

Insights

Employer Tax-Free, Deductible Disaster Relief Benefits for Employees

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An employer seeking to provide additional financial support to employees during the COVID-19 pandemic may want to consider a “qualified disaster relief payment” program. Qualifying disaster relief payments are not only tax-free to employees in most cases, but are also fully tax-deductible to the employer. Access to these benefits became available on March 13, 2020, when President Trump declared the coronavirus pandemic to be a federal disaster pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the “Stafford Act”). This declaration triggered, among other potential benefits, the availability of tax-free qualified disaster relief payments under Section 139 of the Internal Revenue Code (the “Code”). Qualified disaster relief payment programs were originally authorized under Section 139 in response to the September 11 terrorist attacks. In addition to the favorable tax treatment, such a program may be implemented by an employer with little administrative burden.

Qualified Disaster Relief Payments:

“Qualified disaster relief payments” include payments to relieve “reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster.” The exclusion does not include payments for lost wages, unemployment compensation, or payments in the nature of business income replacement.

When Section 139 was adopted, the Joint Committee on Taxation indicated in its report that it was the intent of Congress to include as qualifying expenses:

- Unreimbursed medical expenses under Code Section 213 (which was recently expanded to include over-the-counter medications without a prescription).
- Funeral expenses of the individual or an immediate family member.
- Rent, utilities or other temporary housing expenses.
- Child care expenses and educational expenses resulting from school and daycare closures.
- Personal property expenses.

Employer Taxation and Administration:

Code Section 139 and its limited guidance impose little, if any, administrative burden upon employers administering a qualified disaster relief payment program. Because qualified disaster relief payments are not included in the

gross income of the employee, they are not subject to federal income tax or to FICA and FUTA withholding. As a result, an employer does not need to include a qualified disaster relief payment in an employee's W-2 or 1099, and the payment is generally deductible by the employer. An employer will need to check the tax treatment under applicable state law, however. Indiana is among the states that conforms with federal law by excluding qualified disaster relief payments from gross income.

The Joint Committee on Taxation previously commented, and the IRS has since confirmed, that "in light of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred." Accordingly, employers are not required to substantiate that amounts paid to employees were for qualified expenses. Nonetheless, maintenance of records documenting the method of determining the amount of the benefits, for purposes of establishing the reasonableness of the payments, is highly recommended.

Disaster Relief Program Administration:

As ERISA and nondiscrimination testing rules do not apply, no plan document is required to establish a qualified disaster relief payment program; nevertheless, a written explanation of the program's basic structure will benefit the employer in administering the program, including:

- To whom expense payments or reimbursement may be made.
- Duration of the program and deadlines for submitting requests for payment or reimbursement.
- General types of expenses available to be paid or reimbursed under the program (perhaps with examples included).
- Notice that only amounts reasonable and necessary to meet the qualified expense will be paid or reimbursed (does not include the cost of luxury, decorative, or nonessential items and services).
- Aggregate payment limits under the program, per employee or per family.
- Exclusions employees must be aware of (e.g. employees cannot seek reimbursement for expenses compensated by insurance or otherwise).

Potentially, third-party administrators of flexible spending accounts (FSAs) or health reimbursement arrangements (HRAs) could provide administration services for a Section 139 program. In such case, these services should be vetted with legal counsel for compliance with the Code Section 139 requirements.

Conclusion:

Because it is a very flexible tax-free benefit, the qualified disaster relief payment program may be of interest to employers who want to assist certain employees by covering expenses associated with the COVID-19 pandemic. If you would like more information about these programs, please contact Sharon B. Hearn, Bryan J. Gross or another member of the Krieg DeVault Employee Benefits & Executive Compensation Practice Group. Also, please look to Krieg DeVault's Coronavirus Resource Center for posts and links addressing a number of legal and other issues related to COVID-19, including the CARES Act. We are with you through this pandemic and are standing by to help with any challenges and questions you may have.