PKF O'CONNOR DAVIES
ACCOUNTANTS AND ADVISORS

Tax Notes

Tax Issues and Best Practices for Employee Disaster Relief Payments

By Alan S. Kufeld, CPA, Partner, and Christopher Migliaccio, JD, Senior Manager

Over the course of a difficult 2020 and a still uncertain 2021, employers have grappled with how to provide needed support for employees to keep their business going. Employees have needed help transitioning to working from home, arranging care for children suddenly not attending school, and dealing with personal or family medical expenses. As employers sought to address these issues on the fly, they moved fast to do what was necessary. At the start of the new year, it's worth taking stock of what's been done and how it will be treated for tax purposes; employers may not think that paying for employees to get monitors set up at a home or even day care expenses are "disaster relief," but that's how they are likely to be characterized. It's also a good time to consider best practices going forward at a time when additional assistance may be needed to keep a business strong.

Background

Internal Revenue Code §139 generally provides that "*qualified disaster relief payments*" made by an employer to an employee are **excluded** from gross income and are not subject to any federal payroll taxes. In addition, they are **fully deductible** by the employer. On March 20, 2020, the IRS issued Notice 2020-18 determining that COVID-19 constitutes a "qualified disaster," thus allowing employers to offer employees "qualified disaster relief payments" in connection with the pandemic. While there are no specific dollar limits on qualified disaster payments, any payment to replace wages or salary (i.e., severance payments) does not qualify.

Eligible Qualified Disaster Relief Payment

While there is no specific guidance on the types of expenses that may be paid or reimbursed tax free, it is clear that the expenses must be reasonable and necessary (much like any deduction for business expenses). Some types of expenses that would qualify include but are not limited to:

- commuting or transportation expenses
- work-from-home expenses such as costs to create a home office, purchasing a printer or other office supplies, or expanded internet access
- unreimbursed medical expenses such as insurance co-payments, deductibles and over-the-counter medication
- dependent care expenses including tutoring costs due to school closings, remote learning or home schooling, educational materials, subscriptions to online educational resources
- legal and accounting fees
- funeral expenses for an employee, spouse or dependent who dies from COVID-19
- caregiver and domestic employees

Considerations and Best Practices

Although employers are not required to adopt a formal written plan or policy to offer qualified disaster payments, you should consider, as a best practice, establishing one in order to outline the specifics of the plan and facilitate communication with your employees. There are a number of decisions that are important to make before relaying the information to your employees. These include, but are not limited to:

- who is eligible for such payments
- what types of expenses will be reimbursed or paid and whether there are limits on the amount of reimbursements or payments

- determine maximum amounts of expense allowed
- whether employees must provide receipts or other proof of their expenses to the employer to be eligible for payments
- how and when payments are made

§139 does not require receipts or any other proof of expenses incurred by employees and you are not required to account for the actual expenses to qualify, as long as the payment amount can be reasonably expected to be commensurate with the expenses incurred. However, you may consider doing so in order to control costs, or mitigate the risk of employees submitting false claims. Absent such concerns, a carefully designed plan or policy (e.g., with specified types of expenses reasonably expected to be incurred and related limits), combined with a certification by the applicant that they have in fact incurred such expenses, may be sufficient to mitigate any risks to employers of not requiring employees to submit supporting documentation.

What Now?

The beginning of the year is a good time to assess if establishing a Disaster Relief Payment Plan makes sense for your employees and business, as it is still a viable option in this continuing pandemic. If so, it is important to assess the kind of records that have been kept. Is there a formal policy, and if so, is it being adhered to? Going forward, are there expenses being paid for employees that can be excluded from employee gross income? Is a policy needed to provide clarity?

Contact Us

PKF O'Connor Davies is here to assist our clients and provide consultation. Please feel free to reach out to us with questions about how these rules may affect your business.

Alan S. Kufeld, CPA
Partner
akufeld@pkfod.com | 646.449.6319

Christopher Migliaccio, JD
Senior Manager
cmigliaccio@pkfod.com | 646.699.2890

About PKF O'Connor Davies