

Employment Law *Trending Now*

Employers Can Make Tax-Free Payments to Employees for COVID-19 Expenses

On March 13, 2020, the President issued an emergency declaration under the *Robert T. Stafford Disaster Relief and Emergency Assistance Act* in response to the ongoing COVID-19 pandemic. This declaration put into play a little-known existing provision of the tax law –Section 139 of the Internal Revenue Code.

Section 139 allows employers to assist employees during a federally declared disaster with “qualified disaster relief payments” that are tax-free to the employee and fully deductible to the employer. These payments are not subject to any federal withholding obligations and do not need to be reported on a Form W-2 or 1099. Employers wishing to aid employees impacted by COVID-19 should consider taking advantage of the Section 139 disaster relief provision by familiarizing themselves with the Section 139 qualifications and adopting a Section 139 program to help their employees through these unprecedented times. In the absence of Section 139, any payment by an employer to an employee would be taxed to the employee as compensation (because under rules of general application an employer cannot make a “gift” to an employee, regardless of the intent of the employer in making the payment).

Added to the Internal Revenue Code after the attacks on September 11, 2001, Section 139 allows employers to make tax-free “qualified disaster relief payments” to help employees in the wake of a qualified disaster. A “qualified disaster relief payment” under Section 139 includes payments by

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an employer, not compensated for by insurance or otherwise, paid to or for the benefit for its employees 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.

Section 139 has been utilized in the past for other Stafford Act disasters. It was clear during a natural disaster, such as Hurricane Katrina, that employer expenses paid to employees related to property repair and replacement, temporary housing, and food would be covered. However, the situation with COVID-19 is unique in that Section 139 has yet to be invoked for a disease pandemic. The IRS has not issued any guidance specific to COVID-19; thus, it is not entirely clear at this time what types of expenses will be considered “qualified disaster relief payments.” Payments are not qualified disaster relief payments if they compensate employees for expenses that are otherwise compensated for by insurance or that are intended to replace lost income. Thus, payments of sick pay, family medical leave pay, or other type of salary leave pay, remain fully taxable to the employee, and remain subject to income and payroll tax withholding and reporting.

Because this is the first time Section 139 has been applied to a national pandemic, no regulations have been issued to provide guidance on exactly which expenses and under what circumstances reimbursement or payments may occur. As a result, there is some uncertainty as to the specific types of expenses that will meet the definition of “qualified disaster relief payments.” Nevertheless, legislative history and a reasonable interpretation of the statutory text provides that the following payments or reimbursements from employer to employee should qualify under Section 139, provided the expenses are reasonable and necessary, relate to the COVID-19 pandemic, and are not otherwise compensated by insurance:

- Medical expenses of the employee not covered by insurance or otherwise (e.g., co-pays incurred for COVID-19 treatment)
- Other health-related expenses, such as over-the-counter medications, hand sanitizers and personal protective equipment
- Dependent care and tutoring/home schooling/remote learning expenses due to school closings (e.g., educational materials, computer for use by a dependent, subscriptions to educational resources)
- Increased home expenses due to telecommuting (e.g., home office set-up, internet, printer costs, cell phone costs, increased utility expenses)

- Transportation expenses due to work relocation
- Critical care and funeral expenses of an employee or a member of the employee's family who dies from a COVID-19 infection.

Section 139 does not impose any limits on the amount of "qualified disaster relief payments" an employer can make to employees, either individually or in the aggregate. Nor does it require that employees achieve a certain period of service before being eligible to receive tax-free payments under the provision, and employees are not required to account for actual expenses, provided that the amount of the payments they receive is reasonably commensurate with the expenses that are incurred. Although no formal plan or documentation is required to be maintained by the employer, it would be advisable for employers to document their intention to make payments covered by Section 139, and consider including:

- The amounts paid and to whom
- The start and end date of any Section 139 "program"
- A general listing of the expenses that will be paid or reimbursed on behalf of the employees
- Any maximum amount - per employee or in the aggregate - that the employer will pay
- Whether the employee will be required to submit an application

Although Section 139 does not require employers to collect receipts or other proof of expenses incurred by employees, employers should consider doing so to control costs and to avoid fraudulent claims from employees, even though implementing such aspect of the program may also lead to an increased administrative burden.

Aronberg Goldgehn remains open during this time and we are here to help. We encourage you to reach out with any questions, concerns or legal issues you may have, including those related to COVID-19 or the implementation of a COVID-19/Section 139 plan.