



Robert W. Wood

THE TAX LAWYER

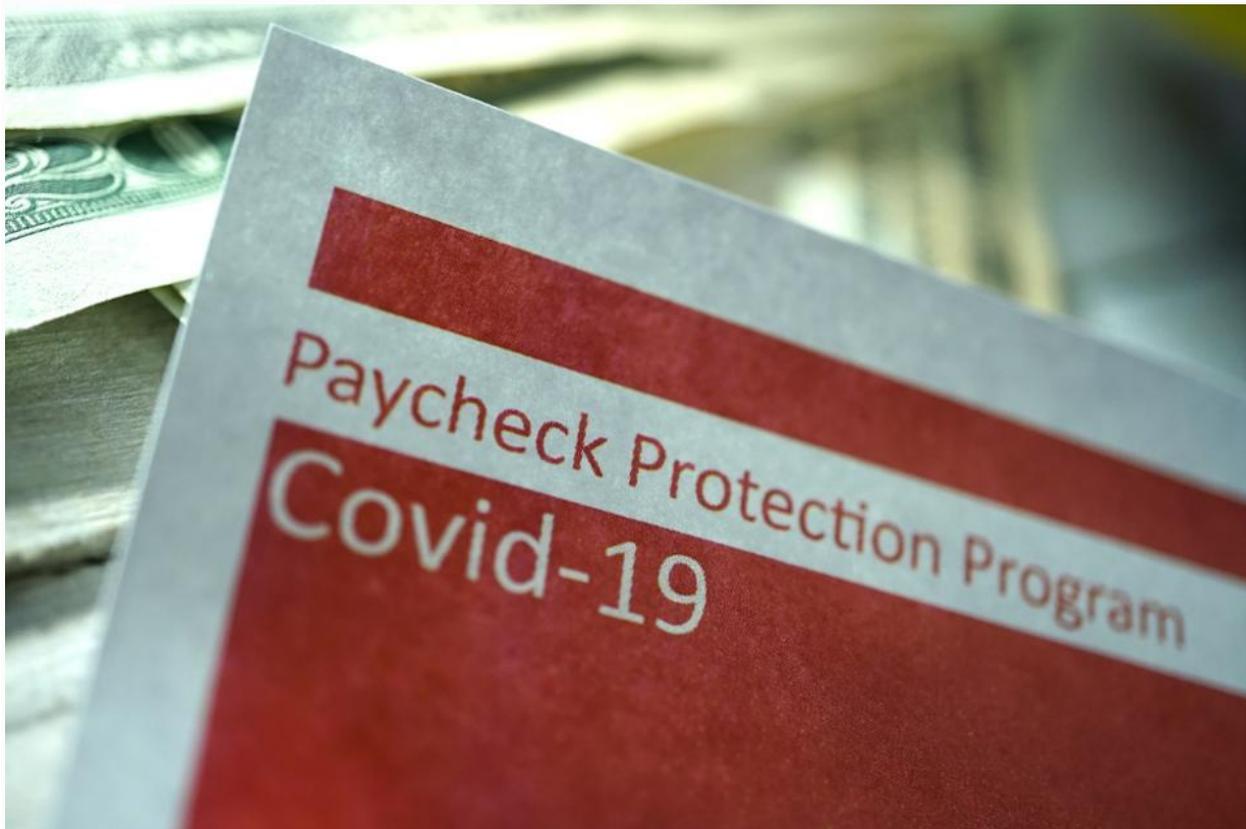
TAXES 06/15/20

Tax Deductions For Paycheck Protection Expenses Remain In Doubt

The Paycheck Protection Program is a key part of Congress' virus relief, and it's gotten way better. In late May, [Congress passed a bill expanding](#) the program in key ways, extending the tight 8 weeks covered by the law to 24 weeks. What's more, Congress relaxed the rule that 75% of funds must go to wages, cutting it to 60%. But many points of debate remain, none hotter than the question whether the wages, rent, etc. paid with PPP monies can or cannot be deducted on tax returns. The CARES Act may not have been clear, but the IRS evidently thought the basic tax rules were. On April 30, the [IRS ruled out tax deductions for wages and rent paid with forgivable PPP loans](#). The IRS views it as a double dip. But some Senators and Congressmen pushed back, saying expenses funded with small business loans *should* be tax deductible after all. The IRS could backtrack, but the IRS has not, and Treasury Secretary Mnuchin seems to think the IRS is right.

So the Small Business Expense Protection Act of 2020 [S.3612 - 116th Congress \(2019-2020\)](#) would *reverse* the IRS and make the expenses deductible after

all. Some observers thought this bill would sail through, but there has been surprising push-back, and it still has not passed. The stakes clearly matter to businesses who have scooped up Paycheck Protection Program loans of up to \$10M to keep their employees on the payroll during the shutdown. For most businesses, the key feature of the loan is that it can be forgiven without any income tax consequences. That makes the “loan” really more of a government grant. Usually, a cancellation of debt triggers income tax as [cancellation of debt income](#). Denying expense deductions in [Notice 2020-32](#), the IRS says “this treatment prevents a double tax benefit.” Of course, the PPP loans are *supposed* to be used for exactly that purpose.



Sen. Marco Rubio, R-Fla., agreed that the bill would allow a kind of double dip for taxes, but, “In the environment that we’re in, we should make the assumption that we want to make it easy for businesses to survive and as easy as possible for them to do their taxes.” Although it still seems likely the tax

deduction bill will pass, it isn't certain. What's more, it isn't clear *when* that might occur. There are other changes to the PPP being debated too. For example, the now relaxed rule that 60% of the money must go for wages is being read as a bright line or cliff. So if you spend 59% of your loan money on wages, you get no forgiveness of your loan at all. A more gentle rule would involve a cutback in forgiveness, but not complete disqualification for forgiveness.

The double dip point was debated in tax circles before the IRS made its grave announcement. Tax deductions are plain vanilla for business wages and rent, and some advisors cite support for the deductions, since the CARES Act did not expressly say otherwise. The IRS cites traditional tax principles for the notion that if income is tax exempt, you usually cannot *also* claim deductions relating to it. Applying the rules consistently, the IRS says, you shouldn't be able to get the free money, not pay discharge of debt income, *and still* deduct the payments of wages and rent made with the free money. Still, there are good arguments for deductions, and Senator Rubio's view seems hard to dispute.

Senate Finance Committee Chair Chuck Grassley, R-Iowa stated, "The intent was to maximize small businesses' ability to maintain liquidity, retain their employees and recover from this health crisis as quickly as possible. This notice is contrary to that intent." And immediately on the heels of the IRS notice, House, Ways and Means Committee Chair Richard E. Neal, D-Mass., announced with his spokesperson Erin Hatch that "We are planning to fix this in the next response legislation."

If the correction bill is not passed, could bold taxpayers proceed? Despite the IRS statement, some people have said they may try to deduct these expenses anyway and fight with the IRS about it if needed. The tax law is sufficiently

debatable that some of those taxpayers could win, too. However, that will clearly be tougher if a bill to make the expenses deductible is introduced, debated, and fails. The Paycheck Protection Program allows loans of up to \$10 million at 1% interest to employers with fewer than 500 workers to cover two months of payroll and overhead.

Check out my [website](#).