

**Office of Chief Counsel
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memorandum**

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subject: Proper Treatment of Improperly Forgiven PPP Loans

This Chief Counsel Advice responds to your request for assistance. You have requested advice on whether a taxpayer whose Paycheck Protection Program (PPP) loan was forgiven even though the taxpayer did not qualify for the forgiveness must include the PPP loan proceeds in gross income under section 61 of the Internal Revenue Code.

This advice may not be used or cited as precedent.

Issue

If a taxpayer makes one or more representations that he or she satisfies the conditions for forgiveness of a PPP loan under 15 U.S.C. §§ 636m and 636(a)(37)(J) (“qualifying forgiveness”), but does not factually satisfy the conditions for a qualifying forgiveness¹, and as a result, has the PPP loan forgiven improperly, may the taxpayer exclude the amount of the forgiven loan from gross income under 15 U.S.C. § 636m(i) or § 276(b)(1) of the COVID-related Tax Relief Act of 2020 (CTRA 2020)?

¹ A variety of fact patterns may establish that the taxpayer was not eligible for forgiveness under the statute and related regulatory guidance. For example, the taxpayer may have used the funds for personal expenditures. No implication is intended from the facts in the Situation presented below that it limits the reasons why a particular forgiveness is not a qualifying forgiveness.

Conclusion

If a taxpayer who does not factually satisfy the conditions for a qualifying forgiveness causes its lender to forgive the PPP loan by inaccurately representing that the taxpayer satisfies them, the taxpayer may not exclude the amount of the forgiven loan from gross income under 15 U.S.C. § 636m(i) or section 276(b)(1) of the CTRA 2020.

Background on the Paycheck Protection Program Loans

A. PPP loans

PPP loans are loans made in accordance with the terms, conditions and processes under the PPP. There were two rounds, or draws, of PPP loans. The first was provided under section 1102 of the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (March 27, 2020) (CARES Act), to assist small businesses in the United States adversely affected by the COVID-19 pandemic in paying payroll costs and other eligible expenses. The second was provided under the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, Pub. L. No. 116-260, div. N, title III, 134 Stat. 1993 (December 27, 2020) (Economic Aid Act), which amended and extended the existing PPP provisions. The PPP is administered by the Small Business Administration (SBA) as part of its "7(a) Loan Program" under § 7(a) of the Small Business Act (15 U.S.C. § 636(a)). For both rounds of PPP loans (collectively, "covered loans"), the lender may forgive, and the SBA may guarantee, the full principal amount, if certain criteria are met as described below. See 15 U.S.C. §§ 636(a)(36), (a)(37), and 636m.

To implement the PPP, the SBA issued regulatory interim final rules (IFRs) in the Federal Register in 2020 and 2021, including the Consolidated IFR implementing updates to the PPP ("Consolidated IFR"),² and the IFR on Loan Forgiveness Requirements and Loan Review Procedures ("Loan Forgiveness IFR").³ The Consolidated IFR provides general rules governing covered loans and qualifying forgiveness of those loans, and the Loan Forgiveness IFR further details the SBA rules on qualifying forgiveness.

Lenders participating in the PPP may make PPP loans, fully guaranteed by the SBA, to eligible recipients only under specified terms, conditions and processes of the program. An "eligible recipient"⁴ is an individual or entity that is eligible to receive a covered loan. A prospective recipient is eligible to receive a covered loan if the recipient (i) is a small business concern (as determined by the SBA), independent contractor, eligible self-employed individual, sole proprietor, business concern, or a certain type of tax-exempt

² 86 Fed. Reg. 3692 (January 14, 2021).

³ 86 Fed. Reg. 8283 (Feb. 5, 2021).

