



# What's News in Tax

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## Employers Helping Employees – Disaster Relief

October 15, 2018

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When a disaster hits, employers often want to help their affected employees. It is possible for employers to make certain payments, implement reimbursements, and provide other forms of assistance, so that some or all of the employer provided assistance is non-taxable, but nonetheless deductible. The article discusses those possibilities as well as other approaches that employers consider for assisting employees in these times of need.

### Section 139 – Qualified Disaster Relief Payments

Under section 139,<sup>1</sup> qualified disaster relief payments (including payments from an employer to an employee) are not includible in income. Determining whether a payment is a qualified disaster relief payment involves three steps:

1. Is the event a “qualified disaster” under the Internal Revenue Code definition?
2. Is the employee’s loss within the qualified disaster zone?
3. Are the payments on account of or reimbursing expenses that are considered qualified under section 139?

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<sup>1</sup> Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

A qualified disaster is:

- ◆ A federally declared disaster (i.e., a disaster subsequently determined by the President of the United States to warrant assistance by the federal government under the Disaster Relief and Emergency Assistance Act);
- ◆ A disaster that results from an accident involving a common carrier, or from any other event, which is determined by the Secretary of the Treasury to be of a catastrophic nature;
- ◆ A disaster that results from terrorist or military action; or
- ◆ A disaster that results in payments by federal, state, or local governments or their agencies or instrumentalities (with respect to payments not otherwise compensated for by insurance or otherwise).

As an example, a federally declared disaster had been announced for certain counties in Virginia, North Carolina, and South Carolina due to Hurricane Florence.<sup>2</sup> Thus, payments or reimbursements from an employer that qualify as qualified disaster relief payments will not be includable in the income of the recipient if paid to an affected employee who resides in one of the counties that has been listed under the federally declared disaster zone.

A qualified disaster relief payment is any payment received or incurred (to the extent not otherwise compensated for by insurance or otherwise) as a result of a qualified disaster that:

- ◆ Is to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses;
- ◆ Is to 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;
- ◆ Is from a person engaged in the furnishing or sale of transportation as a common carrier by reason of the death or personal physical injuries incurred as a result of a qualified disaster, or
- ◆ Is paid by a federal, state, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare.<sup>3</sup>

Qualified disaster relief payments do not include income replacements such as lost wages. Accordingly, qualified disaster relief payments made to employees are not subject to payroll taxes.

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<sup>2</sup> *Disasters*, FEMA.gov, <https://www.fema.gov/disasters>.

<sup>3</sup> Section 139(b).

## The Insurance Clause

As noted above, qualified disaster payment made by an employer to an employee affected by the qualified disaster are not wages or compensation subject to employment taxes.<sup>4</sup> Therefore, no federal income tax withholding is required, and qualified disaster relief payments are not subject to FICA/Medicare. However, if the employer pays or reimburses for expenses covered by the employee's insurance, the payment is likely to be taxable compensation subject to the usual FICA/Medicare and income tax withholding. Thus, the employer needs to consider the insurance requirement.

We generally recommend that an employer with more than one location coordinates its monetary efforts from a central location, rather than having each individual office decide to provide aid on its own. Several offices that are not working with the same information may inadvertently provide aid that does not meet the section 139 rules, resulting in taxable compensation for the employees receiving help.

Employees do not have to account for their actual expenses in order to receive qualified disaster relief payments and qualify for the exclusion from income for such payments, provided the payments received by the employee are reasonably commensurate with the expenses he or she incurred. Further, employers need not require employees to provide any evidence or documentation to support a reimbursable expense, unless the expense appears to be unreasonable or unnecessary. However, as a best practice, employers should consider obtaining a self-certification from an employee receiving a qualified disaster relief payment that sets forth the expenses covered by the payment (i.e., temporary lodging, meals, home repairs), and requires the employee to certify that the expense is not reimbursable by insurance.

Nonetheless, because of the statutory requirements, it is also useful to have a policy in place to try to determine whether the payments or aid sent are likely to be covered under the employee's insurance. Some employer have a short list of questions for employees to ascertain the employees' needs and provide additional expense confirmation. For example, the following are frequent inquiries in this process:

- ◆ How can we contact you going forward?
- ◆ Where are you staying this week? Do you have a place to stay after this week (out of town with relatives, hotel, etc.)?
- ◆ Do you have transportation?
- ◆ What are your immediate needs?
- ◆ What sort of insurance do you have (homeowners, tenant, flood)?

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<sup>4</sup> Section 139(d).

- ◆ Have you had a chance to contact your insurance agent and talk about coverage?
- ◆ Are the expenses of living elsewhere, transportation, etc. covered under your policy?

While all insurance policies are different, some homeowners insurance might cover staying in a hotel until certain types of damage is being repaired, but the policy might not cover meals while displaced. Having a general understanding of the likely coverage can help determine the types of payments that are more likely to be subject to taxation and the types that are more likely to be tax free.

Companies sometimes want to send reimbursement payments before the insurance coverage can be determined. If so, the company should keep track of the payments so that payroll can report the amounts if some of the payments are taxable. Given the broad benefits available under section 139, in many cases the payments can be used for reimbursements that are more likely to be tax free, but having a mechanism to show that the insurance issues were considered makes it easier to argue for tax-free treatment.

### General Insurance Issues

For some sorts of disasters, such as a large wildfire affecting an area (that is declared a federal disaster), regular homeowners insurance may cover some of the damage and may also cover the cost of living somewhere else while the damage is repaired. As such, the employer needs to be aware of the insurance coverage once the employee has information from the insurance agent. For floods, most regular homeowners insurance policies do not cover flood damage and thus people in flood zones sometimes have separate flood insurance (some mortgage lenders require separate flood insurance if the property is in a flood zone). As a practical matter, many flood insurance policies do not cover all costs incurred because of a flood, making it likely that even an employee with flood insurance will have costs not covered by insurance.

### Employer Loans to Employees

Employers can generally loan up to \$10,000 to employees without charging interest. A loan is not taxable compensation so long as there is a reasonable expectation of repayment. For a loan from an employer to an employee eligible for section 139 qualified disaster payments, it may be possible to provide higher dollar value interest-free loan. Note that loans from employers to employees may also be governed by state payroll laws, which are beyond the scope of this article.

### Employee-to-Employee Gifts

Sometimes employees want to help out affected colleagues, but need some help in coordinating their efforts. Companies may collect amounts from various employees for a group of affected employees or even a specific affected employee. There are a few issues to consider if the employer gets involved in the effort.

Section 102(c) does not respect “gifts” from an employer to an employee (other than as discussed in section 139 above). If an employer helps by simply pooling employee-to-employee payments, these gifts need to be separate from any employer assistance. Generally, companies set up a separate bank account just for these amounts. The employer is essentially acting as agent for the employees, collecting the employee amounts, and sending them along to the recipients on behalf of the donor employees.

When providing the funds to a specifically affected employee, these payment can be labelled “employee-to-employee amounts” or as “gifts from your fellow employees”.

Companies should be mindful of the employee personal information rules when trying to help employees give to other employees.

### Paid Time Off Donations

The IRS also, separately, may allow employees of a company to donate “paid time off” to be used by employees affected by a disaster (the affected employee taking the additional paid time off is taxed on the paid time off). The IRS has generally allowed companies to set up this sort of donation program after a specific major disaster. The IRS has not yet done so for Hurricane Florence in North and South Carolina, but it is possible that it will do so in the near future. This separate rule is not specifically under section 139. The employee donating the leave does not have compensation income on the “donation,” but also cannot take a charitable deduction.



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