



PPP LOAN FORGIVENESS – WHAT ARE THE TAX CONSEQUENCES?

A key part of the federal government's response to COVID-19 was the creation of the Paycheck Protection Program ("PPP") managed by the Small Business Administration ("SBA"). Since March 2020, the SBA has processed hundreds of billions of dollars in forgivable loans to small businesses around the country. In December 2020, Congress authorized an additional round of PPP loans for both first-time borrowers, as well as "second-draw" loans. Businesses that receive PPP loans can apply to have the loans forgiven if the proceeds are used for specified business expenses; however, PPP loan forgiveness raises two critical questions for taxpayers:

1. Will a forgiven PPP loan be counted as taxable income?
2. Does PPP loan forgiveness affect your ability to take deductions for expenses?

Federal Tax Treatment of PPP Loans and Expenses

For federal income tax purposes, Section 1106(i) of the CARES Act excludes forgiven PPP loan proceeds from taxable income. Without this provision, forgiven loan proceeds would have been subject to U.S. income tax.

The CARES Act did not address whether receiving PPP loan forgiveness would affect the recipient's ability to deduct business expenses, but the December 2020 COVID-19 relief bill made clear that no deductions would be disallowed in connection with PPP loan forgiveness for federal income tax purposes.

Massachusetts Tax Treatment of PPP Loans and Expenses

In Massachusetts, the tax treatment of forgiven PPP loans and expenses depends on how a business has elected to be treated for tax purposes (e.g., as a C Corporation, S Corporation, partnership or proprietorship).

For taxpayers subject to Massachusetts corporate excise, which would include all C Corporations, as well as S Corporations to the extent their gross receipts are \$6 million or higher, the PPP loans should be treated the same as under the federal tax code—forgiven PPP loans should not be counted as income and business expenses should be deductible as normal. Note that S Corporations should not be required to include the amounts of forgiven PPP loans when calculating their gross receipts.

With respect to entities where items of income and expense are passed through to their shareholders, members or partners, the general tax rule that forgiven indebtedness is counted as income would continue to apply, and therefore forgiven PPP loans are includible as income and subject to tax. This is because for personal income tax, Massachusetts generally mirrors federal tax law as in effect on January 1, 2005, which does not reflect the federal COVID-19 relief programs. Deductions for expenses paid using PPP loans would still be allowed.

Connecticut Tax Treatment of PPP Loans and Expenses

Connecticut tax treatment of PPP loans and expenses should mirror federal income tax treatment regardless of whether you are taxed as an individual or as a corporation because Connecticut generally follows current federal tax law for both individuals and corporations.

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