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How Employers Can Assist Employees Who Are Victims of Hurricanes

Tax Free IRC Section 139 Disaster Relief Payment; Taxable Wage Continuation; Shared Leave Plans and Streamlined Access to Retirement Funds

Summary

In the case of a presidentially declared disaster, such as a hurricane, an employer has several opportunities to provide assistance to affected employees that have favorable tax treatment.

Details

Tax Free Employer Assistance under IRC 139

An employer may provide assistance to employees affected by a presidentially declared disaster that is exempt from federal income and employment taxes.[1] The provision of assistance, whether in cash or services, is relatively straightforward and requires no substantiation from the employees, while still allowing the employer to deduct the payments. Since there are virtually no administration requirements, employers can react very quickly to help alleviate its employees' immediate needs.

The exclusion is provided by Internal Revenue Code ("IRC") Section 139(a) and specifically exempts from gross income "Qualified Disaster Relief Payments" that are not compensated by insurance or otherwise. IRC Section 139(b), in part, defines a "Qualified Disaster Relief Payment" as any amount paid to, or for the benefit of, an individual to reimburse or pay reasonable and necessary expenses incurred:

- As a result of a qualified disaster for family, living, or funeral expenses,
- For the repair or rehabilitation of a personal residence;[2] or
- For repair or replacement of the contents of a personal residence, to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster.

Revenue Ruling 2003-12 ("Rev. Rul.") provides a particularly relevant example for employers trying to help employees affected by a hurricane. In Situation 3 of the Rev. Rul. the IRS wrote, "(p)ayments that employees receive under an employer's program to pay or reimburse unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood are excluded from gross income under § 139." In addition, the Rev. Rul. determined that the amounts excluded from gross income under Section 139 are not subject to information reporting requirements generally imposed by Section 6041.

Salary Continuation will be Taxable to the Employee

The most helpful benefit to employees is often for their wages to continue without interruption even though they cannot perform their expected services for the employer. Wages paid under a policy of salary continuation will continue to be subject to all of the usual income and employment tax provisions.

Contributions of Cash by Fellow Employees to Affected Employees

Planning is required in order to avoid taxation being imposed on employees whom provide assistance to

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[1] In addition to a presidentially declared disaster such as a hurricane, Section 139(c) includes a disaster resulting from any event that is determined by the Secretary of the Treasury to be of a catastrophic nature, a disaster resulting from terrorist or military actions, or a disaster resulting from an accident involving a common carrier.

[2] A personal residence can be one that is rented or owned, according to IRS Publication 3833

those employees affected by the disaster. An employee cannot simply redirect compensation earned from an employer to an affected employee without being taxed on the earnings under the "assignment of income" or "constructive receipt" doctrine. In order for the employee to make tax deductible contributions of cash to disaster victims, a charitable organization must be involved to secure the personal income tax deduction under IRC 170. This can be accomplished by the employer creating a private foundation (which requires time), or by utilizing an existing charitable organization that creates a fund for a specified group of victims that includes its employees. Once established, contributors can obtain an income tax deduction for their charitable contributions.

Contributions of Unused Paid Time-Off by Fellow Employees to Affected Employees

Another way that employees can assist is by sharing their unused paid time off with employees who have exhausted their earned vacation days. Under the general rules of income taxation the employee who earned the paid time off would be taxed on the value of the days if they were given away to a fellow employee. However, under a written employer-sponsored leave sharing program for a major disaster, employees can donate unused vacation days to other employees who have been adversely affected by a major disaster, without triggering taxation to the donor for the donated time (in this scenario they would not receive a charitable deduction as the income was never recognized initially). Note that an employee is considered adversely affected if the disaster caused a severe hardship that requires the employee to be absent from work. The plan must further provide that donations of leave cannot exceed the donor's annual accrual; can be drawn upon by other employees who have been adversely affected by a major disaster; cannot be specified by the donor for a particular recipient; and will be valued when paid at the recipients' normal compensation rate without regard to the normal compensation rate of the donor.

Leave deposited for a particular disaster may be used by only those employees affected by that disaster and should be available only for a reasonable amount of time after the disaster has occurred. Any donated leave that is not used by recipients by the end of the specified time must be returned to the donors within a reasonable time so that the donor may use the leave, except in the event the amount is so small as to make accounting for it unreasonable or impractical. The amount of leave returned to all donors must be in the same proportion as that which was donated. A recipient may not receive cash in lieu of using the paid leave received.

Streamlined Access to Retirement Funds Prior to February 1, 2018

In Announcement 2017-11, the IRS relaxed procedural and administrative rules that normally apply to retirement plan loans and hardship distributions. As a result, participants in 401(k) plans, 403(b) tax-sheltered annuities, and 457(b) deferred-compensation plans sponsored by state and local governments may be eligible to take advantage of streamlined loan procedures and liberalized hardship distribution rules designed to provide quicker access to their money. In addition, the six-month ban on 401(k) and 403(b) contributions that normally affects employees who take hardship distributions will not apply.

While IRA participants are not allowed to borrow from the IRA, they may be eligible to make IRA withdrawals under liberalized procedures.

Not only does this broad-based relief apply to victims of hurricanes, it also applies to a person who lives outside the disaster area who takes out a retirement plan loan or hardship distribution and uses it to assist a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

Plans will be allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter. If a plan requires certain documentation before a distribution is made, the plan can relax this requirement as described in Announcement 2017-11.

To qualify for this relief, hardship withdrawals must be made by January 31, 2018.

Before accessing retirement funds, it is important to remember that the relaxed procedures have not changed the tax treatment of loans and distributions. Retirement plan loan proceeds are tax-free if they are repaid over a period of five years or less and hardship distributions are generally taxable and subject to a

10-percent early-withdrawal tax unless one of several exceptions is satisfied.

For Further Information

Further details are in Announcement 2017-11. More information about other tax relief related to Hurricane Harvey can be found on the IRS disaster relief page. Information on other tax relief for Hurricane Irma will be added to the disaster relief page when available. For information on government-wide relief efforts, visit www.USA.gov/hurricane-harvey or www.USA.gov/hurricane-irma.