Background on PPP Loan Forgiveness

When the PPP was adopted as part of the CARES Act, Congress made clear that any loan forgiveness under the program would be excluded from the borrower’s taxable income. Specifically, a recipient of a PPP loan was eligible for forgiveness of indebtedness for amounts equal to certain payroll, mortgage interest, rent, and utility payments made during a prescribed period, with any resulting cancelled indebtedness excluded from the borrower's taxable income. As Section 1106(i) makes clear:

(i) TAXABILITY. For purposes of the Internal Revenue Code of 1986, any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in subsection (b) shall be excluded from gross income.

The publication of IRS Notice 2020-32 effectively overturned this policy by denying these borrowers the ability to deduct the same expenses that qualified them for the loan forgiveness. The Notice argues “...section 265(a)(1) of the Code disallows any otherwise allowable deduction... for the amount of any payment of an eligible section 1106 expense to the extent of the resulting covered loan forgiveness...."

The correctness of the IRS’s reasoning in issuing Notice 2020-32 is a debatable point and if left intact, it will certainly result in extensive legal challenges. What is not debatable, however, is congressional intent regarding the tax treatment of these forgiven loan amounts. As part of the next round of COVID-19 relief, we are requesting that Congress reaffirm its intent and restore the tax benefits it intended to give distressed businesses as part of the CARES Act. Key tax-writers in Congress recognize this as a technical correction restoring what Congress intended, as does the Joint Committee on Taxation. The three major letters written to Congress requesting this fix can be found here, here and here. NECA joined more than 180 business trades sending a message to congressional leadership that makes it clear that loan forgiveness under the Paycheck Protection Program should be tax-free as intended in the CARES Act.