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MEMORANDUM

TO: Our Clients
FROM: Jennifer M. Oertel
DATE: March 21, 2020
SUBJECT: Employer Sponsored Disaster Relief

As a result of President Trump’s declaration of a national emergency that warrants assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, the COVID-19 crisis is treated as a “qualified disaster” for purposes of “qualified disaster relief payments” under Internal Revenue Code (IRC) section 139. This means that qualified payments that comply with the IRC will not result in taxable income to the recipient, are not subject to employment taxes and withholding, and are subject to certain exceptions to the self-dealing and donor advised fund rules. However, as described in more detail below, the rules against impermissible private benefit, self-dealing, and recipient charitable class still apply.

It is important to note that these provisions have traditionally been applied to natural disasters, isolated to a geographic locale. ***Therefore, discussion of particular facts with your tax advisor are crucial in order to assess what would likely be acceptable in the current COVID-19 crisis.***

Under IRC 139, qualified disaster relief payments include payments received for the following expenses (only noting those relevant to COVID-19): reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster. (Payments to restore or replace a residence and the contents thereof damaged in the qualified disaster also qualify.) Payments by a federal, state, or local government, or their agencies or instrumentalities, to persons affected by a qualified disaster in order to promote general welfare are also considered to be qualified disaster relief payments. It is worthwhile to note, however, that qualified disaster relief payments do not include: payments for expenses otherwise paid for by insurance or other reimbursements, nor do they include income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation. Payments for things that would otherwise be the legal responsibility of the employer (including under a collective bargaining agreement) would also not be permitted.

Indefinite Charitable Class. The eligible class of charitable beneficiaries must be so large as to be indefinite – so that donors aren’t earmarking their contributions to particular individuals. When the group of eligible beneficiaries is limited to a smaller group, such as the employees of a particular employer, the group of persons eligible for assistance must be open-ended and include employees affected by the current disaster and those who may be affected by a future disaster.

Needy or distressed individuals. A disaster relief program must target those financially or otherwise in need (financially or with the inability to obtain basic necessities due to the disaster). Charitable funds cannot be distributed to individuals merely because they are victims of a disaster, and an organization's decision about how its funds will be distributed must be based on an objective evaluation of the victims' needs at the time the grant is made. By way of IRS example, "A charity may provide crisis counseling, rescue services, or emergency aid such as blankets or hot meals in the immediate aftermath of a disaster without a showing of financial need. Providing such services to the distressed in the immediate aftermath of a disaster serves a charitable purpose regardless of the financial condition of the recipients. However, as time goes on and people are able to call upon their individual resources, it may become increasingly appropriate for charities to conduct individual financial needs assessments."

Employer-sponsored disaster relief is provided through several different avenues:

Corporate Foundations. Because of the IRS' concern over private foundations aiding their related corporations in recruiting and retaining employees (which amounts to prohibited self-dealing), certain safeguards must be enacted to ensure that such assistance is serving charitable purposes rather than the business purposes of the related corporation. The IRS will presume that payments in response to a qualified disaster made by a private foundation to employees (or family members of employees) of an employer that is a disqualified person to the foundation (such as the related corporation) are consistent with the foundation's charitable purposes if all of the following are satisfied: (i) the class of beneficiaries is large or indefinite (a "charitable class"); (ii) the recipients are selected based on an objective determination of need; and (iii) the selection is made using either an independent selection committee or adequate substitute procedures to ensure that any benefit to the employer is incidental and tenuous. In other words, at least a majority of the selection committee must not be in a position to exercise substantial influence over the affairs of the related corporation. However, while payments that meet the above-noted criteria are not deemed to be self-dealing, that presumption does not apply to payments that would otherwise constitute self-dealing. For example, the presumption does not apply to payments made to (or for the benefit of) individuals who are directors, officers, or trustees of the private foundation or members of the private foundation's selection committee. Nor would they apply to payments that relieve the corporation of a legal obligation. In all cases, procedures must be instituted so that any benefit to the corporation is incidental and tenuous.

Employer-sponsored Donor Advised Funds (DAFs). Typically, DAFs cannot make grants to individuals. However, there is an exception from the definition of DAF for certain employer-related funds established to benefit employees and their family members who are victims of a qualified disaster. A DAF may make grants to employees and their family members in the following circumstances: (i) the fund serves the single identified purpose of providing relief from one or more qualified disasters; (ii) the fund serves a charitable class; (iii) grants are selected based upon an objective determination of need; (iv) the selection of recipients of grants is made using either an independent selection committee or adequate substitute procedures to ensure that any benefit to the employer is incidental and tenuous (meaning that a majority of its members must consist of persons who are not in a position to exercise substantial influence over the employer's affairs); (v) no payment is made from the fund to or for the benefit of any director, officer, or trustee of the sponsoring organization or any member of the selection committee; and (vi) the fund maintains adequate records to demonstrate the recipients' need for the disaster assistance provided.

Sometimes, employers sponsor the establishment of a separate public charity that is not subject to the additional rules of private foundations and DAFs. For example, these charities may provide relief in the event of any type of disaster or qualified employee emergency hardship, so long as the related employer does not exert excessive control over the organization. In order to meet the public support test, these charities are typically funded by a large employee base, and those employees also serve on the charity's board of directors. To ensure the program is not impermissibly serving the related employer, the following requirements must be met: (i) the class of beneficiaries must be large or indefinite (a "charitable class"); (ii) the recipients must be selected based on an objective determination of need; and (iii) the recipients must be selected by an independent selection committee, or adequate substitute procedures must be in place to ensure that any benefit to the employer is incidental and tenuous. The charity's selection committee is independent if a majority of the members of the committee consists of persons who are not in a position to exercise substantial influence over the affairs of the employer. If these requirements are met, the public charity's payments to the employer-sponsor's employees and their family members in response to a disaster or emergency hardship are presumed: (1) to be made for charitable purposes; and (2) not to result in taxable compensation to the employees.

Employers may also choose to make payments directly to employees, as opposed to going through a tax-exempt entity. Section 139 of the IRC provides for special tax treatment of qualified disaster relief payments made to victims of a qualified disaster, regardless of the source. Therefore, the qualified disaster relief payments will not be included in the income of recipients to the extent that any expenses covered by these payments are not otherwise compensated by insurance or other reimbursements. Qualifying payments are also not subject to income tax, self-employment tax, or employment taxes even though the payments are made directly from the employer.

Conclusion. This memorandum necessarily provides a summary of the complex rules related to employer-sponsored disaster relief. It does not address things such as process and required recordkeeping, and, as mentioned above, its application to a pandemic is novel. Therefore, before instituting any program, please consult your legal or tax advisor.