Reminder from the IRS: Expenses Paid with 2020 PPP Loans Can Be Deducted on 2021 Tax Returns

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If you are a business owner that received PPP funds but did not utilize them on your tax return, pay close attention to the substance of this publication. The IRS has publicized a safe harbor for certain companies that received first-draw Paycheck Protection Program (PPP) loans but did not deduct any of the original qualified expenses because they relied on direction issued before the execution of the Consolidated Appropriations Act, 2021 (CAA), in December 2020.

In Notice 2020-32 and Rev. Rul. 2020-27 (which were made obsolete by Rev. Rul. 2021-2) the IRS stated that a taxpayer who received a loan through the PPP was not permitted to deduct expenses that are normally deductible under the Code to the extent the payment of those expenses resulted in PPP loan forgiveness. Essentially, if you paid for usually deductible expenses using PPP loans, you could not claim a deduction on your tax return.

In reliance on that advice, many taxpayers, such as ones with odd tax end years, did not deduct expenses paid with PPP loan proceeds on their 2020 tax returns. Congress later clarified and overruled the IRS in the CAA, stating that deductions are allowed for otherwise deductible expenses paid with the proceeds of a PPP loan that is forgiven and that the tax basis and other attributes of the borrower's assets will not be reduced because of the loan forgiveness. The new safe harbor in Rev. Proc. 2021-20 allows taxpayers who filed a tax year 2020 return on or before Dec. 27, 2020, to deduct those expenses on their 2021 tax return rather than file amended returns or administrative adjustment requests.

Under the safe harbor, a taxpayer may elect to deduct otherwise deductible original eligible expenses on the taxpayer's timely filed, including extensions, original federal income tax return or information return for the taxpayer's immediately subsequent tax year, rather than on an amended return or administrative adjustment request for the taxpayer's 2020 tax year in which the expenses were paid or incurred, if the taxpayer meets the following criteria:

1) The taxpayer must be a "covered taxpayer" (to be discussed later); and

2) The taxpayer must satisfy all of the requirements for the time and manner of making the election to apply the safe harbor.

A covered taxpayer must satisfy all of the following requirements:

1) The taxpayer received an original PPP covered loan;

2) The taxpayer paid or incurred original eligible expenses during the taxpayer's 2020 tax year;

3) On or before December 27, 2020, the taxpayer time filed a federal income tax return or information return for the 2020 tax year; and

4) On the taxpayer's federal income tax return or information return, the taxpayer did not deduct the original eligible expenses because: (a) The expenses resulted in

forgiveness of the original PPP covered loan; or (b) the taxpayer reasonably expected at the end of the 2020 tax year that the expenses would result in that forgiveness.

To make a valid election to apply the safe harbor, a covered taxpayer must attach the statement described below to the covered taxpayer's timely filed, including extensions, federal income tax return or information return for the covered taxpayer's first tax year following the covered taxpayer's 2020 tax year in which the original eligible expenses were paid or incurred.

The statement must be titled "Revenue Procedure 2021-20 Statement" (and named RevProc2021-20.pdf for e-file attachments) and include the following:

1) The covered taxpayer's name, address, and Social Security number or taxpayer identification number;

2) A statement that the covered taxpayer is applying the safe harbor in Rev. Proc. 2021-20;

3) The amount and date of disbursement of the taxpayer's original PPP covered loan; and

4) A list, including descriptions and amounts, of the original eligible expenses paid or incurred by the covered taxpayer during the covered taxpayer's 2020 tax year that are reported on the federal income tax return or information return for the first tax year following the 2020 tax year.

The revenue procedure is effective for any tax year ending in calendar year 2020 and for the immediately subsequent tax year. The safe harbor does not apply to PPP second-draw loans enacted under the CAA. Because PPP second-draw loans are not original PPP covered loans, eligible expenses that may result in forgiveness of those loans are not covered by Rev. Proc. 2021-20.

Are you a taxpayer that received PPP funds but did not utilize them on your tax return? The taxation and legal professionals at The Center for Financial, Legal, and Tax Planning are more than knowledgeable to assist in your issues. For a consultation, please contact us at (618) 997-3436 or reach out to us online at https://www.taxplanning.com/.