KPMG

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FAQs on payroll support for air carriers and contractors (COVID-19)

The IRS released a set of "frequently asked questions" (FAQs) concerning certain payroll support provided for air carriers and contractors in the United States.

As reported in an **IRS transmittal message**, provisions of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) authorize the Treasury Department to provide payments to passenger air carriers, cargo air carriers, and certain contractors that must be exclusively used for the continuation of payment of employee wages, salaries, and benefits—"payroll support."

Another provision of the CARES Act provides that the Treasury Department may receive warrants, options, preferred stock, debt securities, notes or other financial instruments issued by a company receiving payroll support as "appropriate compensation" for the federal government's provision of the financial assistance. These are referred to as "taxpayer protection instruments."

The IRS release further explains that unless otherwise provided in guidance issued by the IRS or Treasury Department, "…the form of any Taxpayer Protection Instrument held by the Treasury Department and any subsequent holder will be treated as such form for purposes of the Internal Revenue Code of 1986 (for example, a Taxpayer Protection Instrument in the form of a note will be treated as indebtedness for purposes of the Internal Revenue Code of 1986)."

The FAQs (as of April 21, 2020) are provided below.

> ***Q. If a Recipient does not issue Taxpayer Protection Instruments to the Treasury Department in exchange for Payroll Support, is the receipt of the Payroll Support taxable to the Recipient under the Internal Revenue Code (Code)?***
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> *A. Yes. If the Recipient does not provide Taxpayer Protection Instruments to the Treasury Department as compensation for the Payroll Support, the receipt of the Payroll Support is not excluded from the Recipient's gross income under the Code and therefore is taxable.*

Q. When a Recipient that does not issue any Taxpayer Protection Instruments uses the Payroll Support to pay wages, salaries, and benefits to its employees as required under the Payroll Support Program, are all of those expenses deductible under the Code?

A. Yes. The Code generally permits the payment of wages, salaries, and benefits to employees to be deducted as ordinary and necessary business expenses.

Q. If a Recipient issues to the Treasury Department any warrants, options, preferred stock, debt securities, or notes (or a combination of these Taxpayer Protection Instruments) as compensation for the Payroll Support, is the receipt of the Payroll Support taxable under the Code?

A. Part of the Payroll Support received is taxable and part of the Payroll Support received is not taxable. Payroll Support in excess of the fair market value of the warrants, options, or preferred stock, plus the issue prices of any debt securities or notes issued, is taxable to the Recipient under the Code. The remaining Payroll Support is not taxable to the Recipient under the Code.

Q. When a Recipient that issues Taxpayer Protection Instruments to the Treasury Department uses the Payroll Support to pay wages, salaries, and benefits to its employees as required, are all of these expenses deductible under the Code?

A. Yes. The Code generally permits the payment of wages, salaries, and benefits to employees to be deducted as ordinary and necessary business expenses, regardless of whether the Recipient issues Taxpayer Protection Instruments.