

LEGAL UPDATES AND NEWS

Employers Can Provide Tax-Free Relief to Employees Affected by Hurricane Sandy

As a consequence of Hurricane Sandy being designated by the IRS as a qualified disaster for federal tax purposes, employers may make tax-free qualified disaster relief payments directly to affected individuals. Section 139 of the Internal Revenue Code permits such payments which are exempt from federal income and employment taxes. Such payments will not be included in the employee's Form W-2.

No substantiation is required from the employee and no administration is involved for the employer. While there is no limit on the amount that can be provided, the relief provided must be reasonably commensurate with the employee's expenses. Because of the extraordinary circumstances surrounding a qualified disaster, individuals are not required to account for actual expenses in order to qualify for the relief under Code Section 139.

Qualified disaster relief payments include amounts to cover reasonable and necessary personal or family living expenses, funeral expenses, and expenses to repair or replace personal residences and their contents (regardless of whether the residence is owned or rented), but only to the extent insurance coverage does not exist and only to the extent that such repair or replacement is due to Hurricane Sandy.

Income replacement payments, such as lost wages, are not qualified disaster relief payments. For example, if an employer continues regular payroll for employees who cannot report to work due to hurricane-related reasons, such payments are treated as "wages" (i.e., paid time off) and not as qualified disaster relief payments. Thus, qualified disaster relief payments are separate payments made to employees outside of regular payroll.

In addition, the IRS recently announced that employers may make a tax-deductible cash contribution to a Hurricane Sandy relief organization that is funded by donated leave time from employees. Under these programs, employees elect to forgo vacation, sick or personal leave in exchange for cash payments by the employer to a relief organization. Such donated leave time will not be treated as wages (and therefore would not be included on the employee's Form W-2) so long as the donation is made before January 1, 2014. Employees may not deduct the value of the leave contribution as a charitable gift, since the gift was exempt from taxation as wages.

Finally, employers may create a leave sharing bank funded by employees who contribute their accumulated paid time off to be used by employees that need time off on account of Hurricane Sandy. To avoid adverse tax consequences, such leave donations must provide that (i) leave recipients may not convert leave into cash; (ii) donors cannot specify who receives the donation; and (iii) the leave must be used for Hurricane Sandy relief. The donation is exempt from federal income and employment taxes and therefore should not be included on the donating employee's Form W-2. However, the leave recipient would be treated as having taxable wages for the "paid time off" used by that employee.

Employer-sponsored foundations may also provide disaster relief to employee-victims in areas affected by Hurricane Sandy without risk of losing the foundation's tax exempt status.

IRS Publication 3833 provides further disaster relief guidance. For more information regarding this Alert, please contact one of the following attorneys.

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