

Employer Provides Assistance Directly

A qualified disaster payment made by an employer to an employee impacted by a qualified disaster is excluded from compensation, and is not treated as net earnings from self-employment.

Under section 139 of the Internal Revenue Code, disaster relief payments can be made by an employer to an employee if:

- there is a qualified disaster
- the employee is within the disaster area
- the payment is of the type defined in the Internal Revenue Code.

A qualified disaster is one that is a presidentially declared disaster (a disaster determined by the U.S. president to warrant assistance by the federal government). The COVID-19 pandemic was designated a disaster under the Stafford Act on March 13.

A qualified disaster relief payment can be made:

- to reimburse or pay reasonable and necessary personal, family, living or funeral expenses incurred as a result of a qualified disaster. This could include money, services or goods to ensure that the victims have the basic necessities, such as food, clothing, housing, transportation and medical care, regardless of their financial resources.
- to pay or reimburse reasonable and necessary expenses to repair or rehabilitate a personal residence or its contents, provided these actions are necessary as a result of a qualified disaster.

No regulations have been issued that provide guidance on which expenses and under what circumstances reimbursement or payments may occur. Prior disasters have been natural disasters, such as floods and hurricanes. Although COVID-19 is a different type of disaster, there is no reason to think that the same rules would not apply to payments made by employers. Expenses unique to this disaster might include:

- child care due to school closings
- tutoring due to school closings
- increased utility expenses due to working from home
- additional home expenses to set up and maintain a home office
- health-related expenses that are not medical expenses, such as disinfectant cleaning products and sanitizers
- transportation expenses necessitated by a shutdown or limitation in public transportation.

One restriction for payments made pursuant to section 139 is that the payment cannot be for an item that is compensated by insurance or other means. For that reason, the employer should require that employees affirm that they do not have insurance that would cover expenses. An employer should ask an employee what types of insurance the employee has, whether the employee has contacted its insurance agent to determine what coverage is available, and whether items such as living expenses and transportation are covered under the insurance policy. An employer should keep records of all disaster aid.

It is advisable for the employer to adopt a written program. It should state that the program is implemented pursuant to the COVID-19 pandemic Stafford declaration, list the expenses that will be reimbursed, set forth eligibility requirements, explain how employees apply for reimbursement, and list the limits of coverage.

Providing Assistance Through an Employer-Sponsored Charitable Organization

Instead of providing relief directly, an employer can provide relief through a charitable organization that it creates. The organization must apply to the IRS for recognition as tax-exempt under section 501(c)(3).

Like all section 501(c)(3) organizations, disaster relief organizations cannot confer a private benefit on an individual. If the employer controls the selection of recipients, the charity could be viewed as a means of helping the employer recruit and retain employees, resulting in an impermissible private benefit to the employer. Consequently, with an employer-sponsored charity, the employer cannot control the selection of recipients who will receive aid. The charity can provide a wider range of benefits than are provided directly by the employer as a qualified disaster payment, although the criteria set forth above should be considered.

The charity must show that the payments are not being made for the employer's benefit. This can be demonstrated in several ways. **First**, the charity should select recipients based on an objective determination of need. The charity must determine that the recipient is in need — being completely destitute is not necessary, and a person can be considered impoverished if the person lacks the resources to obtain the basic necessities. A person can also be deemed to be in need if he or she is temporarily in need of food or shelter. A charity, however, may provide crisis counseling, rescue services or emergency aid, such as blankets or hot meals, in the immediate aftermath of a disaster *without* the recipient needing to show financial need.

If selecting recipients based on an objective determination of need, the charity should establish written criteria for the employees' applications for relief, the criteria for making a selection, and the disbursement of funds. There should be an objective evaluation of the victim's situations at the time the grant is made, and documentation should be preserved. Documentation should include the following:

- description of the assistance, including amount and type
- purpose for which it was given
- how the recipients were selected
- charity's criteria for disbursing assistance under the particular program
- name, address and position of the recipient
- relationship between the recipient and the officers, directors or key employees of and substantial contributors to the charity

- composition of the selection committee
- all correspondence with applicants, particularly if assistance was denied, and a written record of all conversations.

