

Paycheck Protection Program: Certain Tax Issues Involving Loan Forgiveness

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The Paycheck Protection Program (PPP) was established by section 1102 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act and is implemented by the Small Business Administration (SBA) with support from the Department of the Treasury. The PPP is intended to provide relief to certain small businesses in the form of loans during the coronavirus pandemic. One important attribute of PPP loans under the CARES Act is that such loans are eligible for forgiveness if the loan proceeds are spent in the manner prescribed by the CARES Act and SBA guidance. Another important attribute of PPP loans is that the forgiveness of such loans is not taxable to the borrower for federal income tax purposes.

Tax Consequences of PPP Loan Forgiveness

A borrower that qualifies to have its PPP loan forgiven should keep in mind certain tax consequences of the loan forgiveness. For example, if a business borrows funds under a PPP loan, spends the loan proceeds in the manner prescribed by the CARES Act and SBA guidance, and the PPP loan is forgiven, it is not clear whether these expenditures would be deductible for federal income tax purposes. On one hand, the IRS has issued tax guidance specifically denying a deduction under such circumstances. On the other hand, some members of Congress have recently introduced legislation to clarify that such deductions should not be denied due to the mere fact that the borrower's PPP loan is forgiven. That proposed legislation, however, has yet to become law.

Another tax consideration of PPP loan forgiveness that a borrower should not lose sight of is the potential state income taxation of the loan forgiveness. The fact that PPP loan forgiveness is excluded from taxable income at the federal level does not necessarily mean that the forgiveness is excluded from income for state tax purposes. The state tax consequences of PPP loan forgiveness will depend on the applicable tax laws of each state.

Potential for Updated Tax Guidance

Small businesses that are considering applying for PPP loan forgiveness should plan ahead for any potential tax consequences that could arise from such forgiveness. Each business's unique facts and circumstances should be reviewed in light of updated tax guidance applicable to the taxation of PPP loan forgiveness as such guidance becomes available. Although the current IRS position is that

expenditures that give rise to PPP loan forgiveness are not deductible, this result could potentially be changed by Congress, but that remains to be seen.

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