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Providing Tax-Advantaged Employee Assistance in the Wake of COVID-19

In the face of substantial economic strain on a workforce that has been furloughed, laid off or otherwise removed from a normally reliable stream of income, companies are seeking ways to support their employees. In this alert, we highlight some of the tax-advantaged mechanisms available to employers to provide employee emergency assistance, including:

1. Paying Direct “Qualified Disaster Relief Payments”;
2. Establishing or Partnering with an Existing Public Charity;
3. Establishing or Using an Existing Private Foundation; and
4. Providing Interest-Free Loans.

Direct “Qualified Disaster Relief Payments”

President Trump’s declaration of the COVID-19 outbreak as a national emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act opened the door for employers to make certain tax-free emergency assistance payments to employees who are affected by the novel coronavirus. Most payments by an employer to an employee are normally included in the employee’s taxable income. However, under Section 139 of the Internal Revenue Code, “qualified disaster relief payments” from any source are not taxable income to the recipient.

When “qualified disaster relief payments” are made by employers, the employer organization may also fully deduct these payments from its taxable income as ordinary and necessary business expenses. In the context of employee assistance, “qualified disaster relief payments” include *any amount* paid to or for the benefit of an individual which are reasonably expected by the employer to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses (not otherwise compensated for by insurance or

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otherwise) incurred as a result of a qualified disaster. As clarified in a recent IRS Notice, as a result of President Trump's declaration of a national emergency, COVID-19 is a "qualified disaster" for purposes Section 139.

By way of background, Section 139 was enacted following the terrorist attacks of September 11, 2001. Since its enactment, Section 139 has most commonly been used to provide assistance to victims of natural disasters, such as floods, hurricanes and fires. The COVID-19 outbreak presents an unprecedented type and scope of need and, accordingly, there is little guidance from the IRS on exactly what expenses qualify for tax-free reimbursement under Section 139.[1] However, examples in the context of COVID-19 likely include:

- Costs of over-the-counter medications and other medical expenses not covered by insurance;
- Costs for hand sanitizers, home disinfectant supplies, and other supplies needed to maintain a healthy living environment;
- Child care or tutoring costs due to school closings;
- Costs associated with working from home, such as home office supplies, increased utility expenses, higher internet costs, cell phone, etc. (even if not normally deductible as a home-office expense);
- Increased transportation costs due to work relocation or needing to take a taxi or ride share service rather than mass public transportation; and
- Costs for seasonal workers to travel home due to closure of employee housing facilities.

Other costs associated with a quarantine situation or with respect to travel restrictions may also fit within this definition (again, only to the extent not covered by insurance).

"Qualified disaster relief payments" **do not** include payments used to cover:

- Non-essential, luxury, or decorative items or services;
- Expenses compensated for by insurance or other reimbursements; or
- Payments intended to replace wages (such as paid sick or other leave) or otherwise intended as unemployment compensation. *Importantly, this excludes severance or other payments made to laid-off employees from the purview of Section 139.*

There is currently no cap on the amount of direct financial assistance an employer may provide to an employee under Section 139, but assistance must be reasonably expected to be commensurate with the unreimbursed reasonable and necessary personal, living, or family expenses that the employee incurs as a result of COVID-19. The employer is not required to make a determination of financial need before providing the assistance, and employees are not required to provide receipts or other proof supporting their expenses. Note that while many states follow the federal income tax rules, an assessment of applicable state law should be made as well before assuming that qualified disaster relief payments are not subject to state income tax.

Establish or Partner with an Existing Public Charity

If an employer desires to provide assistance beyond the scope of qualified disaster relief payments under Section 139, it may be able to do so through a Section 501(c)(3) public charity. Contributions to such organizations are generally tax-deductible by the donors, and the individuals receiving assistance are not generally subject to federal income tax on the value of assistance they receive. The type of aid that a public charity may provide to individuals is not limited to the definition of “qualified disaster relief payments” under Section 139. For example, public charities can potentially provide aid to furloughed workers to help cover the costs of basic necessities even though the expenses are not new or increased as a result of COVID-19, such as routine utilities, groceries, or rent payments that the individual is struggling to cover, if the circumstances warrant. The type, duration and amount of aid that is appropriate depends on the individual’s needs and resources.