Second, a charity may show that payments are not being made for the employer's benefit by ensuring that a broad charitable class is served. This class should include victims of the current disaster and future disasters, and should include current and future employees. This ensures that the class is indefinite.

Third, the charity could create an independent selection committee in which a majority of the committee consists of individuals not in a position to exercise substantial influence over the employer's affairs. This is designed to ensure that any benefit to the employer is incidental.

Even if an existing charity was not specifically organized to provide disaster relief and these activities were not specified in its application for exempt status, an existing recognized charity may engage in disaster relief activities without obtaining prior permission from the IRS. However, it must report this new activity on its annual tax return.

Employer-Sponsored Public Charity

An employer-sponsored public charity could be classified as either a public charity or a private foundation. If the employer solicits and receives contributions to the charity from employees or the general public, the charity could become a public charity. To ensure that it receives broad public support, the charity must meet specific tests relating to the source of its support.

An employer-sponsored public charity has more flexibility than an employer-sponsored private foundation. An employer-sponsored public charity can provide relief to employees in any emergency or personal hardship situations. They include serious illness, injury, fire, flood, natural disaster, military deployment, being a victim of violent crime, the death of an employee or dependents, as well as qualified disasters. The payments are not limited by section 139 and can be made for a wider range of purposes.

If all of the rules set forth above relating to an employee-sponsored charity are followed, payments made to a victim of a disaster or emergency hardship by the employer-sponsored public charity are presumed to be made for a charitable purpose. As long as the charity is established to assist employees who are victims of all disasters, both present and future, the payments will be viewed as made to an indefinite class. In that case, the payments should not be taxable compensation to the employees.

Employer-Sponsored Private Foundation

If the employer-sponsored charity does not solicit contributions, and thus the employer is the sole contributor, then the charity will be a private foundation. A private foundation is more limited in the assistance that it can provide because a private foundation is potentially subject to the excise tax on self-dealing. Unlike an employer-sponsored public charity, an employer-sponsored private foundation can only provide support in response to a qualified disaster. It cannot make payments to individuals in an emergency situation like a house fire or severe illness of an employee's child. In addition, an employer-sponsored private foundation must avoid self-dealing. An assistance payment to a member of the selection committee or an officer or director (or one of their family members) of the foundation would be considered self-dealing.

Gifts of Cash or Property by Employees to Other Employees

In addition to providing or facilitating assistance from a charity, an employer may wish to help its employees give to their fellow employees who are the victims of a disaster or personal hardship. If an employee gives funds or property to a fellow employee, the transfer should be treated as a gift for tax purposes. The donor has no consequences unless the gift exceeds the annual exclusion amount (\$14,000 in 2017, \$15,000 in 2018), and the recipient pays no tax on the receipt of a gift.

If an employer facilitates gifts between employees, the employer needs to separate those gifts from any amounts provided by the employer. Gifts from an employer (other than those covered by section 139) are treated as taxable income. If an employer merely helps employee-to-employee gifts, but makes no contributions, the payment should be respected as a gift. If an employer's role is to help set up a bank account or other mechanism to collect the funds, the employer should be treated as acting as agent for the employees. Its role should be limited to collecting the payments and providing them to the recipients selected by the employees who contributed.

Takeaways

Given the widespread nature of the COVID-19 pandemic, many employers may be seeking to help their employees and their families during this period. In order to provide this assistance tax-free to their employees, employers must navigate the detailed maze of provisions governing assistance programs. Employers may wish to provide assistance directly or through a charitable organization. It is crucial that the program be documented, including identifying who is eligible, how the particular employee satisfies the eligibility criteria, whether they have insurance to cover any of the types of losses that the employer is planning to fund with payments made under the program, and who is on the selection committee. Creation of or use of a charitable organization requires compliance with the rules governing these organizations.