

Tax Notes

National Emergency Declaration: Permits Employers to Provide Tax-Free Financial Assistance to Employees

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This article is an update from an earlier version.

When the COVID-19 pandemic was declared a national emergency disaster earlier this year, many thought it would be short-lived. Unfortunately, this has not been the case – the pandemic continues with a million additional cases worldwide. On a positive side, there has been vast progress on therapeutics and with a renewed hope in a vaccine, the world may soon begin to transition toward normalcy.

Employers who have offered – or may still want to offer – financial support to their employees may question if the provisions of Internal Revenue Code §139 still apply and, if so, when will a formal end to this disaster be declared. The IRS may never provide formal guidance with respect to these questions; however, the broad scope of IRC §139 provides for flexibility and is subject to interpretation.

While there are no definitive answers as to when the pandemic will end, based on the latest developments some predict an end to the pandemic in the latter part of 2021. Employers may presumably continue to offer tax-free financial assistance until the national emergency declaration expires or is revoked. This is likely to occur when public-health emergency interventions are no longer necessary, immunity has been achieved and is sufficient to prevent additional widespread transmission, and the risk of COVID-19 to the public health and welfare has been eliminated or eradicated.

Internal Revenue Code §139

The President declared a national emergency on March 13, 2020 and invoked the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Declaration) in response to the COVID-19 pandemic. This Declaration allows employers to provide tax-favored financial assistance to employees who are impacted, directly or indirectly, by the coronavirus.

Employers may provide assistance, whether in cash or services, to employees affected by COVID-19 and that assistance shall be treated as tax-free to the recipients, exempt from federal income and employment taxes. In addition, because there are no mandatory administrative requirements under this provision – and it does not require itemized receipts from employees – employers can react promptly to provide financial support and help alleviate the immediate needs of their employees.

IRC §139 states that “qualified disaster relief payments” are not treated as taxable wages or income to employees and are fully deductible by the employer as an ordinary and necessary business expense. A “qualified disaster relief payment” includes any amount paid to reimburse or pay reasonable and necessary personal, family, living or funeral expenses (not otherwise compensated for by insurance) incurred because of a “qualified disaster” [as defined below]. Examples of reasonable and necessary expenses created by COVID-19 may include, but are not limited to, medical expenses, medical equipment, over-the-

counter medications, hand sanitizers, home cleaning and disinfectant supplies, work-from-home expenses, transportation costs due to work relocation, etc.

The term “qualified disaster” includes a disaster in an area that has been subsequently determined by the President to warrant federal assistance under the Disaster Relief and Emergency Assistance Act. Rev. Rul. 2003-29, 2003-1 CB 587, 02/26/2003 clearly sets forth that a disaster includes an event declared as a major “disaster” or an “emergency” under the Declaration.

Employers who provide qualified disaster relief payments to employees are not required to report the payments on an employee’s federal Form W-2 or on a federal Form 1099. The payments are not subject to income taxes, employment taxes, or self-employment taxes. Since state laws may vary, employers should make certain that qualified disaster relief payments – excludable for federal tax purposes – are also excludable for state tax purposes. For example, New York State conforms to the federal law and, accordingly, exempts disaster relief payments from adverse tax implications when granted to New York recipients.

It should be noted that wage replacement payments, such as sick leave, are not qualified disaster relief payments under IRC §139, and such payments are considered taxable wages to the recipients, subject to income and payroll tax withholding.

In addition, the CARES Act permits higher education institutions to use supplemental educational opportunity grant funds received through the Higher Education Act to award emergency financial aid grants to support both graduate and undergraduate students with unexpected expenses or unmet financial need caused by the pandemic. Emergency financial aid grants to students toward unexpected expenses, unmet financial need, or expenses connected to the disruption of campus operations, such as expenses for food and housing, course materials, technology, health care costs, and childcare expenses also qualify as disaster relief payments pursuant to IRC §139. Such payments are not includible in the student’s gross income and not reportable on IRS Form 1098-T, Tuition Statement.

Establishment of an IRC §139 Program

Although IRC §139 programs are not subject to the Employee Retirement Income Security Act (ERISA), it may be prudent for an employer to follow and apply ERISA principles in administering its program as a good practice to ensure the program is applied uniformly. For instance, an employer should consider adopting a program that is approved by its governing body.

In Rev. Rul. 2003-12, the IRS favorably concluded that payments made pursuant to a written program qualified for the income tax exclusion. Furthermore, adopting a program may be fundamental in informing its employees as to the program details and should contain the following features:

- Indicate that the program is in response to the COVID-19 Outbreak Stafford Declaration;
- Describe the employees eligible to receive assistance or employee class or group;
- Describe the types of expenses that may be covered by payments from the program;
- Describe the method for reimbursement/payment and whether an application is required;
- Specify a per-employee maximum or any restrictions on the grants, if any;
- Name the administrator and the administrator’s powers, such as the authority to make discretionary decisions; and
- Provide an end date by which applications for grants under the program must be submitted.

Employers should review their original IRC §139 programs and implement any revisions, as necessary. With an unforeseeable end to the pandemic, the program end date may need to be extended to indicate that applications will be accepted and evaluated until further notification is issued – and whereby sufficient evidence is available to demonstrate that the emergency declaration has ended.

Recommendations

It is recommended that strong governance practices be implemented, including forming a committee of three or more employees to make decisions regarding the grants, including a determination as to whether an employee qualifies for assistance and the amount of the grant to each employee. Because there is no specific cap on the amount of assistance that may be provided to an employee other than it must be “reasonable and necessary” and must not be for an expense reimbursable by the employee’s insurance, a committee can have full discretion in approving different grant amounts for each employee.

In addition, it is advisable that employers have employees complete a basic application form indicating the below:

- the amount of assistance being requested,
- representation that the employee resides in the disaster area,
- affirmation that the request does not exceed the amount of the employee's unreimbursed reasonable and necessary expenses, and
- that the grant will be used solely for qualifying purposes as defined in IRC §139.

Contact Us

If you have any questions with respect to this IRC §139 program, please contact Garrett M. Higgins, CPA, Partner at ghiggins@pkfod.com, Eva Mruk, CPA, EA, Tax Director at emruk@pkfod.com or a member of your client service team at PKF O'Connor Davies, LLP.

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