



Tax-free disaster relief payment plans for employees: What employers need to know

By Alexandra Lugo, Jenny Holmes, and Ken Silverberg

As the COVID-19 (coronavirus) pandemic spreads, it will continue to adversely impact our personal and professional lives. Employees and their families are facing unprecedented financial insecurity due to reductions in hours, furloughs, layoffs, and increased expenses resulting from new medical, childcare, transportation, and living expenses. Employers are seeking solutions to assist employees and their families who have been, and will be, financially impacted by the pandemic.

One type of immediate financial assistance employers can provide is a cash payment through a qualified Section 139 disaster relief payment plan.

Qualified disaster relief payments are exempt from federal and most states' personal income tax for the recipient and exempt from tax withholding, FICA, FUTA, Medicare, and self-employment taxes for all parties if structured properly. Further, qualifying payments are still deductible business expenses for the employer, even though they are not taxable to the recipients. The following summary provides an overview of the rules governing employer-provided disaster relief payments and several specific types of payments that are permissible.

Section 139 disaster relief payments

Historically, disaster relief funds paid by governmental agencies were considered tax-free to the individuals who received such funds. In response to the terrorist attacks of September 11, 2001, Section 139 was added to the Internal Revenue Code to provide a mechanism for private entities to also provide disaster relief payments to individuals on a tax-free basis. If qualified, such payments are not included in the gross income of employee-recipients and are not subject to employment taxes. They are, nevertheless, deductible business expenses for employers.

In order to qualify as a coronavirus-related disaster-relief payment subject to Section 139, the payment must be a "reasonable and necessary" payment or reimbursement for personal, family, living, or funeral expenses incurred as a result of a qualified disaster. The coronavirus pandemic became a "qualified disaster"¹ for purposes of Section 139 relief payments on March 13, 2020, and it

¹ ["Letter from President Donald J. Trump on Emergency Determination Under the Stafford Act."](#) March 13, 2020

will remain qualified until the president declares that the federally declared disaster condition has ended. While the designation is in effect, the only remaining question is what qualifies as “personal, family, living, or funeral expenses” related to coronavirus.

“Personal, family, living, or funeral expense” payments eligible for tax relief

IRS guidance confirms that medical, temporary housing, transportation expenses, in addition to “other” personal, family, living, or funeral expenses, can be provided on a tax-free basis. However, the IRS has made clear that payments in the nature of income replacement, such as payments to individuals for lost wages or unemployment compensation, are not eligible for tax relief.

If payments are “reasonably commensurate” with the expenses incurred, employees are not required to account for actual expenses incurred. To-date, the IRS has issued guidance formally approving an employer-provided Section 139 payment, which provided a uniform payment that was available to all employees regardless of length or type of service with the employer.

Potential expenses eligible for tax relief

Employer-provided payments to pay or reimburse employees for the following expenses may fall within the scope of qualified Section 139 disaster relief payments:

- Out-of-pocket medical costs²
- Child care costs for employees who must report to a workplace
- Mortgage, rental, or other temporary housing costs
- Grocery/meal delivery expenses
- Commuting costs via Uber/Lyft because public transportation is not available, reliable, or presents the risk of coronavirus exposure
- Expenses for caregivers of family members who don’t live in the same home, such as food deliveries, postage, private duty nurses, or eldercare, etc.
- Laptops, hot spots, internet access, or cellular devices for remote learning and employment needs of all family members
- Rental cars and parking expenses

In order to protect employees who are the recipients of these payments, we strongly recommend that employers adopt a disaster relief plan customized to the needs of their workforce and business, and document that the actual payments comply with their own plan. The plan benefits should be designed to be responsive to the “reasonable and necessary expenses” employees are likely to incur. The relief payment amounts should not be proportionate to salary levels, longevity of employment, or other factors that might indicate an intent to subsidize lost wages.

Employers considering adopting a disaster relief plan should consult with counsel before implementing such arrangements in order to avoid adverse tax consequences for the employer and employees.

² Although disaster relief payments may subsidize the cost of medical expenses that would otherwise be deductible for employees who itemize their tax deductions, Section 139 prevents taking an itemized deduction for those amounts. This will not affect employees who claim the standard deduction.

For more information on the content of this alert, please contact our [Coronavirus Response team](#), your Nixon Peabody attorney, or:

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