A timely and robust response to the COVID-19 virus demands the attention and resources of, and action by, federal and state regulators, employers, and individuals alike. The stakes could not be higher. State and local “shelter-in-place” orders have effectively, if not actually, resulted in widespread job losses for at least some indeterminate period of time.

As employers seek way to minimize the disruption to their business, it’s worth recalling that, in addition to actions Congress and state legislatures are taking in response to the COVID-19 virus, the Internal Revenue Code ( “Code”) already includes provisions that offer relief to taxpayers affected by natural or man-made disasters. This relief includes a deduction for casualty losses under Code section 165; an exemption from taxation for certain insurance payments under Code section 123; and the deferral of gains from the involuntary conversion of homes destroyed or
damaged by a disaster under Code section 1033. Employers too are provided with relief in the form of an exemption from taxation for disaster relief payments to individuals under Code section 139. It is the latter exemption that is the subject of this post. (We briefly mentioned this exemption in our CARES Act summary post, but expand on it here.)

Code section 139 exempts qualified disaster relief payments from the recipient’s income. These include payments made to, or for the benefit of, an individual:

1. To reimburse or pay for reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster;
2. To reimburse or pay for 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; and
3. By a federal, state, or local government in connection with a qualified disaster in order to promote the general welfare. This exclusion applies only to expenses not compensated for by insurance or otherwise.

A “qualified disaster” is one determined by the President to warrant federal assistance under the Stafford Act and, for the third type of payment, a disaster determined by an appropriate federal, state, or local authority to warrant government assistance. President Trump has, among other things, made the requisite determination under the Stafford Act, making COVID-19 a “qualified disaster” for purposes of Code section 139.

Qualified disaster relief payments are excludable from the recipient’s income. There is no requirement that an employer have a written plan or policy in order to make these payments to employees, but there are some limitations. First, payments must reimburse or pay only “reasonable and necessary” expenses. Payments failing this are included in an employee’s income and may not be deductible. Second, the payments must be for a specific expense and not intended to replace the employee’s income. Payments in the nature of income replacement are garden variety compensation/wages that are taxable as such. Third, payments under this provision may not be applied to the reimbursement of insurance. And, lastly, the employee receiving a qualified disaster relief payment cannot claim a deduction for the excluded amount of the benefit.

Examples of what might qualify for the relief afforded by Code section 139 in response to COVID-19 include medical expenses, childcare (including the costs of homeschooling as a result of school closings), and costs occasioned by having to work from home.

Despite the fact that formal policies and procedures are not required, Code section 139 relief payments will require at least some minimal administrative infrastructure. Employers that are disposed to take advantage of this provision of the Code will need to establish eligibility criteria consistent with the applicable law, communicate the program to employees, and establish application processing criteria. Thus, some basic documentation is recommended, if for no other reason than to set and manage employee expectations and manage the accompanying workflow.