

IRS Provides Safe Harbor for 2020 Expenses Paid with PPP Loans

Eligible expenses can be retroactively deducted on tax returns filed this year

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The IRS has created a safe harbor for small businesses that received first-round Paycheck Protection Program (PPP) loans but did not deduct certain expenses because they relied on guidance issued before the enactment of the Consolidated Appropriations Act, 2021, in December 2020.

The safe harbor, which the IRS announced April 23 in Revenue Procedure 2021-20 (<https://www.irs.gov/pub/irs-drop/rp-21-20.pdf>), provides relief to PPP loan recipients who filed their 2020 tax returns and did not deduct business expenses paid with funds from PPP loans.

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law in March 2020, the U.S. Small Business Administration manages PPP loans for qualifying businesses with fewer than 500 employees. A year later, the American Rescue Plan Act enabled small businesses to apply for a second round of PPP loans.

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Coronavirus and COVID-19 (www.shrm.org/ResourcesAndTools/Pages/communicable-diseases.aspx)

Guidance issued in April 2020 indicated that small business taxpayers that received PPP loans to pay wages and interest on covered mortgage, rent and utility payments could not claim a tax deduction for those expenses (www.shrm.org/resourcesandtools/hr-topics/compensation/pages/irs-says-no-deducting-of-expenses-paid-with-ppp-grant-funds-coronavirus.aspx). Relying on that guidance, many small businesses did not deduct expenses paid with PPP loan funds on their 2020 tax returns.

With the December 2020 enactment of the Consolidated Appropriations Act, 2021, small businesses may claim deductions for those expenses.

"Unfortunately, some taxpayers filed using the original guidance, meaning they did not claim deductions for which they [subsequently became] eligible," wrote Ryan Norton, an account executive at Drake Software, based in Franklin, N.C. "Given just how devastating 2020 was for small businesses across the country, saying 'every little bit counts' is an understatement (<https://www.drakesoftware.com/content/irs-announces-safe-harbor-for-first-round-ppp-deductions/>)," he noted. "Luckily, the IRS [safe harbor] should help."

Claiming the Deduction

Under the safe harbor, "a taxpayer that filed its 2020 tax return prior to the change in law can elect to deduct these expenses on the taxpayer's timely filed return for the immediately subsequent taxable year rather than filing an amended return for the taxpayer's 2020 taxable year (<https://www.klehr.com/publications/irs-to-provide-safe-harbor-to-certain-businesses-that-received-a-ppp-loan-but-did-not->

deduct-eligible-expenses/)," wrote Sharon Shachar and Sarah Herman, attorneys in law firm Klehr Harrison's New York City and Philadelphia offices, respectively. "The IRS notice provides that such safe harbor election should be made by attaching a statement titled 'Revenue Procedure 2021-20 Statement' that would include the required information to the applicable tax return," they noted.

According to Lauren Contino, marketing director at Springfield, Pa.-based CPA firm Brinker Simpson, "an important limitation on the scope of the revenue procedure is that it applies only to returns that were originally filed on or before Dec. 27, 2020 (<https://brinkersimpsoncares.com/irs-gives-safe-harbor-to-small-businesses-to-claim-deductions-for-ppp-loans/>). Thus, the guidance applies only to fiscal-year taxpayers whose year ended during 2020, for which a return was filed on or before the Consolidated Appropriations Act, 2021, was signed into law."

Consequently, as Norton pointed out, "it's important to note that this guidance does not apply to second-draw PPP loans" and that, going forward, the IRS will not provide retroactive relief for expenses paid with PPP loans that aren't deducted on the appropriate tax year's tax return.

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