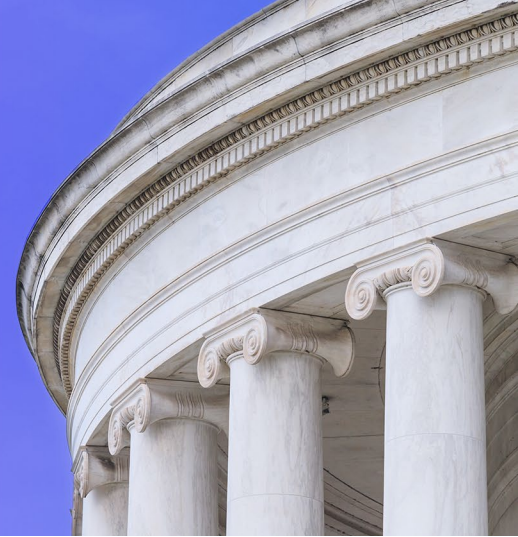


What's News in Tax

Analysis that matters from Washington National Tax

May 3, 2023



“And Now, the End Is Near”: COVID-19 Disaster Relief Payments Under Internal Revenue Code Section 139

by Robert Delgado, Gary Cvach, and Terri Stecher, Washington National Tax

As the national emergency ends, now is a good time for employers to take a fresh look at expense and reimbursement policies.

The national emergency declaration due to coronavirus disease 2019 (COVID-19) ends on May 11, 2023. The end of the emergency declaration has repercussions in a variety of areas, including the way in which employers provide benefits or reimburse employees for certain expenses that are due to the COVID-19 pandemic. Specifically, section 139 was triggered by the emergency declaration and permits tax-free reimbursements by employers for qualified disaster payments, a term that can be broadly defined to include additional expenses of employees (whether personal or business) related to the COVID-19 pandemic.¹ Now, employers that continued to utilize section 139 to provide benefits are evaluating whether it is appropriate to continue offering tax-free benefits as a working condition fringe benefit consistent with the accountable plan rules and/or taxable benefits in certain situations.

National Emergency

On March 13, 2020, in light of the severity and magnitude of the COVID-19 pandemic, President Trump declared an emergency under section 501(b) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121-5207 (the “Stafford Act”). President Trump later approved major disaster declaration requests under the Stafford Act for all 50 states, five territories, the District of Columbia, and the Seminole Tribe of Florida. President Biden would later go on to approve major disaster declaration requests from the Navajo Nation and the Poarch Band of Creek Indians. These declarations remain outstanding and in effect since declared.

On January 30, 2023, President Biden announced that the national emergency would end on May 11, 2023. Further, on February 10, 2023, FEMA confirmed that consistent with the president’s announcement all COVID-19 emergency and major disaster declarations under the Stafford Act would end on May 11, 2023.

¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

Section 139 Qualified Disaster Relief Payments

Section 139 provides that qualified disaster relief payments are not includible in income. These qualified disaster relief payments can include tax-free payments made by an employer to an employee if the section 139 rules are satisfied. Determining whether a payment is a qualified disaster relief payment involves three steps:

- Is the disaster a “qualified disaster”?
- Is the employee within the qualified disaster zone?
- Are the payments made for expenses as a result of the disaster and considered qualified under section 139?

A qualified disaster includes a federally declared disaster under section 165(i)(5)(A) (i.e., a disaster subsequently determined by the President of the United States to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act). Prior to COVID-19, a federally declared disaster usually related to a natural disaster, such as a hurricane or tornado. Qualified disaster relief payments can be paid to an affected employee who resides in the area that has been listed under the federally declared disaster area. When the emergency is due to a natural disaster, there is a specified limited area that qualifies as the disaster zone. The COVID-19 emergency declaration was unusual in that it covered the entire county in its disaster zone.

A qualified disaster relief payment is any amount paid to or for the benefit of an individual to reimburse or pay reasonable and necessary:

- Personal, family, living, or funeral expenses incurred as a result of the qualified disaster; or
- 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 the repair, rehabilitation, or replacement is attributable to a qualified disaster.

Any payment or reimbursement for an amount otherwise compensated by insurance is not a qualified disaster relief payment.