⁴ For purposes of PPP Second Draw Loans, the term "eligible entity" is substituted for "eligible recipient." See 15 U.S.C. § 636(a)(37)(A)(i).

organization as specified by the authorizing statutes; and (ii) was in business on February 15, 2020, and either had employees or independent contractors whom the recipient paid for services or was an eligible self-employed individual, sole proprietor, or independent contractor.⁵

PPP loan proceeds may be used only for “eligible expenses,” namely, payroll costs, rent, interest on the business’s mortgage, utilities, and other specified operations expenditures, subject to repayment and additional liability if the proceeds are misused.⁶ The application for a PPP loan requires that a prospective recipient attest to eligibility, verify certain financial information, and meet other legal qualifications.⁷ The SBA allows lenders to rely on prospective recipients’ certifications and documentation to determine whether to originate PPP loans. Similarly, the SBA allows lenders to rely on loan recipients’ certifications and documentation in determining whether to forgive PPP loans. Lenders are held harmless for recipients’ failure to comply with program criteria if they act in good faith and comply with relevant statutory and regulatory requirements.⁸

A PPP loan bears a non-compounding interest rate of one percent and matures in five years.⁹ The recipient must generally make the first repayment in 24 weeks after the loan disbursement. If, however, the recipient applies for forgiveness of any portion of the loan within 10 months following the 24 weeks after the disbursement, the repayment of the principal (and interest) is not due unless and until the SBA notifies the recipient that the forgiveness request is rejected.¹⁰

B. Qualifying forgiveness of a PPP loan

Qualifying forgiveness occurs in the PPP if the PPP loan recipient satisfies the forgiveness criteria set forth in 15 U.S.C. §§ 636m and 636(a)(37)(J), the participating lender forgives the PPP loan in whole or in part, and the forgiveness amount does not exceed the full principal amount of the PPP loan. While the term “qualifying forgiveness” does not appear in the statute or regulations, for purposes of this memorandum, it reflects PPP loan forgiveness that is authorized by 15 U.S.C. §§ 636m and 636(a)(37)(J) and that is described in the aforementioned IFRs. To receive qualifying forgiveness on a PPP loan, at least 60 percent of the PPP loan amount must be used for payroll costs, while up to 40 percent of the PPP loan amount may be used for other specified costs.¹¹ In addition, the qualifying forgiveness amount may not exceed the sum of specified costs that were incurred and paid during a covered

⁵ Consolidated IFR, Part III, B.1.a through 1.g., 2.a. through 2.c., 86 Fed. Reg. 3692, 3695-3698. See also 15 U.S.C. § 636(a)(36)(D), (a)(37)(A)(iv).

⁶ Consolidated IFR, Part III, B.11, 86 Fed. Reg. 3692, 3704-3705. See also 15 U.S.C. § 636(a)(36)(F).

⁷ Consolidated IFR, Part III, B.12.ix, 86 Fed. Reg. 3692, 3706. See also 15 U.S.C. § 636(a)(36)(G).

⁸ Consolidated IFR, Part III, A, C.3, 86 Fed. Reg. 3692, 3694, 3707-3708. See also 15 U.S.C. § 636(a)(36)(G).

⁹ Consolidated IFR, Part III, B.5 and B.6, 86 Fed. Reg. 3692, 3703.

¹⁰ Consolidated IFR, Part III, B.9, 86 Fed. Reg. 3692, 3703-3704.

¹¹ Consolidated IFR, Part III, B.9, 86 Fed. Reg. 3692, 3706-3707. See also 15 U.S.C. § 636m(d)(8).

period.¹² The specified costs consist of payroll costs, interest on covered mortgage obligations, covered rent obligations, covered utility payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures.¹³

To receive qualifying forgiveness of a PPP loan, a PPP loan recipient must submit the application, including documentation and representations required by the statute and by the SBA.¹⁴ To request forgiveness of a PPP loan, the loan recipient must attest to eligibility for forgiveness, including verifying that the loan proceeds were properly expended on eligible expenses and that the amount applied for forgiveness satisfies all the limitations relating to specified costs, and meet other legal requirements.

Once the lender grants qualifying forgiveness to a PPP loan recipient in compliance with the terms, conditions and processes of the PPP, the lender may treat the amount forgiven as "canceled indebtedness." The SBA, as the guarantor, is required to remit the same amount to the lender within 90 days from the date when the lender approves the qualifying forgiveness.¹⁵ If the SBA later determines that a given forgiveness was not a qualifying forgiveness, the SBA may seek repayment of the loan.¹⁶ Civil and criminal remedies (including recoupment of the improperly forgiven amount) are also available in coordination with the Department of Justice. See, e.g., SBA Inspector General Report no. 22-13 (May 26, 2022).

