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Analysis that matters from Washington National Tax

Employers Helping Employees – Disaster Relief

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by the Washington National Tax Compensation & Benefits group

When a disaster hits, employers often want to help their affected employees. Although employer-provided assistance raises tax questions, it may be possible for employers to make certain payments, implement reimbursements, and offer other forms of help, so that some or all of the employer-provided assistance is non-taxable, but nonetheless deductible. This article discusses those possibilities, as well as other approaches that employers may want to consider for assisting employees in times of need.

Section 139 – Qualified Disaster Relief Payments

Under section 139,¹ qualified disaster relief payments (including payments from an employer to an employee) are not includible in income. In addition to exclusion from gross income for federal income tax purposes, qualified disaster relief payments made to employees are not considered wages subject to certain other federal payroll taxes, such as Federal Insurance Contributions Act (“FICA”) taxes consisting of social security and Medicare taxes.

Determining whether a payment is a qualified disaster relief payment involves consideration of several different issues, such as:

- Is the event a “qualified disaster” as defined under section 139?
- Are the expenses incurred or reimbursements made “due to” a qualified disaster?

¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

- Was the expense necessary and the amount reasonable?
- Was the employee compensated for the expense by insurance?

Qualified Disasters

A qualified disaster is:

- A federally declared disaster (i.e., a disaster determined by the President of the United States to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act – the “Stafford Act”);
- A disaster that results from an accident involving a common carrier, or from any other event, which is determined by the Secretary of the Treasury to be of a catastrophic nature;
- A disaster that results from terrorist or military action; or
- A disaster that results in certain payments made by federal, state, or local governments or their agencies or instrumentalities.²

Section 139 was enacted in response to the September 11, 2001 terrorist attacks, and specifically applies in the context of a federally declared disaster within the meaning of the Stafford Act. A federally declared disaster for this purpose has been interpreted to include both “a major disaster declaration under section 401 of the Stafford Act and an emergency declaration under section 501 of the Stafford Act.”³

For example, following severe winter storms in February 2021, a federal disaster was declared for certain counties in Texas.⁴ Another example is the national emergency proclaimed in relation to the COVID-19 pandemic beginning March 1, 2020, authorizing assistance to all U.S. states, territories, tribes, and the District of Columbia.⁵ Thus, payments or reimbursements from an employer that qualify as “qualified disaster relief payments” in either of these two scenarios may be excludible from an employee’s gross income under section 139.

Qualified Disaster Relief Payments

A qualified disaster relief payment is any payment received or incurred (to the extent not otherwise compensated for by insurance or otherwise) as a result of a qualified disaster that:

- Is to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses;

² Section 139(c).

³ IRS Program Manager Technical Assistance, PMTA 2019-008 (June 28, 2019), <https://www.irs.gov/pub/irsoia/pmta-2019-08.pdf>.

⁴ See Disaster Information, FEMA.gov, <https://www.fema.gov/disasters>.

⁵ See Cong. Research Serv., *Stafford Act Declarations for COVID-19 FAQ* (Apr. 22, 2020), available at: <https://crsreports.congress.gov/product/pdf/R/R46326>.

- Is to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence, or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster;
- Is from a person engaged in the furnishing or sale of transportation as a common carrier by reason of the death or personal physical injuries incurred as a result of a qualified disaster, or
- Is paid by a federal, state, or local government, or agency or instrumentality thereof, in connection with a qualified disaster to promote the general welfare.⁶

Qualified disaster relief payments do *not* include income replacements, such as lost wages.

With respect to a qualified disaster, the IRS has indicated that the payment of unreimbursed medical expenses, temporary housing, and transportation incurred as a result of the qualified disaster may be treated as qualified disaster relief payments for purposes of section 139.⁷ Whether a particular expense is considered a qualified disaster relief payment is a facts and circumstances analysis, including whether the expense is both reasonable and necessary.

