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Benefits**Employment Question of the Day: April 23, 2020****Legal Update**

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Question**Can employers provide tax-free financial assistance to their employees during the COVID-19 outbreak?****Answer**

Yes; employers can make qualified disaster relief payments to their employees if certain conditions are met.

Statutory basis/background

Under Internal Revenue Code (IRC) Section 139, employers may provide non-taxable financial assistance to their employees impacted by a qualified disaster through paying them qualified disaster relief payments.

Normally, payments made by an employer to or for the benefit of an employee must be included in the employee's income for income and employment tax purposes. Such payments also cannot be treated as non-taxable gifts under IRC Section 102. However, because President Trump declared a national emergency concerning the COVID-19 outbreak on March 13, 2020, the COVID-19 outbreak is a "qualified disaster" for purposes of IRC Section 139, and payments made by an employer to its employee to reimburse or pay them for expenses related to the qualified disaster can be excluded from the employee's income for tax purposes.

The payments should not be subject to state income tax withholding in Minnesota, but may be subject to other taxes, such as unemployment taxes. The state tax requirements may differ from state to state, so employers should consult their tax advisors to confirm what, if any, state taxes may apply.

General rules for qualified disaster relief payments

In order to ensure that payments from employers to employees qualify as IRC Section 139 qualified disaster relief payments, the payments:

- Must be for “reasonable and necessary” expenses arising from or incurred as a result of the COVID-19 outbreak. The payments or reimbursements can be for a broad range of personal, family and living expenses.

Examples of these expenses include: unreimbursed medical expenses (*e.g.*, co-pays, deductibles), increased expenses associated with working at home or being quarantined at home (*e.g.*, increased utilities and home office expenses for enhanced internet connections, computer equipment), increased childcare expenses and travel expenses incurred to prevent the spread of COVID-19 (*e.g.*, the cost of transportation above that of public transportation).

- Cannot be income replacement payments. For example, qualified leave wages are not excludible qualified disaster relief payments because qualified leave wages are intended to replace wages or compensation that an individual would otherwise earn, rather than to serve as payments to offset any particular expenses that an individual would incur due to the COVID-19 outbreak.
- Cannot be reimbursed or reimbursable by insurance or otherwise.

No expense substantiation by employee, but employer should adopt a plan

Employees are not required to account for or substantiate actual expenses in order to have the payments be non-taxable as qualified disaster relief payments. That said, employers should adopt a plan that includes certain information (*e.g.*, who is qualified to receive payments, how to apply for payments, the start and end date of the plan) and should create an application form that employees fill out to request payments. The form should also contain a statement to validate that the payments meet the requirements of IRC Section 139; that is, that the amounts requested are reasonable and necessary, that they are related to the COVID-19 outbreak and that the amounts are not reimbursable by insurance or otherwise.

Other information

Qualified disaster relief payments are deductible to the employer as ordinary and necessary business expenses. There are no dollar limits under IRC Section 139 for the payments, as long as the payments meet the requirements outlined above. Unlike fringe benefits provided under IRC Section 132, payments made under IRC Section 139 are not subject to nondiscrimination testing. In addition, the payments are not subject to informational reporting on wage-related forms such as Form W-2 or Form 1099-MISC.

Below are two examples of how employers could take advantage of this opportunity to provide tax-free qualified disaster relief payments:

- An employer with mostly “office employees” who are able to work remotely can provide a one-time payment to employees for the purchase of enhanced technology (e.g., printers, scanners, telephones, enhanced monitors, upgraded computers) to allow employees to work from home more effectively, subject to the “reasonable and necessary” requirement.
 - A health care employer may wish to provide varying disaster relief payments (for one of the purposes outlined in the summary above) to first responders and other front-line workers who are continuing to put their health and lives on the line by showing up to work every day.
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