



STATE OF SOUTH CAROLINA  
DEPARTMENT OF REVENUE

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SC INFORMATION LETTER #20-28

**SUBJECT:** Federal Payroll Protection Program Loans for Small Businesses due to COVID-19 (Income Tax)

**DATE:** November 2, 2020

**AUTHORITY:** S.C. Code Ann. Section 12-4-320 (2014)  
S.C. Code Ann. Section 1-23-10(4) (2005)  
SC Revenue Procedure #09-3

**SCOPE:** An Information Letter is a written statement issued to the public to announce general information useful in complying with the laws administered by the Department. An Information Letter has no precedential value.

**OVERVIEW OF FEDERAL PAYROLL PROTECTION PROGRAM (PPP)**

On March 27, 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)<sup>1</sup> in response to the COVID-19 pandemic. As part of the relief provided, the Paycheck Protection Program (PPP) was established in Section 1102<sup>2</sup> to provide loans to small businesses<sup>3</sup> for the purpose of paying payroll costs (e.g., wages and benefits) and occupancy costs (e.g., mortgage interest, rent, and utilities) to keep the businesses operating and employees on the payroll.

The loan can be forgiven, in whole or part, if the business meets or exceeds certain thresholds related to payroll and occupancy costs.<sup>4</sup> Any portion of the PPP loan that is not forgiven must be repaid over two years at 1% interest.

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<sup>1</sup>Public Law 116-136, March 27, 2020.

<sup>2</sup>Section 1102 of the CARES Act, "Paycheck Protection Program," amends the Small Business Act, 15 U.S.C. 636(a).

<sup>3</sup>An eligible small business is one with 500 or fewer employees and includes nonprofits, self-employed individuals, sole proprietorships, and independent contractors. Businesses with over 500 employees are eligible in certain industries.

<sup>4</sup>The Paycheck Protection Program Flexibility Act of 2020, enacted on June 5, 2020, amended the PPP provisions in the CARES Act to ease the business requirements for PPP loan forgiveness.

The PPP is implemented by the Small Business Administration with support from the Department of Treasury. For complete information about the PPP, go to [www.sba.gov](http://www.sba.gov) or [www.coronavirus.gov](http://www.coronavirus.gov).

## **TAX CONSEQUENCES OF THE PAYCHECK PROTECTION PROGRAM LOANS**

### Federal Tax Treatment

General Rule. For federal income tax purposes, the receipt of a loan is not a taxable event, expenses paid with loan proceeds are generally deductible often under IRC Section 162, “Trade or Business Expenses” or IRC Section 163, “Interest,” and the forgiveness of a loan is often treated as taxable income under IRC Section 108, “Income from Discharge of Indebtedness.”

Exception for PPP Loan Forgiveness and Deduction for Related Payroll and Occupancy Business Expenses. The CARES Act amended the Small Business Act to provide loan forgiveness for SBA loans under the PPP. The CARES Act did not amend IRC Section 108. The CARES Act, Section 1106, overrides IRC Section 108, and treats the forgiven portion of the PPP loan as exempt from federal income tax.

IRC Section 265, “Expenses and Interest Relating to Tax-Exempt Income,” disallows deductions attributable to one or more classes of income that is exempt from income tax. According to IRS Notice 2020-32, dated April 30, 2020, no deduction is allowed for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan for which the income associated with the forgiveness is excluded from gross income under the PPP provisions of the CARES Act under Section 1106(i).<sup>5</sup>

### South Carolina Tax Treatment – For Tax Year 2020

During the 2020 Legislative Session, South Carolina conformed to the IRC as of December 31, 2019,<sup>6</sup> but did not conform to the federal CARES Act enacted by Congress in March 2020, which includes the exclusion from income of forgiven PPP loans. The South Carolina General Assembly, however, in enacting Act No. 147 on September 28, 2020, addressed the forgiveness of the PPP loan and the federal treatment of business expenses for tax year 2020. Act No. 147, Section 2, reads:

For tax year 2020, to the extent loans under the paycheck protection program in Section 1102 of Public Law 116-136, Title 1 are forgiven and excluded from gross income for federal income tax purposes under Section 1106 of Public Law 116-136, Title 1, those loans are excluded for South Carolina income tax purposes. Further, to the extent the federal government allows the deduction of expenses associated with the forgiven paycheck protection program loans, these expenses will be allowed as a deduction for South Carolina income tax purposes.

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<sup>5</sup>This is consistent with the purpose of IRC Section 265 to prevent a double tax benefit.

<sup>6</sup>Act No. 147, Section 3, signed by the Governor on September 28, 2020.

Accordingly, for South Carolina income tax purposes, the PPP loan is not taxable and the forgiveness of the PPP loan is not taxable for tax year 2020.<sup>7</sup> The Department will follow the IRS's position in Notice 2020-32 and will disallow related payroll and occupancy costs to the forgiven portion of the PPP loan (i.e., a business is not permitted to deduct expenses that are normally deductible, to the extent the expenses were reimbursed by a PPP loan that was then forgiven). If, however, Congress or the IRS alters this treatment<sup>8</sup> to allow for the deduction of these costs, then South Carolina will also allow the deduction of these costs for tax year 2020 as directed by the General Assembly in Act No. 147 dated September 28, 2020.

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<sup>7</sup>It is the Department's position that the apportionment provisions in Code Section 12-6-2240 apply to any loan forgiveness, related expenses, and other items related to the PPP loan.

<sup>8</sup>As of the date of this Information Letter, several bills are being considered in Congress to further simplify the PPP aid package to businesses.