



COVID-19 Tax-Free Section 139 Benefits: Silver Lining on the Cloud of a Novel Disaster

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The novel Coronavirus, or COVID-19, was designated as a disaster under the Stafford Act on March 13, 2020. This action caused the novel Coronavirus pandemic to escalate to that category of disasters which permit tax-free reimbursements by employers as a “Qualified Disaster Payment.”^[1] Adding to the individual tax benefit, the employer’s payments remain fully deductible.

Under the Act, Section 139 provides that gross income does not include any amount received by an individual as a “Qualified Disaster Payment.” This includes payments by an employer, not otherwise reimbursed by insurance, to its employees, which are *reasonably expected* by the employer to:

- 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.

No regulations have been issued to provide guidance on exactly which expenses and under what circumstances reimbursement or payments may occur. With respect to natural physical disasters, the IRS issued Rev. Rul. 2003-12 to provide guidance where participants were living in a “hypothetical flood area” that was a “presidentially declared disaster area.” Under the employer’s program, grants were made to employees to pay or reimburse certain reasonable necessary medical, temporary housing, and transportation expenses incurred as a result of a flood. Reimbursements did not include nonessential, luxury, or decorative items or services. The participants were not required to *account for actual expenses* in order to qualify for the exclusion.

CORONAVIRUS “PERSONAL, FAMILY, LIVING, OR FUNERAL EXPENSES”

The Coronavirus is unique as compared to other Stafford Act disasters in that unlike the others caused by “mother nature,” e.g. Hurricane Katrina, it was clear that all the expenses related to property damage such as temporary

housing, food, and property replacement would be covered.

Regardless of the type of disaster, wage replacement such as paid sick leave would not be covered by Section 139 and would remain taxable to the employee recipient.^[2]

However, other than actual payment for lost wages, the employer can reimburse, or provide in-kind, benefits reasonably believed by the employer to result from the Coronavirus that are not covered by insurance. Such expenses might include:

- Medical expenses
- Health-related expenses that are not medical expenses, such as over-the-counter medications, hand sanitizers
- Child care due to school closings
- Tutoring expenses due to school closings
- Increased home expenses due to telecommuting, e.g. home office set-up, internet, printer
- Cell phone
- Increased utility expenses
- Transportation expenses due to work relocation
- Increased cost of home supplies, e.g. disinfectant, soap
- Critical care and funeral expenses

SECTION 139 PROGRAM RECOMMENDATIONS

The guidance to date does not require the employer establish a written Section 139 program. However, the Rev. Rul. 2003-12 fact pattern described a situation where the employer did have a written program and the IRS favorably concluded the payments would meet the criteria for income tax exclusion. Furthermore, the employer may wish to inform employees as to the details of the employer system of reimbursement. Accordingly, the following features may be considered as part of the program:

- State that the program is with respect to the COVID-19 Outbreak Stafford declaration
- Describe eligible employee class or group
- List expenses that will be reimbursed, or provide per-employee allowance for presumed reasonable expenses
- Describe the method for reimbursement/payment, e.g. whether application is necessary
- Provide any employer-imposed expense limit per employee (no limit applies per the statute)
- Name the administrator and the administrator's powers, e.g. discretionary decisions
- Provide the start and end date of the program

WINSTON TAKEAWAY

The Coronavirus pandemic is now the type of disaster for which an employer may reimburse employees for disaster-related expenses on a tax-free basis, free from Form W-2 or Form 1099 reporting. Employers may make payments to cover the increased per-employee costs relevant to all unreimbursed health-related expenses, child care expenses or costs associated with telecommuting. Making these payments pursuant to Section 139 on a tax-free basis to employees and on a deductible basis for the employer, along with decreased administrative burdens, creates a silver lining to this novel disaster situation.

View all of our COVID-19 perspectives [here](#). Contact a member of our COVID-19 Legal Task Force [here](#).

[1] Section 139(c)(2) and Section 165(i)(5)(A)

[2] The Joint Committee on Taxation's Technical Explanation (JCX-93-01) acknowledges that the exclusion does *not* apply "to payments in the nature of income replacement, such as payments to individuals for lost wages or unemployment compensation or payments in the nature of income replacement to businesses."

3 Min Read

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