

## LITCHFIELD ALERT

# QUALIFYING DISASTER RELIEF PAYMENTS AMID COVID-19

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**IRC Section 139(a)** permits individuals to exclude a "qualifying disaster relief payment" from income. **IRC Section 139** applies when, among other factors, the United States President declares a "disaster" within the meaning of **IRC Section 165(i)**, which references a presidentially declared disaster under the Stafford Act. **Revenue Ruling 2003-29** states that a disaster includes, for purposes of **IRC Section 165(i)**, an event declared a major disaster or an emergency under the Stafford Act. On March 13, 2020, President Donald J. Trump made an emergency declaration, so these provisions apply.

An employer that provides a qualifying disaster relief payment is not required to include those amounts as wages (or as self-employment earnings) under **IRC Section 139(d)**. Thus, these amounts are tax-free for federal tax purposes. The relevant question pursuant to the **COVID-19** pandemic is what constitutes a "qualified disaster relief payment." The category that is likely most relevant to COVID-19 is a payment "to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster," provided the amount is not reimbursed by insurance or otherwise.

The key analysis is whether an expense is "incurred as a result of" the COVID-19 pandemic. Whether any particular payment is a qualifying disaster relief payment will be a factual determination. Under current guidance, voluntarily continuing wages when a retail establishment is closed (by order or otherwise) would not appear to satisfy the statutory standard. While that fact pattern undoubtedly results in hardships, the standard is whether expenses are incurred as a result of the disaster. In contrast, if an employee is teleworking and must incur new expenses, such as childcare as a result of school closures, such expense likely does meet the qualifying disaster relief definition.

### BACKGROUND

**IRC Section 139**, added to the Code by the **Victims of Terrorism Tax Relief Act of 2001**, provides that gross income does not include any amount received by an individual as a "qualified disaster relief payment." **IRC Section 139(d)** further specifies that a qualified disaster relief payment also will not be treated as wages for employment tax purposes or as net earnings from self-employment for self-employment tax purposes.

The term, "qualified disaster relief payment," means any amount paid to or for the benefit of an individual:

- To reimburse or pay reasonable and necessary personal, family, living or funeral expenses incurred as a result of a qualified disaster;
- 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 such need is attributable to a qualified disaster; and
- 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.

However, qualified disaster relief payments do not include payments for any expenses compensated by insurance or otherwise.

A "qualified disaster" means, among other things, a presidentially declared disaster as defined in **IRC Section 165(h)(3)(C)(i)**—i.e., any disaster determined by the President to warrant assistance by the federal government under the **Robert T. Stafford Disaster Relief and Emergency Assistance Act**.

The legislative history to **IRC Section 139** indicates that a qualified disaster relief payment may be from any source, including an employer. The legislative history further provides that "in light of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of payments can be reasonably expected to be commensurate with the expenses incurred."

In **Revenue Ruling 2003-12** the IRS cited this legislative history and ruled that employer grants to employees to cover medical, temporary housing and transportation expenses incurred as a result of a presidentially declared disaster (which were not reimbursed through insurance or otherwise) were excludable from income, even though the employees were not required to provide proof of actual expenses in order to receive a grant.

However, the IRS indicated that the employer program at issue contained requirements to ensure that the grant amounts were reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing and transportation expenses incurred as a result of the disaster.

### **DEDUCTIBILITY OF RELIEF PAYMENTS**

The legislative history for **IRC Section 139** states that no change from prior law was intended as to the deductibility of qualified disaster relief payments made by an employer merely because the payments are excludable by recipients. "Thus, it is intended that payments excludable from income under the provision are deductible to the same extent they would be if they were includable in income."

### **ERNST & YOUNG LLP OBSERVATIONS**

Payments an employer makes to employees due to **COVID-19** will be excludable from income if they are intended to cover reasonable and necessary personal, family, living or funeral expenses incurred as a result of **COVID-19**.

Such qualified disaster relief payments also will not be treated as wages for employment tax purposes or as net earnings from self-employment for self-employment tax purposes.

Employers do not need to require employees to document their actual expenses, provided that the amount of the relief payments are reasonably expected to be commensurate with the expenses incurred.

Importantly, although not required, employers should secure **Section 139** signed statements from employees affirming that their claims arise from an area covered by the disaster declaration, that they have incurred qualified expenses, and that their expenses will not also be covered through an insurance policy.

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Litchfield Cavo operates out of 22 offices, serving clients in more than 35 states nationwide.

**DISCLAIMER:** This article is a guide to point your company in the correct direction and should not be used as legal advice for your specific situation. In order to have your company's specific situation reviewed, contact a qualified tax attorney before relying on any commentary as each situation is unique and complex.

Credit: Thomson Reuters/Tax & Accounting (2020). "Understanding the Requirements for Employee Disaster Relief Payments Under IRC Section 139 for COVID-19," EY Tax Alert I.D. No. 2020-0754 (03/27/2020). Retrieved from Thomson Reuters Checkpoint Edge.