

Thinking Outside the Box to Help Employees During COVID: Section 139 Tax-Free Reimbursements

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In the face of the unprecedented COVID-19 pandemic, many employees may experience financial hardship. For example, they may incur unexpected expenses as a result of COVID-19, including being quarantined or under a stay at home order. Employers are looking for ways to help their employees get through these difficult times. One way in which an employer can provide assistance to employees impacted by the COVID-19 pandemic is by making tax-free “qualified disaster relief payments” under Code section 139. Qualified disaster relief payments are attractive to employers because they are both excludable from employees’ incomes and deductible by the employer – which is in the “win-win” category.

Below we briefly summarize the rules that apply to these payments, the types of permissible expenses that an employer can pay, and how employers can adopt these programs.

What Is a Qualified Disaster Relief Payment?

As relevant here, a qualified disaster relief payment is a payment to or for the benefit of an employee “to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster.” A “qualified disaster” includes a federally declared disaster. Although there was some initial confusion about whether President Trump’s national emergency declaration in March meant that the COVID-19 pandemic is a disaster for this purpose, the IRS has confirmed that COVID-19 pandemic is a disaster for this purpose.

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There has been limited IRS guidance on the scope of Code section 139, and what little guidance we have is focused on natural disasters, such as hurricanes and wildfires. Thus, there are still open questions on how the Code section 139 rules apply in the context of the COVID-19 pandemic.

What Type of Expenses Are Covered?

The expenses must be incurred “as a result of” the COVID-19 pandemic. IRS guidance in the context of other qualified disasters (e.g., Hurricane Katrina) have permitted the payment/reimbursement of the costs of travel/transportation, lodging/temporary housing, meals, medical expenses, and incidental expenses incurred as a result of the disaster. In the context of COVID-19, some permissible expenses may include (note this is not an exhaustive list):

- Travel and parking at the office if the employee is driving to work to avoid taking public transportation.
- Lodging if the employee or a family member has to stay at a location besides his/her home to avoid a family member who has been diagnosed with COVID-19.
- Grocery and meal delivery fees.
- Medical expenses.
- Funeral expenses if the employee or a relative passes away due to COVID-19.
- Protective items, such as hand sanitizer, face masks, and gloves.

What Expenses Are Not Covered?

The employer cannot pay any expenses for which the employee is compensated for by insurance or otherwise. Based on the prior IRS guidance, the payments should not indemnify all disaster-related expenses or reimburse the cost of nonessential, luxury, or decorative items and services. Further, the payments cannot be a replacement for lost wages or income replacements such as sick leave or other paid time off paid by an employer.

How Can an Employer Make the Payments?

In some cases, these disaster-related payments reimburse on an expense-by-expense basis (up to a limit), and in other cases, employers simply provide a lump sum amount that the employer reasonably estimates to the amount of expenses the employee has incurred. An employer can make the payments in the following ways:

- *Direct payments to employees* – direct payments to employees via the employee’s paycheck.
- *Donor-Advised Fund Within a Public Charity* – establish or donate to an already established donor-advised fund within a public charity to provide qualified disaster relief payments to employees.
- *Private Foundation* – establish or donate to an already established private foundation to provide qualified disaster relief payments to employees.

The logo for Groom Law Group, featuring the word "GROOM" in a large, light-colored, serif font.

Are There Any Substantiation Requirements?

Unlike other employer-provided tax-free reimbursements, there are no express substantiation requirements for these payments. Therefore, employers are not required to collect and review receipts and related documentation of expenses. However, the payments must be reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary COVID-19-related expenses.

How Does an Employer Offer These Benefits?

An employer should adopt a written policy that outlines the program requirements, the types of expenses are covered, and the administrative process and restrictions. This is helpful to the employer not only in the event of an IRS audit, but also to communicate the requirements to employees.

An employer can administer these payments itself in-house or can outsource administration to a third party administrator. For example, the same TPA that handles the employer's health FSA could also administer the disaster relief payments. In some cases, TPAs have template program documents that an employer can use.

While some employers want to limit these payments to their U.S. workforce, some employers may also want to provide these payments to employees working outside the U.S. Whether those payments are excludable is a country-by-country determination. Note that some countries have been rapidly adopting coronavirus relief, so it is possible there may be a mechanism to make these payments tax-free to employees outside the U.S. as well.

For How Long Can an Employer Make the Payments?

An employer can make the payments until the President declares that the COVID-19 pandemic is no longer a qualified disaster – that is at least through the remainder of the year.

If you are interested in this program for your employees, please contact your Groom attorney to discuss how we can help.

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