

EMPLOYERS CAN IMMEDIATELY PROVIDE TAX-FREE QUALIFIED DISASTER PAYMENTS TO EMPLOYEES IN CONNECTION WITH COVID-19

Employers are scrambling to find ways to help their employees who are impacted by the novel coronavirus (COVID-19). Help is available. Now that the COVID-19 has been declared a national emergency,¹ Internal Revenue Code Section 139 can be used to allow employers to make tax-free payments or reimbursements to employees as “qualified disaster payments.” Below are some frequently asked questions about how employers can use Section 139 immediately to help employees cope with COVID-19.

Q1: **What is a “qualified disaster payment”?**

A1: Qualified disaster payments are payments that are not otherwise reimbursed by insurance made by an employer to an employee that are *reasonably expected* by the employer to:

- Reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; and
- 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.

The payments should not include non-essential, luxury, or decorative items or services.

Insight

Wage replacement (such as paid sick or other leave) would ***not*** be covered by Section 139, so such payments would still be taxable wages and would remain subject to income and payroll tax withholding and reporting.

Q2: **What expenses might be considered to be eligible as a qualified disaster payment with respect to COVID-19?**

¹ COVID-19, was designated as an emergency under the Stafford Act on March 13, 2020. Although there is some debate over the legal technicalities of that declaration, it appears that Section 139 relief has been triggered. Specifically, Rev. Rul. 2003-29 says that for Section 165(i) (which is cross-referenced in Section 139), an “emergency” is treated as a “disaster.” In addition, an IRS Chief Counsel Memorandum dated June 28, 2019, states “A Federally declared disaster includes a major disaster declaration under section 401 of the Stafford Act and an emergency declaration under section 501 of the Stafford Act.”

A2: With respect to COVID-19 circumstances, it appears that employers can pay for, reimburse, or provide in-kind benefits reasonably believed by the employer to result from the COVID-19 national emergency that are not covered by insurance. For example, it appears that employers could pay for, reimburse or provide employees with tax-free payments for over-the-counter medications, hand sanitizers, home disinfectant supplies, child care or tutoring due to school closings, work-from-home expenses (like setting up a home office, increased utilities expense, higher internet costs, printer, cell phone, etc.), increased costs from unreimbursed health-related expenses and increased transportation costs due to work relocation (such as taking a taxi or ride-sharing service from home instead of using public mass transit).

Q3: **What is the federal tax treatment of qualified disaster payments?**

A3: Qualified disaster payments are federal tax-free to employees and are fully deductible to the employer. Such payments are not considered “gifts.” There is no federal reporting or disclosure, so such payments are not reported on Form W-2 or 1099 and are not subject to federal income or payroll tax withholding.

Q4: **What is the state tax treatment of qualified disaster payments?**

A4: Generally, state treatment for income tax withholding purposes will mirror the federal treatment of qualified disaster relief payments. That is, states generally exclude qualified disaster relief payments from the definition of wages for state income tax withholding purposes, either expressly or by applying the federal definition of “wages” for state income tax withholding purposes. However, qualified disaster relief payments may still be considered “wages” for purposes of state unemployment insurance tax. Employers should determine on a state-by-state basis whether certain income tax withholding and/or unemployment insurance tax contribution obligations may arise in connection with such payments.

Q5: **Is there a cap on how much an employer can provide to an employee as a qualified disaster payment?**

A5: No. Section 139 does not impose any limit on the amount or frequency of qualified disaster payments that an employer can make to any individual employee or to all employees in the aggregate.

Q6: **Must employers have a written plan to make qualified disaster payments to employees?**

A6: No. Employers are not required to have a written program for qualified disaster payments. But having such a program is recommended, so employers can inform employees about the parameters of the employer’s program in the COVID-19 context. Such a program might include a description of who is eligible, what expenses will be reimbursed (perhaps up to a “per employee” maximum), how and when payments will be made, etc.

Q7: **Are employees required to substantiate their expenses to prove that they are eligible for qualified disaster payment treatment?**

A7: No. Employees are not required to provide receipts or other proof supporting their expenses. However, employers could require such proof as part of its written program, perhaps using rules similar to the long-standing IRS “accountable plan” rules.