

Small Business Notes

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Section 1106(i) of the CARES Act excludes from the gross income of a PPP loan recipient the amount of income received as a result of loan forgiveness. This exclusion operates regardless of whether such forgiveness would have been included in gross income as the discharge of a debt under section 61(a) (11) of the Internal Revenue Code.

On April 30, 2020, the IRS issued Revenue Notice 2020-32 which addresses the deductibility of expenses paid with PPP funds from a forgiven loan. With the CARES Act such expenses can include rent, utilities, and interest payments so long as the total percentage of non-payroll expense payments does not exceed 25% of the loan. These expenses would normally be deductible under section 162 of the Internal Revenue Code (ordinary and necessary expenses of the business) or under section 163 (interest payments).

The new notice indicates that no deduction is available for expenses paid “if the payment of the expense results in forgiveness of a covered loan pursuant to section 1106 of the CARES Act”. The IRS bases its position on section 265(a)(1) of the Internal Revenue Code which provides that no deduction is allowed a taxpayer for amounts otherwise classed as deductible if the monies used to pay the otherwise deductible expenses are wholly exempt from taxes imposed elsewhere in the Code.

The Notice goes on to note that this interpretation is intended to prevent a double tax benefit (non-taxability of income derived from loan forgiveness and deductibility of expenses paid using loan proceeds) and that this interpretation is consistent with prior rulings. Further, the Notice states that this interpretation is consistent with case law and published rulings (cited in the Notice) that disallow a deduction for otherwise deductible payments for which the taxpayer receives reimbursement.

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This position has attracted considerable opposition – including from the American Institute of Certified Public Accountants – that such an interpretation was never the intent of Congress which, instead, sought to make maximum benefits available to recipients of PPP loans.

Because Minnesota has not conformed to federal tax changes related to the CARES Act, Minnesota’s tax treatment of both the amounts of forgiveness and the deductibility of expenses paid with PPP funds is different. In Minnesota, the amount of forgiveness must be added back into the taxpayer’s federal adjusted gross income when calculating Minnesota taxable income. The related expenses remain deductible, if otherwise deductible under Minnesota law. This situation could still change if the 2020 legislature acts conform Minnesota’s tax treatment of these loans to the treatment under the CARES Act.

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