An employer may establish a new Section 501(c)(3) public charity to provide emergency assistance to employees or partner with an existing nonprofit organization that is either specifically organized to provide disaster relief or has the capacity and resources to establish a special program to address the hardships created by the COVID-19 outbreak. It is possible, under certain circumstances, to expedite the process of forming a new public charity, but in the face of immediate need, the more practical solution is often to combine resources with existing community-based organizations or disaster relief charities with a local presence.

To qualify as a public charity (as opposed to a private foundation, addressed below), generally, the charitable organization must normally receive a substantial part of its support in the form of contributions from publicly supported organizations, governmental units, and/or the general public (in contrast to a private foundation, which usually has one or a limited number of sources of funding). In the case of an employer-sponsored public charity, financial support typically comes from a combination the employer company, its employees and sometimes members of the community.

If an employer establishes a charitable organization (whether a public charity or a private foundation) to provide disaster assistance specifically to its employees, particular procedural safeguards must be in place for the IRS to respect the activities as charitable, as opposed to an employee recruiting or retention mechanism. For example, the employer must intend for the fund to provide employee emergency hardship relief for future emergencies and disasters as well, not just the COVID-19 outbreak; the recipients must be selected based on an objective determination of need; and the recipients must be selected by an independent selection committee, a majority of the members of which consists of persons who are not in a position to exercise substantial influence over the affairs of the employer. We encourage employers to seek legal counsel before administering employee emergency assistance through an employer-sponsored charitable organization to confirm all required safeguards are in place.

Establish or Use an Existing Private Foundation

An employer can also sponsor a private foundation to make qualified disaster relief payments to employees. In contrast to public charities, private foundations usually have one or a limited number of sources of funding (typically contributions from a single family or, in this case, a single company). Because private foundations do not typically solicit funds from the general public, the IRS perceives them as, theoretically, subject to less public scrutiny and oversight than public charities. Accordingly, the federal tax code and accompanying regulations place greater restrictions on the ability of private foundations to give directly to individuals. In the case of an employer-sponsored foundation, assistance to employees is limited to “qualified disaster relief payments” for a “qualified disaster” under Section 139, the

same as if the employer were to make the payments directly. This is required both for the payment to be tax-free to employee and, importantly, for the distributions to not trigger hefty self-dealing excise taxes and related unfavorable consequences for the foundation. In addition, the procedural safeguards mentioned above that apply to public charities also apply to employer-sponsored private foundations.

Using an employer-sponsored private foundation might be a good option for a company that already has a private foundation established and funded. As a practical matter, there is little advantage to establishing a new private foundation solely to provide employee assistance because an employer can make the same qualified disaster relief payments directly to employees. While contributions to a private foundation are generally tax deductible for the sponsoring company, so are direct Section 139 payments. Either way, qualified disaster relief payments are excluded from the recipient's gross income (*i.e.*, they are tax-free to the recipient). In contrast to payments made through a private foundation, direct payments made by a for-profit employer may be accomplished without determination of need or detailed documentation.

Interest-Free Loans

In some circumstances, interest-free (up to \$10,000) or low-interest loans to employees may be a potential option for employers to consider as a means of assisting employees in crisis. However, these programs should be carefully scrutinized and structured to avoid treatment as a taxable wage advance. We recommend employers consult an attorney knowledgeable in employment and tax matters before offering interest-free or low-interest employee loans.

We welcome you to reach out to your Michael Best attorney, or our firm's COVID-19 Task Force for specific guidance on these and other rapidly emerging issues.

[1] On April 3, 2020, the American Bar Association Section of Taxation provided comments to the Department of Treasury and the IRS regarding tax-related issues arising from the COVID-19 emergency. Noting that guidance is limited given the unprecedented nature of the pandemic, it was suggested that Treasury issue guidance on qualified disaster relief payments for this emergence to clarify what expenses qualify, during what time period, and whether there is a limit on the amount that can be excluded from income.

Related People

Carrie Byrnes

Partner

cebyrnes@michaelbest.com

T 312.596.5838

Elizabeth Prendergast

Associate

eaprendergast@michaelbest.com

T 303.536.1737

Timothy Schally

Partner



tgschally@michaelbest.com

T 414.225.4987

Martin Tierney

Partner

mptierney@michaelbest.com

T 414.223.2533