Insurance

As noted above, qualified disaster relief payments do not include amounts that are compensated for by insurance or otherwise. If the employer pays or reimburses the employee for expenses covered by insurance, the payment will not qualify as a disaster relief payment under section 139 and is likely to be taxable compensation subject to the usual income and FICA tax withholding. Thus, the employer may likely need to inquire as to whether the payment or reimbursement to the employee is compensated by insurance or otherwise before making the payment.

For some types of disasters, such as a large wildfire affecting an area (that is declared a federal disaster), homeowners insurance may cover some of the damage and the cost of temporary housing while the damage is repaired. As such, the employer may need to consider the effect of any reimbursement or potential payment from the employee's insurer. As many homeowners insurance policies do not cover flood damage, an employer may need to inquire as to whether the employee maintains separate flood insurance (some mortgage lenders require separate flood insurance if the property is in a flood zone). As a practical matter, many flood insurance policies do not cover all costs incurred because of a flood, making it likely that even an employee with flood insurance will have costs not covered by insurance.

In addition, while all insurance policies are different, some homeowners insurance policies may cover temporary housing while certain types of damage is being repaired, whereas other policies may not cover meals while the employee is displaced from the home. Having a general understanding of the likely coverage may help the employer to determine the types of payments that, if made in connection

⁶ Section 139(b).

⁷ See Rev. Rul. 2003-12, 2003-1 C.B. 283; Notice 2006-10, 2006-1 C.B. 386.

with the disaster, are more likely to be qualified disaster relief payments for purposes of section 139 and payments that are likely subject to taxation because they do not satisfy section 139 requirements.

Implementation Considerations

An employer may want to consider developing a qualified disaster relief program to coordinate payments to employees from a central location or department rather than having each individual office decide whether and when to provide qualified disaster relief payments to employees who are affected by a qualified disaster. Without a central location or department coordinating payments to employees, there is a risk that payments may not satisfy the criteria to be considered qualified disaster payments for purposes of section 139, resulting in taxable compensation for the employees receiving assistance from the employer.

There is no regulatory requirement under section 139 that necessitates that employees account for their actual expenses or employers maintain an accountable plan (or collect receipts from employees) for payments to qualify as qualified disaster relief payments excludible under section 139. However, the payments made to employees should be reasonably expected to be commensurate with the expenses the employee incurred, and the employer should be able to demonstrate that the payments were qualified disaster relief payments. As a best practice, an employer may want to consider developing a specific policy to describe what type of payments are eligible for reimbursement, what information must be provided by the employee (if any) to receive a payment under the policy, when payments will be made, employees who are eligible to receive payment, and which expenses will not be covered under the policy (e.g., expenses covered by insurance or otherwise, expenses considered to represent luxury items). Alternatively, employers may want to consider obtaining a self-certification from any employee receiving a qualified disaster relief payment that sets forth the expenses covered by the payment (i.e., temporary lodging, meals, home repairs), and require the employee to certify that the covered expense is not reimbursable by insurance.

In developing a policy or deciding whether to make a qualified disaster relief payment, employers likely need to consider certain questions to ascertain the employees' needs and provide additional information around the expenses likely to be incurred. For example, the following questions may be relevant:

- How can we contact you going forward?
- Where are you staying this week? Do you have a place to stay after this week (out of town with relatives, hotel, etc.)?
- Do you have transportation?
- What are your immediate needs?
- What sort of insurance do you have (homeowners, tenant, flood)?
- Have you contacted your insurance agent and talk about coverage (and if so, what will be covered)?
- Are the expenses of living elsewhere, transportation, etc. covered under your policy?

An employer may want to reimburse an employee before the insurance coverage can be definitively determined. If an employer does make a payment, it may want to keep track of the payments so that the payment can be reported as taxable to the extent the expense is reimbursed by insurance or require the employee to return the payment to the employer. Given the broad parameters of section 139, in many cases payments made to employees in connection with a qualified disaster are tax free. However, a mechanism to show that reimbursement by insurance was considered may make it easier to support the position that the payment is not taxable under section 139 (assuming the other requirements are satisfied).

