



Brenner, Saltzman & Wallman LLP

Attorneys at Law – Established 1963

UPDATE ON PPP LOAN FORGIVENESS AND INCOME TAXES

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In April 30, 2020, the Internal Revenue Service (the “**IRS**”) issued guidance that expenses such as eligible payroll costs, interest, rent and utility expenses (collectively, “**Eligible Expenses**”) that served as the basis for “loan forgiveness” under the Paycheck Protection Program (“**PPP**”) would not be deductible for income tax purposes. In Revenue Ruling 2020-27 (the “**Revenue Ruling**”) the IRS affirmed that guidance and also ruled that Eligible Expenses cannot be deducted in the taxable year in which they were incurred if, at the end of that taxable year, the taxpayer “reasonably expects” that its PPP loan will be forgiven on the basis of those Eligible Expenses. This result occurs even if the PPP borrower has not submitted a PPP loan forgiveness application to its lender by the end of that taxable year and did not plan to file a loan forgiveness application until after its tax return for 2020 was filed.

The IRS did not elaborate on the factors that should be considered in determining if a PPP borrower “reasonably expects” to receive loan forgiveness. We believe that the bottom-line practical effect of this Revenue Ruling for most PPP borrowers that pay income taxes (e.g., excluding non-profit organizations) will be that the amount of loan forgiveness that they have applied for, or will apply for, will require them to recognize that amount as taxable income in 2020.

We strongly suggest you consult with your tax advisor on how this Revenue Ruling impacts you and whether you need to make any adjustments to your estimated income taxes for the 4th quarter of 2020 or your planning for tax payments that will be due at the time of filing your tax return for 2020.

The Revenue Ruling can be found here: <https://www.irs.gov/pub/irs-drop/rr-20-27.pdf>.

The IRS’s prior guidance disallowing a tax deduction for Eligible Expenses can be found here: <https://www.irs.gov/pub/irs-drop/n-20-32.pdf>.

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