September 11, 2020

Dear Clients & Friends,

In the wake of Almeda and Obenchain Fires, many employers will be seeking ways to financially assist employees who are impacted by qualified disasters. Co-workers of those affected may also want to provide funds for the relief effort. Several tax-advantaged arrangements, discussed below, allow employers and employees to financially assist affected employees.

Employer assistance

Qualified disaster relief payments

Employers can make direct payments to affected employees which are not taxable if the requirements for qualified disaster relief payments under section 139 are met. The following are some of the qualifications:

- Payments must be made due to a qualified disaster (federally declared or result of a terroristic or military action).
- Employee's expenses must be reasonable and necessary and cannot be compensated for by insurance or otherwise.
- Employees are not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of the payments they receive can be reasonably expected to be commensurate with the expenses incurred.
- Employees are not entitled to any other tax deduction or credit on their individual income tax returns due to expenses for which they receive qualified disaster relief payments. Qualified disaster relief payments are deductible by employers as business expenses.

If qualified, employer payments to employees are not treated as wages and ultimately are excludable from federal income tax, employment taxes and Form W-2 reporting.

These qualified disaster relief payments can include:

- Amounts paid to or for the benefit of an individual to reimburse or pay personal, family, living or funeral expenses incurred as a result of the disaster.
- Expenses for medical care, temporary housing and transportation.
- Expenses incurred for the repair or rehabilitation of an individual's residence, or for repair or replacement of its contents.

Employer-sponsored funds, foundations and charities

The following are other ways that employers can assist employees facing financial loss due to a disaster:

- Employer-sponsored donor advised funds:
    - created when an employer contributes to a separate account held by a community foundation or public charity to benefit the employer's employees and their family members impacted by a disaster.
    - funds can only be used for a qualified disaster and not for other purposes.
    - account holder is required to maintain adequate records to demonstrate the recipients' need for the disaster assistance provided.

- Employer-sponsored private foundations:
  - provide assistance to employees or family members affected by a disaster, as long as certain safeguards are in place to ensure that this assistance is serving charitable purposes rather than the business purposes of the employer.
  - can only make payments due to qualified disasters and not for non-qualified disasters or other emergency hardship situations.

- Employer-sponsored public charities:
  - can assist employees with any type of disaster or emergency hardship situation, as long as the sponsoring employer does not exercise excessive control over the organization.
  - can provide a broader range of assistance to employees than can be provided by employer-sponsored donor advised funds or private foundations.

There are different requirements that apply to each type of program so an employer would need to determine which program best suits its needs, and then work with appropriate advisers to establish the program. Under each of these programs, the recipients must be in a charitable class and be selected based on an objective determination of need. The recipients must be chosen either by an independent selection committee or through other procedures which ensure that any benefit to the employer is incidental and tenuous. Additional information about these programs is available in IRS Publication 3833, Disaster Relief: Providing Assistance through Charitable Organizations.

Employer loans

Employers can loan money to employees without the loan being treated as taxable compensation if appropriate repayment terms are established and other requirements are met. The following some other useful information:

- The aggregate of all loans made to a given employee are under $10,000, the loans can be interest-free.
- Loans above $10,000 in the aggregate are required to accrue interest.
- Employers need to be sure that they meet applicable state law requirements regarding payroll withholding for loan payments.

Retirement plan distributions and loans

Employers that sponsor certain retirement plans have the option to allow distributions and loans from their plans for employees impacted by a disaster.

- Hardship distributions: Employers may draft their retirement plans to allow hardship distributions to employees facing certain financial needs. The rules allow a hardship distribution for expenses and losses incurred by an employee due to a federally declared disaster if the employee's residence or place of employment is located in the designated disaster area. Although hardship distributions for disaster relief are subject to income taxes, Congress occasionally waives the additional 10 percent early distribution penalty on distributions received prior to age 59 ½.

- Loans: Many employers allow employees to take tax-free loans from their retirement plans. At various times, Congress and the IRS have enacted special rules regarding plan loans to employees affected by a major disaster. These special rules apply to loans taken within a time period established by the government.

- Qualified disaster distributions: From time to time, Congress may enact legislation providing special rules for qualified disaster distributions. Qualified disaster distributions may be any distribution from an eligible retirement plan to an employee whose residence is in a disaster area and who suffers economic loss due to a disaster. The government establishes the time period during which these distributions can be taken. These distributions may be granted favorable tax-treatment.

Employee assistance

Leave-donation programs
Employer-sponsored leave-donation programs allow employees to trade their paid leave for cash payments made by their employers to charities. The leave is not treated as wages if exchanged for employer payments to qualified charities by certain dates set by the IRS and it is not included in Boxes 1, 3 or 5 of the donor's Form W-2. The IRS will announce the disasters that can be funded through leave-donation programs and the dates by which the donations must be paid to the charities.

Leave-sharing plans
Employer-sponsored leave-sharing plans allow employees to donate leave to their fellow employees impacted by a major disaster as additional paid time-off. Plans that meet the IRS requirements treat the donated leave as wages of the recipient, not of the donor, and not taxable to the donor. Donated leave received by a recipient is treated as wages and is subject to federal income tax and employment tax withholding.

The following are the requirements for major disaster leave-sharing plans (Notice 2006-59):

- The plan must be in writing and apply only to an event declared by the President of the United States as a major disaster or emergency.
- The employee donating leave can deposit accrued leave (up to the maximum amount the employee normally accrues during the year) into an employer-sponsored leave bank for use by other employees who have been adversely affected by the disaster; however, the donor cannot designate a specific recipient.
- An employee can receive the leave if the disaster has caused severe hardship to the employee or a family member that requires the employee to be absent from work. The leave recipient is paid leave (at his or her normal rate of compensation) from the leave bank for purposes related to the disaster, and cannot convert the leave into cash in lieu of using the leave.
- The plan applies a reasonable limit on the period of time during which leave can be donated and used, and also imposes a limit on how much leave any one recipient may receive. Leave donated on account of one major disaster may only be used for employees affected by that disaster, and unused leave in the bank must be returned to the leave donors.

Other employee contributions

- Employees may choose to contribute funds to qualified charities for disaster relief through programs sponsored by their employers.
- Employees can send their contributions directly to the charities or have them collected by the employer, such as via after-tax payroll deduction, and then forwarded to the charities. (Pretax payroll deduction contributions for disaster relief are not allowed, but employees may be entitled to a charitable contribution deduction on their individual income tax returns for these contributions.)

Please feel free to contact us if you have any questions.

Your team at KDP Certified Public Accountants, LLP