Note that the tax treatment of qualified disaster relief payments may be different under state or local laws, which is beyond the scope of this article. While most states follow the federal tax treatment of section 139 with respect to disaster relief payments, taxpayers should consider the applicable laws of their relevant jurisdiction(s) as well as any additional obligations to provide assistance.

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In addition to providing section 139 qualified disaster relief payments, employers frequently assist employees experiencing hardship in other ways. Employers may facilitate employee-to-employee gifts of cash, employee leave sharing or donations, or may provide assistance to employees experiencing a wide range of hardships in collaboration with charitable organizations. Often, this assistance is not limited to situations involving a qualified disaster.

Employee-to-Employee Gifts

Sometimes employees want to help affected colleagues, however, they may need assistance in coordinating their efforts. For example, employees may pool cash or other resources for the benefit of a group of affected employees or even a specific affected employee, and the company may offer to help in collecting those funds or resources. However, there are a few issues to consider if the employer decides to become involved in the effort to coordinate employee-to-employee gifts.

Generally, any amount paid by an employer to an employee is considered taxable compensation and is not characterized as a tax-free “gift” under section 102(c). If an employer wants to assist a group of employees who want to help their colleagues by simply pooling amounts collected and/or contributed from employees that will be disbursed to an affected employee, these amounts should be kept separate and apart from other employer funds. Generally, an employer may set up a separate bank account just for these employee contribution amounts. In this situation, the employer is essentially acting as agent for the employees, collecting the amounts contributed by employees, and disbursing the amounts to affected employees, as directed by the contributing employees.

When providing the funds to an affected employee, the employer may want to label these payments as “employee-to-employee amounts” or as “gifts from your fellow employees,” to clearly identify and document the source of the funds.

Companies should also be mindful of the rules and best practices around protecting employee personal information when trying to help facilitate employee assistance to affected employees or identifying employees in need of assistance.

Paid Time Off Donations

Leave-Sharing Programs

The IRS generally permits employers to establish a program allowing employees to donate “paid time off” to be used by other employees who are affected by a major disaster or a medical emergency.⁸ Often employers set up a program that can be used as qualifying needs arise. Generally, the affected employee receiving the additional paid time off is taxed on that paid time off while the donor employee is not.

Leave Donation Programs

In addition, in certain circumstances, the IRS has also allowed employers to set up a donation program that allows employees to elect to forgo vacation, sick, or personal leave in exchange for cash donations made by the employer to a charitable organization after a specific major disaster. For example, Notice 2016-69 addresses leave-based donation programs under which an employer makes cash payments to charitable organizations before January 1, 2018, for the relief of victims of Hurricane Matthew in exchange for leave that its employees elected to forgo. Similarly, Notice 2020-46 (extended by Notice 2021-42) addresses the tax treatment of cash payments made by employers under leave-based donation programs to provide relief to victims of the COVID-19 pandemic. The employee donating the leave would not be taxed on the value of the leave “donation” if certain conditions are satisfied, but also would not be able to take a charitable deduction. Provided the requirements of section 170 regarding charitable contributions are otherwise satisfied, the employer may be entitled to a deduction for the donated cash payments.

Assistance Through Funding of Charitable Organizations

Employers may also provide assistance to employees by funding hardship assistance programs operated by a related or unrelated public charity. In developing these programs, different rules may apply depending on the type of charitable organization and the type of assistance provided. For more information on assistance provided through charitable organizations, read [KPMG report: Employers providing employee hardship assistance related to coronavirus](#) (Mar. 17, 2020).

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⁸ See Notice 2006-59, 2006-2 C.B. 60 (with respect to amounts paid pursuant to a leave-sharing plan to assist employees affected by a major disaster); Rev. Rul. 90-29, 1990-1 C.B. 11 (holding that an employee who surrenders leave under an employer-sponsored leave-sharing arrangement to benefit employees suffering from “medical emergencies” does not realize income nor incur a deductible expense).

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