Section § 636m(i)(1) of the United States Code, Title 15, provides that "no amount shall be included in the gross income of the eligible recipient by reason of forgiveness of indebtedness described in subsection (b)". Similarly, § 276(b)(1) of the CTRA 2020, which was enacted as Subtitle B of Division N of the Consolidated Appropriations Act, 2021, Public Law 116-260, provides that "no amount shall be included in the gross income of an eligible entity (within the meaning of [15 U.S.C. § 636(a)(37)(J)]) by reason of forgiveness of indebtedness described in clause (ii) of such paragraph, . . . " 134 Stat. 1182, 1979 (Dec. 27, 2020).

Situation

Taxpayer X applied for and received a first draw PPP loan in 2020. Taxpayer X did not use the loan proceeds for eligible expenses and applied for forgiveness of the PPP loan in 2020 as if she were entitled to a qualifying forgiveness. In the loan forgiveness

¹² Consolidated IFR, Part III, B.9, 86 Fed. Reg. 3692, 3706-3707; IFR on Loan Forgiveness, Part IV, 86 Fed. Reg. 8283, 8286-8294. See also 15 U.S.C. § 636m(a)(4)(covered period), (b). For the PPP Second Draw Loans, the same terms and conditions of qualifying forgiveness are provided at 15 U.S.C. § 636(a)(37)(J).

¹³ Consolidated IFR, Part III, B.9, 86 Fed. Reg. 3692, 3706-3707; IFR on Loan Forgiveness, Part IV, 1, 3 and 4, 86 Fed. Reg. 8283, 8286-8290. See also 15 U.S.C. § 636m(b).

¹⁴ IFR on Loan Forgiveness, Part IV, 2, 86 Fed. Reg. 8283, 8287-8288. See also 15 U.S.C. § 636m(e).

¹⁵ IFR on Loan Forgiveness, Part IV, 2.a, 86 Fed. Reg. 8283, 8287-8288. See also 15 U.S.C. § 636m(c)(3).

¹⁶ IFR on Loan Forgiveness, Part V, 1.e., 86 Fed. Reg. 8283, 8295.

application submitted to the PPP lender, Taxpayer X failed to include all relevant facts that would indicate that she was not eligible for a qualifying forgiveness of the PPP loan. Based on the omissions and misrepresentations on that application, Taxpayer X received forgiveness of her PPP loan from the lender.

Law and Analysis

There is no accession to wealth under section 61(a) upon receipt of PPP loan proceeds, as the PPP loan is issued by a bank, includes an interest rate and maturity date, and includes an obligation for the eligible recipient to repay. See *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983); *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 207-8 (1990). Once a participating lender forgives a loan originated under the PPP, however, the recipient of the loan proceeds enjoys an accession to wealth in the amount of the loan that is forgiven. Under general principles of Federal income taxation, the amount forgiven must be included in the loan recipient's gross income. However, section 636m(i) of the United States Code, Title 15, and § 276(b)(1) of the CTRA 2020 provide express exceptions to the rule that forgiveness of a PPP loan constitutes gross income.

Thus, a taxpayer who received a PPP loan that is forgiven may exclude the forgiven amount of the PPP loan from gross income if the forgiveness is described in section 636m(i) and § 276(b)(1) of the CTRA 2020. These exclusions apply only to a qualifying forgiveness of a PPP loan. Forgiveness of a PPP loan is a qualifying forgiveness only if the use of the loan proceeds satisfies the conditions relating to specified costs (as described in 15 U.S.C. § 636m(b), (d)). To receive a qualifying forgiveness, the loan recipient must apply for the forgiveness in accordance with the specific procedures set forth in the statute and associated regulations.

