PPP expenses: deductible for federal tax purposes, but what about the states?

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When Paycheck Protection Program (PPP) loans were initially introduced, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) made clear that loan proceeds would not be treated as gross income on federal income tax returns. However, the Act was silent on the tax treatment of expenses paid with loan proceeds. The IRS issued a ruling in May 2020 stating that expenses paid with loan proceeds would not be deductible for federal tax purposes. Much gnashing of teeth in Congress and the business community followed.

On December 27, 2020, when President Trump signed the Consolidated Appropriations Act, expenses paid with a PPP loan's proceeds became deductible on federal income tax returns, assuming the expenses are otherwise deductible. After a short celebration, businesses now face how individual states handle both the gross proceeds from the loans and expenses paid with the proceeds.

While most states have not addressed the subject, Kentucky provided guidance on its website through two "frequently asked questions." Kentucky is treating the loan gross proceeds as tax-exempt income but does not allow a deduction for expenses paid with loan proceeds. A bill has been filed in the Kentucky General Assembly, House Bill 278, that would allow the expenses to be deducted. The prospects for the bill are unknown. The moral of the story—if you file returns in multiple states, check (or have your tax advisor check) the states in which you file to see if treatment of the PPP loan has been addressed.

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