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Robert W. Wood
THE TAX LAWYER

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IRS Denied PPP Write-Offs, Congress May Restore Tax Deductions

Can businesses claim tax deductions for business expenses? It sounds like a silly question, but when it comes to the Paycheck Protection Program (PPP), it has been a question roiled in controversy. The PPP allows loans of up to $10 million at 1% interest to employers with fewer than 500 workers to cover some payroll and overhead. The PPP is a key part of Congress' virus relief, and it now covers up to 24 weeks, with only 60% of loaned funds being required to go to payroll. The key is to try to get loans forgiven, so the money is really a tax-free grant from the government. One still unanswered question is whether you can take a tax deduction for the wages or rent you pay with PPP money. These are *clearly* business expenses, so why not? Because on April 30, the IRS ruled out tax deductions for wages and rent paid with forgivable PPP loans. The IRS says it is a double dip, but some Senators and Congressmen pushed back, saying they *should* be tax deductible. 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, but there has been surprising push-back, and it still has not passed. Senate

Republicans say they will keep trying, and Sen. Marco Rubio, R-Fla, said "It's a horse I would bet on." He isn't the only one pushing for this.
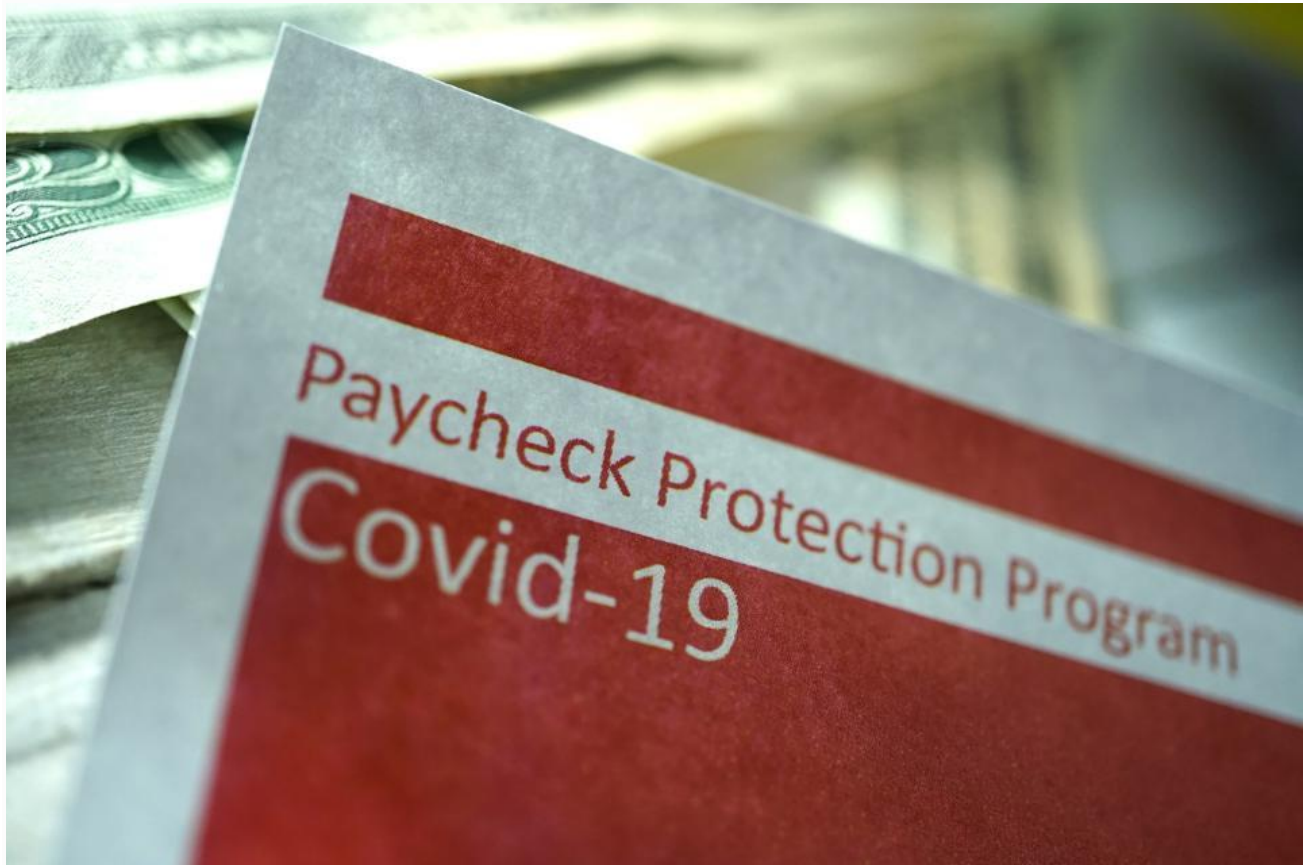
The Treasury Department is the problem, but the stakes clearly matter to businesses who have scooped up Paycheck Protection Program loans of up to $10M to keep their employees on the payroll during the shutdown. For most businesses, the key feature of the loan is that it can be forgiven without any income tax consequences. That makes the "loan" really 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.

Earlier this summer, the bill seemed likely to pass, but that is hardly certain now. Timing is unclear too, as other changes to the PPP are being debated. In

the awkward meantime, more than a few small businesses are worried about this. The question whether tax deductions on expenses paid with PPP loans were a double dip was debated in tax circles long before the IRS made its grave "no deduction" 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.

Yet 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.

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