

Legal Update

Turbo-Charging COVID-19 Relief Payments to Employees with Tax Benefits

The response of the federal government to the COVID-19 pandemic has focused on fiscal incentives and tax relief. These initiatives include triggering the ability of employers to make payments to employees that are deductible to the employer but are not subject to either federal income tax, or federal social security tax, in the hands of the employee. This incentive allows employers to turn up to “one dollar into two” for employees by complying with the provisions of Section 139 of the Internal Revenue Code of 1986, as amended (the “Code”) when making COVID-19 relief payments. Code § 139 is not subject to any top-heavy limitations or non-discrimination rules and provides significant flexibility to employers.

Specifically, the opportunity to treat employee payments as described in Code § 139 was triggered on March 13, 2020, when President Trump declared the ongoing COVID-19 pandemic a national emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the “Stafford Act”).

Qualified Disaster Relief Payments Under Code § 139

Code § 139, which was added to the Code after the September 11, 2001, terrorist attacks, allows employers to help employees during a qualified disaster by making “qualified disaster relief payments” that are tax-free to the employee and fully deductible to the employer.¹ These payments are not subject to any federal income or payroll tax withholding obligations and are not required to be reported on Internal Revenue Service (the “IRS”) forms W-2 or 1099.² This benefit inures to the employer as well as the employee because the payment is not treated as wages for purposes of either the employer or employee social security contribution requirement.

A payment eligible for the benefits of Code § 139 includes payments by an employer, not otherwise reimbursed by insurance (for the employee) and not intended to replace lost income, to its employees, which are reasonably expected by the employer to:³

- 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.

“Qualified disaster relief payments” do not include payments for nonessential, luxury or decorative items or services.⁴ Additionally, Code § 139 does not include payments that are income replacement payments (lost wages) such as sick pay, family medical leave pay or any other type of salary or leave pay.⁵ As such, income replacement payments will still be considered taxable wages and will remain subject to income and payroll tax withholding and reporting.

Code § 139 does not impose limits on the amount of “qualified disaster relief payments” that employers can make to employees (either individually or in the aggregate). Also, Code § 139 does not require that employees have been employed for any particular period of time in order to receive such payments. Individuals are *not* required to account to their employer for actual expenses in order to qualify for the exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.⁶ Accordingly, neither the employer nor the employee need maintain a register of expenses that were eligible to be treated as eligible expenditures in order for the employer to treat the payments as eligible payments.

COVID-19-Related Expenses

As noted above, Code § 139 provides that in the event of a qualified disaster, an employer can make tax-free payments to its employees. Code § 139 also applies to any “federally declared disaster” as defined in Code § 165(i)(5)(A).⁷ Code § 165(i)(5)(A) defines such a disaster as any disaster determined by the president to warrant assistance by the federal government under the Stafford Act.

In Notice 2020-18, the IRS stated that President Trump’s emergency declaration constituted a federally declared disaster for purposes of Code § 165. The COVID-19 pandemic should be considered to satisfy the requirement in Code § 139 to be treated as a federally declared disaster. As a result, employers may provide tax-free payments to employees (while still claiming a full deduction for the payments) provided the payment is to reimburse or pay the employee for reasonable and necessary expenses incurred as a result of the COVID-19 pandemic. Clearly, however, payments to compensate for lost wages are not eligible payments.

The IRS has not issued any Code § 139 guidance specific to the COVID-19 pandemic, and therefore, it is not entirely clear what types of expenses during this time are considered “qualified disaster relief payments.” However, payments made by employers to compensate employees for costs incurred in the following categories of reimbursable expenses should qualify under Code § 139, provided the expenses are reasonable and necessary, relate to the COVID-19 pandemic and are not otherwise compensated by insurance:

- Medical expenses not covered by insurance;
- Expenses incurred for child care and tutoring services;
- Expenses incurred to allow the employee to work from home;
- Transportation expenses;
- Caregiver and domestic service expenses; and
- Funeral expenses.

Code § 139 Program Considerations

Code § 139 does not require an employer to have a written policy or program for “qualified disaster relief payments.” Nonetheless, best practices dictate that employers who wish to make such payments due to the COVID-19 pandemic should establish a written program to assist in defining the key elements of the program and to communicate this benefit to employees. Accordingly, the following features should be considered as part of the program:

- State that the program is with respect to the COVID-19 pandemic
- Describe which employees are eligible for the program
- Include a general listing of the expenses that will be reimbursed
- Describe the method for reimbursement (e.g., whether application is necessary)
- Provide any employer-imposed expense limit per employee
- Name the administrator of the program and the administrator’s authority
- Provide the start and end date of the program

Conclusion

Due to the uncertainty surrounding the COVID-19 pandemic, employers may look to Code § 139 in order to provide reimbursements to employees for disaster-related expenses on a tax-free basis, free from IRS forms W-2 or 1099 reporting. Cash-strapped employers can stretch the value of the payments that they can afford to make by taking advantage of Code § 139. Employers can make these payments to cover employees’ reasonable and necessary expenses related to the COVID-19 pandemic, including unreimbursed health-related expenses, child care expenses or costs associated with working from home.

If you wish to receive regular updates on the range of the complex issues confronting businesses in the face of the novel coronavirus, please [subscribe](#) to our COVID-19 “Special Interest” mailing list.

And for any legal questions related to this pandemic, please contact the authors of this Legal Update or Mayer Brown’s COVID-19 Core Response Team at FW-SIG-COVID-19-Core-Response-Team@mayerbrown.com.

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Endnotes

¹ Code § 139(a).

² Code § 139(d); see Joint Comm., Technical Explanation of the Victims of Terrorism Relief Act of 2001, JCX-93-01 (Dec. 21, 2001).

³ Code § 139(b).

⁴ Rev. Rul. 2003-12 (Dec. 19, 2003) (addressing disaster relief payments to individuals).

⁵ See Joint Comm., Technical Explanation of the Victims of Terrorism Relief Act of 2001, *supra*.

⁶ See Joint Comm., Technical Explanation of the Victims of Terrorism Relief Act of 2001, *supra*; see also Rev. Rul. 2003-12, *supra* (stating that in the event of a qualified disaster, “[I]ndividuals will not be required to account for actual expenses in order to qualify for the Section 139 exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.”).

⁷ de § 139(c)(2) (reference to Code § 165(i)(5)(A)).

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