Failure to meet these conditions means that there is no qualifying forgiveness, and thus the exclusions would not apply to the forgiven PPP loan. As the Second Circuit concludes in discussing the forgiveness provision of the PPP (15 U.S.C. § 636m) in *Springfield Hosp., Inc.*, 28 F.4th 403, 424 (2nd Cir. 2022):

[F]orgiveness is neither automatic nor guaranteed. A borrower must apply for forgiveness, which will only be granted if specified criteria are met, see 15 U.S.C. § 636m(b)–(d), and the CARES Act places several additional conditions upon obtaining forgiveness [including that the funds are “used for statutorily authorized purposes”].¹⁷

¹⁷ The Court of Appeals for the Second Circuit reversed and vacated the bankruptcy court's decision that the PPP was a grant program for purposes of section 525(a) of the Bankruptcy Code, an anti-discrimination provision which applies to government “grants.” The Second Circuit analyzed the PPP to determine whether the PPP loans were “loans” or “grants” for purposes of the Bankruptcy Code, and concluded that “[the] forgiveness option, favorable as it is, cannot alter the structure of what a loan forgiveness program fundamentally is—namely, a program to forgive *loans*.” 28 F.4th at 424 (emphasis in original).

Turning to the Situation described above, because the forgiveness of Taxpayer X's PPP loan was based on omissions and misrepresentations, the loan that Taxpayer X received did not fall within the scope of loans that could be forgiven under 15 U.S.C. § 636m. The forgiveness of that loan accordingly did not constitute a qualifying forgiveness described in 15 U.S.C. § 636m, and may not be excluded from Taxpayer X's gross income under 15 U.S.C. § 636m(i). The exclusion provision applies only to a PPP loan that meets the conditions of a qualifying forgiveness. Similarly, the exclusion applies only if the loan recipient is an eligible recipient. Thus, even if the loan forgiveness is otherwise a qualifying forgiveness, the exclusion is inapplicable if the loan recipient is not an eligible recipient.¹⁸ Because section 636m(i) does not apply to forgiveness of her PPP loan, Taxpayer X must include the forgiven amount in her gross income. This result follows from the application of the general principles of Federal income taxation to the amount forgiven in determining the proper tax treatment.¹⁹

Section 61(a) generally provides that “gross income means all income from whatever source derived.” This result applies to all payments that are “undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion” constitute taxable income. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). In 2020, the year of forgiveness and release from the obligation to repay, Taxpayer X had undeniable accessions to wealth, clearly realized, and over which she had complete dominion under the principles of *Glenshaw Glass*. Furthermore, notwithstanding the ability of the SBA to pursue repayment in the case of misuse of funds, Taxpayer X retained the PPP loan proceeds in 2020 under a claim of right.

The claim of right doctrine derives originally from the Supreme Court decision in *North American Oil Consolidated v. Burnet*, 286 U.S. 417 (1932). The court there stated that “[i]f a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.” *Id.* at 424. This doctrine applies regardless of whether the taxpayer acquires the proceeds lawfully; see *James v. United States*, 366 U.S. 213, 219 (1961) (applying the *North American Oil Consolidated* approach “[w]hen a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition”). The ability of the SBA to pursue repayment of the improperly forgiven PPP loan does not preclude the application of the claim of right doctrine to Taxpayer X in 2020. See *United States v. Lewis*, 340 U.S. 590 (1951)

¹⁸ See 15 USC § 636m(i)(1); IFR on Loan Forgiveness, Part V, 1.e., 86 Fed. Reg. 8283, 8295. The same is true for eligible entities in the case of PPP Second Draw Loans. See § 276(b)(1) of the CTRA 2020.

¹⁹ If the SBA later determines that Taxpayer X had her loan improperly forgiven and, consequently, Taxpayer X pays back the SBA in a later year, the repayment that Taxpayer X makes may result in a deductible expense under section 162 or a deductible loss under section 165 for the later year. Whether Taxpayer X may claim a deduction under section 162 or 165 for the later year depends on all facts and circumstances.

(taxpayer received a bonus in 1944 and was required to repay the bonus in 1946 after being informed the original payment was erroneous; the court found that the taxpayer held the bonus under a claim of right in 1944 and rejected his argument that he could amend his 1944 return to reflect the subsequent repayment).

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If you have any questions, please call M. Duke Osborne at (202) 317-7006.