Common section 139 expenses that employers helped employees with due to COVID-19 included:

- Home office expenses due to required working from home, including computer monitors and office supplies
- Additional childcare costs
- Upgraded internet expenses
- Increased utility costs
- PPE expenses, e.g., masks and hand sanitizer

Providing assistance through section 139 has advantages: employees are not required to substantiate their costs and payments to employees are not taxable. Section 139 allowed employers to provide employees with reasonable assistance for additional costs associated with the COVID-19 emergency.

Because additional expenses must be due to the national emergency to qualify as section 139 payments, there has been a decrease in the usefulness of section 139 with the pandemic in decline. Many companies adopted hybrid and remote work policies during the pandemic. However, most employees are no longer required to work remotely due to the pandemic. As employees returned to the office and life started to progress to the new normal, it has become difficult to establish that additional expenses are related to the national emergency. Expenses may appear related to the hybrid and remote work policies and not COVID-19. Starting May 11, 2023, section 139 will no longer be available for expenses related to COVID-19.

Working Condition Fringe Benefits and Accountable Plans

Outside of section 139, employer payments or reimbursements of an employee's personal expenses are taxable to the employee, but there are ways to provide or reimburse employees for business expenses that are excludible from income. With more hybrid arrangements and remote workers, employers are evaluating the business expenses that are covered for reimbursement.

The working condition fringe benefit exception under section 132(d) allows an employer to provide an employee with business related property or services without including the item's value in the employee's gross income to the extent the employee would have been allowed a business related deduction if the employee had paid for the item. This allows an employer the ability to provide items like computers, monitors, and office supplies to employees for business purposes and exclude the value of the items from employees' incomes.

While an employer may directly provide certain items to an employee, in many situations, the employer reimburses the employee for business expenses that the employee paid. Reimbursements may be for items such as office supplies while working remotely, business travel, cell phones, and more recently internet costs related to working from home. If the employer is reimbursing the employee for business expenses, the reimbursement can be done under an accountable plan.

An accountable plan must satisfy a variety of requirements, but it allows an employer to reimburse an employee for business expenses and the reimbursement is not includible in the employee's compensation. Section 1.62-2 provides the specific accountable plan rules, under which the following must be established:

- There is a business reason for the expense,
- The expense reimbursed must be substantiated within a reasonable period, and
- Any excess beyond actual expense must be returned within a reasonable period (e.g., if funds were advanced to pay the expense).

An employee must document the date, time, place, amount, and business purpose of an expense. Generally, receipts are required except for expenses of less than \$75.² The regulations provide safe harbor guidance on a reasonable period of time to substantiate. If the accountable plan requirements are met, the reimbursement is not includible in the employee compensation.

The IRS provides guidelines on the expense amount requiring receipts and the timeliness of substantiation. However, an employer can establish its own reimbursement policy, which may have more stringent requirements. An employer's reimbursement policy establishes specifics such as the:

- Timeframe for substantiating expenses
- Expense amount that requires a receipt
- Timing for the required return of any excess amount

Employers may want to reevaluate their policies, specifically regarding the amount of the expense requiring a receipt. Employers for their own business purposes may have previously established policies requiring receipts for relatively low expenses. If employers are beginning to reimburse for remote workers' business expenses related to internet or increased utility costs, they may want to consider limiting the number of receipts that are submitted. An employer may revise its policy by not requiring receipts for amounts less than \$75. While an employee must still substantiate costs and business purpose, raising the limit on the required amount for a receipt (below the \$75 cap) could reduce the amount of documentation being submitted.

² While expenses below \$75 may not require a receipt, all expenses for lodging must include a receipt. Section 1.274-5(c)(2)(iii).

Looking Forward

While qualified disaster relief payments related to COVID-19 will end, section 139 still exists to allow assistance to employees who are affected by declared disasters in the future. As for the payment of business expenses, employers may want to consider reviewing their expense policies to determine what business expenses are appropriate and what requirements for receipts are suitable in this new work environment. Further, some states require employers to reimburse all work-related expenses and employers will need to continue to consider those requirements within their policies. Of course, employers could offer taxable benefits, but those aren't quite as popular.

kpmg.com/socialmedia



The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.