recipients, this has been the Battle of Evermore “guidance” from the government.

Revenue Procedure 2020-51 Gives Some, But Not Much, Relief

Revenue Procedure 2020-51 offers guidance for taxpayers like “A” and “B” above who reasonably believe that they met the criteria for forgiveness at the end of 2020, but whose loans are not in fact forgiven in a later year because the bank says “no” or the taxpayer decides, for whatever reason, not to apply for forgiveness. The IRS gives the taxpayer three basic choices: (1) claim the deductions on their tax return for 2020 if it is filed timely (taking extensions into account); (2) claim the deductions in an amended tax return for 2020; or (3) claim the deductions in the tax return for the later year in which it becomes clear that the loan will not be forgiven. Revenue Procedure 2020-51 goes through the procedural requirements for this relief, including the form of notice to be attached to the return so that the IRS understands that the taxpayer is relying on Revenue Procedure 2020-51.

What to Do?

Taxpayers not covered by Revenue Procedure 2020-51 – *i.e.*, PPP loan recipients that reasonably expect forgiveness, have applied for or intend to apply for forgiveness by the end of 2020 and succeed in getting forgiveness – continue to be in a tough spot whereby they cannot deduct eligible expenses (at least according to the IRS) in the current tax year if they get the PPP loan forgiven in a later tax year. Our May 5, 2020 eAlert gave two choices for those taxpayers which still apply. The first choice, and more conservative approach, is to file the return without claiming the deduction; hope for a Congressional resolution to the imbroglio or favorable court decisions; and then apply to the IRS for a refund (keeping in mind the statute of limitations for claiming a refund and that the IRS has every incentive to avoid paying up and instead forcing the taxpayer to go to court). The second choice, and more aggressive approach, is to deduct the expenses; develop a considered argument as to why the IRS position is wrong; await an all-but inevitable IRS examination; and then challenge the IRS position in Tax Court without being forced to pony up the back taxes first. Note that if taxpayers pursue the second option then they *must disclose in the return* that they are taking a position contrary to a published IRS revenue ruling or face penalties (in addition to back taxes and interest).

Going to California - Conformity

Since our May 5, 2020 eAlert, the California legislature passed and Governor Newsom signed Assembly Bill 1577, which adopts the CARES Act position that a forgiven PPP loan does not result in cancellation of debt income for California purposes. Unfortunately, AB 1577 also provides that the non-taxed amount must be offset against and reduce otherwise-deductible eligible expenses, thereby essentially adopting the IRS's position. AB 1577 therefore puts California taxpayers in a bind because, even if Congress or a federal court reverses the IRS position, eligible expenses remain non-deductible for California purposes unless the California legislature later conforms state treatment to the federal.

So far, there's no "Stairway to Heaven" for PPP loan recipients. Stay tuned for updates on these issues, including the status of any Congressional fixes which may still have life left, even after the November 3 elections. For what it's worth, Senator Finance Committee members on both sides of the aisle have expressed consternation with the IRS's recent guidance and have committed to try for a Congressional fix before year-end.