

IRS Issues Notice Clarifying Expenses Funded with Proceeds of Small Business Administration Loans under Paycheck Protection Program

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On Thursday, April 30, 2020, the Internal Revenue Service (the “**IRS**”) issued Notice 2020-32 (the “**Notice**”).^[1] The Notice clarifies that, in the IRS’s view, expenses funded using the p

roceeds of Small Business Administration (“**SBA**”) loans extended pursuant to the Paycheck Protection Program are not deductible if the loan is forgiven.

Paycheck Protection Program Background

The Paycheck Protection Program was created by the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. 116–136 (116th Cong.) (Mar. 27, 2020) (the “**CARES Act**”), and significantly expands SBA loan availability for certain businesses.^[2]

Under Section 1106(b) of the CARES Act, if certain conditions are satisfied, recipients of these new SBA loans are eligible for loan forgiveness in an amount equal to the qualifying payroll costs, mortgage interest payments, rent, and utilities incurred or paid by the recipient during the eight weeks following the origination of the loan.^[3]

Tax Treatment of SBA Loan Forgiveness and Associated Deductions

In general, when a loan is forgiven, the borrower includes the forgiven amount in gross income. Section 1106(i) of the CARES Act modifies this rule by excluding from income any forgiven SBA loan amount that otherwise would be includible in the gross income of the recipient. The CARES Act is silent, however, about whether expenses funded with the proceeds of those loans are deductible for federal income tax purposes.

The Notice, which is the first guidance to specifically address the issue, provides that although ordinary and necessary expenses incurred in carrying on a trade or business generally are deductible, no deduction is available for expenses that are funded out of the proceeds of a forgiven SBA loan, reasoning that allowing such a deduction would confer an improper double tax benefit (a deduction for the expenses paid with the forgiven loan proceeds and no income inclusion from the amount of the loan forgiven).

The Notice clearly sets forth the IRS’s position regarding the non-deductibility of expenses funded using the proceeds of Paycheck Protection Program loans that are forgiven. It is worth observing, however, that the applicable law supporting the position taken in the Notice is not entirely clear, and the Notice does not address every practical scenario that might be confronted by a taxpayer who receives a loan under the Paycheck Protection Program.^[4] For example, the Notice does not consider situations in which the related

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expense is incurred in a different taxable year than the taxable year in which the forgiveness of the debt is anticipated or occurs, or whether (or how) a taxpayer can determine with certainty that debt will be forgiven, particularly in light of the fact that the CARES Act requirements continue to be subject to additional regulatory refinements.

[1] The Notice is available on the IRS website at <https://www.irs.gov/pub/irs-drop/n-20-32.pdf>.

[2] CARES Act section 1102. For additional details about the Paycheck Protection Program please refer to Gibson Dunn's [Frequently Asked Questions to Assist Small Businesses and Nonprofits in Navigating the COVID-19 Pandemic](#) and prior Client Alerts about the Program: [SBA "Paycheck Protection" Loan Program Under the CARES Act: Small Business Administration and Department of Treasury Publish Paycheck Protection Program Loan Application Form and Instructions to Help Businesses Keep Workforce Employed](#); [Small Business Administration Issues Interim Final Rule and Final Application Form for Paycheck Protection Program](#); [Small Business Administration Issues Interim Final Rule on Affiliation, Summary of Affiliation Tests, Lender Application Form and Agreement, and FAQs for Paycheck Protection Program, Analysis of Small Business Administration Memorandum on Affiliation Rules and FAQs on Paycheck Protection Program](#); and [Small Business Administration Publishes Additional Interim Final Rules and New Guidance Related to PPP Loan Eligibility and Accessibility](#).

[3] CARES Act section 1106(b).

[4] Virginia Blanton, Michael Q. Cannon & Jennifer A. Fitzgerald, *Double Tax Benefits in the CARES Act*, 167 Tax Notes Fed. 423 (2020).

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Tax Practice Group or its Coronavirus (COVID-19) Response Team, or the following authors:

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