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TAX AND WEALTH ADVISOR ALERT: WISCONSIN DEPARTMENT OF REVENUE SAYS EXPENSES PAID WITH FIRST ROUND FORGIVEN PPP LOANS ARE NOT DEDUCTIBLE

A little less than a month ago, the IRS reversed its original position, and stated that businesses can deduct expenses paid for with the proceeds of a forgiven Paycheck Protection Program (PPP) loan, as further detailed here. However, in guidance issued on Friday, the Wisconsin Department of Revenue clarified that expenses that are paid with the forgivable PPP funds (in the first round) are not deductible for Wisconsin income/franchise tax purposes and must be added back to Wisconsin income in the year incurred or paid. Therefore, unless the legislature acts, businesses that have received PPP loans may find themselves saddled with unexpected Wisconsin tax liabilities as a result of the Wisconsin Department of Revenue's recent guidance.

The guidance clarifies that both federal and Wisconsin law provide an exclusion from income for forgiveness of debt on the first round of PPP loans and signals Wisconsin's plan to deny the expense deduction. Additionally, second-round PPP loans (those issued in 2021) are also set to be taxed by the state, albeit in the opposite manner: expenses will be deductible, but the loans are set to be treated as taxable income.

As we previously wrote about here, Wisconsin is a static conformity state, meaning that unlike a "rolling" conformity state where the state's tax code automatically conforms to the changes in federal tax law, a static state conforms to the federal tax code as it existed on a certain date. Wisconsin conforms to the Internal Revenue Code (IRC) as it existed on December 31, 2017, and although the Wisconsin Legislature adopted omnibus legislation on April 15, 2020, A.B. 1038, to address the coronavirus pandemic, the bill did not update Wisconsin's conformity date. Rather, the bill included express language that brings the state's tax code into conformity with several federal tax law changes under the CARES Act, including the CARES Act exception that permits loan forgiveness on a tax-free basis under the PPP from February 15, 2020 through June 30, 2020.

Therefore, absent legislative action, Wisconsin remains set to treat PPP loans and expenses in a complex and confusing manner given the way in which Wisconsin's tax code currently stands in relation to the federal tax code. PPP loans from the first round will not be taxable

income, but associated expenses are non-deductible. On the other hand, second-round PPP loans are taxable income, but associated expenses can be deducted. That means small businesses, many of which are struggling from the COVID-19 economic downturn, could have to pay state taxes on their PPP loans unless the state legislature and Governor Tony Evers intervene.

O'Neil, Cannon, Hollman, DeJong and Laing remains open and will continue to monitor federal and state law tax changes. For questions or further information relating to taxation under the CARES Act and the new relief bill, please contact Attorney Britany E. Morrison.