Morgan Lewis

alert

disaster response

November 7, 2012

IRS Guidance Encourages Leave Donation Programs for Hurricane Sandy Victims

Employers wishing to provide disaster relief assistance have several tax-relief provisions available to them.

In the wake of Hurricane Sandy and the resulting destruction and devastation to the East Coast, many employers have expressed an interest in providing disaster relief assistance to their affected employees. The following describes the different tax-relief provisions that may be applicable should employers provide such assistance.

Employee Donations of Vacation and Sick Pay

One way that employers can assist affected employees is by enabling employees to donate vacation, sick, or personal leave in exchange for employer contributions to charitable organizations for the relief of disaster victims. Without guidance from the Internal Revenue Service (IRS), these leave-sharing programs would have required the employees receiving any donated leave days to pay income and Federal Insurance Contributions Act (FICA) taxes on the leave-day income. Morgan Lewis, however, assisted the American Payroll Association (APA) in obtaining payroll reduction donation relief from the IRS for Hurricane Sandy, which the IRS released on November 6, 2012, in Notice 2012-69.[1] The APA has been successful in obtaining such guidance twice previously, after both the September 11 attacks and Hurricane Katrina. When the IRS adopted these special relief provisions for 15-month periods after 9/11 and after Hurricane Katrina, some companies estimated that the provisions facilitated millions of dollars of additional donations.

The new IRS guidance permits employers to adopt leave-based donation programs under which the donating employee is not subject to income or FICA taxes on the donated leave, and the payments from charitable organizations to the recipients are also exempt from income and FICA taxes.

The APA's request also asked the IRS to eliminate the requirement that employees designate recipient charitable organizations and allow employees to assign their leave days to disaster relief programs that employers can set up on their own (using the rules in the Internal Revenue Code discussed below, which permit employers to provide certain tax-exempt disaster relief payments to employees affected by major disasters.) The APA also proposed that the IRS might allow employees simply to assign designated amounts of their wages, rather than leave days, for Hurricane Sandy relief. We understand that the IRS may rule on these additional requests in subsequent guidance.

Qualified Disaster Relief Payments to Employees

In addition to encouraging employee donations of vacation and sick pay, employers wishing to provide assistance may utilize Section 139 of the Internal Revenue Code, which establishes a federal income and payroll tax exclusion for payments received by an individual as a qualified disaster relief payment. A "qualified disaster" includes any federally declared disaster, as well as any disaster that is determined by the Secretary of the U.S. Department of the Treasury to be catastrophic in nature. The Federal Emergency Management Agency (FEMA)

1. Read the IRS notice at http://www.irs.gov/pub/irs-drop/n-12-69.pdf.

has declared counties in the states of New York, New Jersey, Rhode Island, and Connecticut to be qualified disaster areas. In addition, the IRS has issued guidance confirming that Hurricane Sandy is designated as a qualified disaster for federal tax purposes.[2]

Employers who wish to provide payments to their affected employees should take steps to ensure that such payments meet the limitations of Section 139 and therefore will be treated as qualified disaster relief payments. Those steps include the following:

- Make payments to employees only for reasonable and necessary personal, family, living, or funeral expenses or reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents.
- Do not make payments for any expenses compensated for by insurance or otherwise.
- Confirm that any expenses are attributable to the qualified disaster.
- While the employer does not have to require employees to account for actual expenses, the employer must reasonably expect the payments to be commensurate with expenses incurred. Consider having a written policy explaining how payments are intended to approximate actual losses.

Employers should also do the following:

- Review 401(k) and retirement plan terms to determine if the payments must be treated as compensation under the plan documents.
- Consider any state law implications.

Payments under Section 139 are an immediate and direct way employers can provide assistance to employees affected by Hurricane Sandy with little administrative cost. There are advantages, however, to providing such assistance through an employer-sponsored public charity.

Helping Through a Charitable Organization

Employer-sponsored public charities can provide a broader range of assistance to employees because payments from these organizations are not subject to the limits of Section 139 discussed above. Further, a charitable organization can respond to any type of disaster or employee hardship situation, not just "qualified disasters," as long as the related employer does not exercise excessive control over the charitable organization.

There are three principal requirements for providing employee assistance through an employer-sponsored public charity:

1. **The class of beneficiaries must be indefinite.** The relief program generally must be available to employees affected by current and future disasters and hardships.
2. **The recipients must be selected based on an objective determination of need or distress.** The program must have some guidelines for determining when to provide assistance and must undertake some due diligence to ensure that the recipients are "needy or distressed." Financial assistance cannot be provided to employees simply because they are victims of a disaster. Typically, public charities providing employee disaster or hardship relief adopt guidelines for awarding assistance and require an application form to be completed by the individual seeking assistance. The application form can then be used to make a determination that the applicant meets the "needy or distressed" requirement.
3. **The recipients must be selected by an independent selection committee.** This is a critical requirement and will be met if a majority of the selection committee consists of members who are "not in a position to

2. Read the IRS announcement at http://www.irs.gov/uac/Hurricane-Sandy-Qualified-Treatment-of-Payments.

exercise substantial influence over the affairs of the employer." As a practical matter, this means that the majority of the selection committee cannot consist of members of the employer's senior management. Many organizations have retired employees or persons from the human resources department serve on the selection committee.

These employer-sponsored public charities also provide a concrete way for company employees to assist other company employees by donating to the organization. Donations from both the employer and other employees are generally tax-deductible charitable contributions, and assistance payments received by employees are excludable from gross income. Providing assistance through these charitable organizations can therefore offer increased flexibility and tax benefits.

Unlike employer-sponsored public charities, which can provide assistance under any type of disaster or employee hardship situation, employer-sponsored private foundations may only provide assistance to employees or family members affected by a qualified disaster as defined in Section 139. Employer-sponsored private foundations also must be sure to meet the safeguards listed above to ensure that such assistance is serving charitable purposes rather than the business purposes of the employer.

* * *

We know that many employers want to provide disaster relief assistance to their employees, and we hope that this information will assist in taking advantage of the tax-relief provisions applicable to such assistance. We will provide updated information on the APA's request to the IRS when it becomes available.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Washington, D.C.		
Celia Roady	202.739.5279	croady@morganlewis.com
Mary B. (Handy) Hevener	202.739.5982	mhevener@morganlewis.com
David R. Fuller	202.739.5990	dfuller@morganlewis.com
Gregory L. Needles	202.739.5448	gneedles@morganlewis.com
Matthew R. Elkin	202.739.5285	melkin@morganlewis.com
Alexander L. Reid	202.739.5941	areid@morganlewis.com
Kimberly M. Eney	202.739.5825	keney@morganlewis.com
Edward T. Chaney	202.739.5831	echaney@morganlewis.com
Caroline W. Waldner	202.739.5993	cwaldner@morganlewis.com
Philadelphia		
Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
Brian J. Dougherty	215.963.4812	bdougherty@morganlewis.com
New York		
Craig A. Bitman	212.309.7190	cbitman@morganlewis.com
Pittsburgh		
John G. Ferreira	412.560.3350	jferreira@morganlewis.com

About Morgan, Lewis & Bockius LLP

With 24 offices across the United States, Europe, and Asia, Morgan Lewis provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labor and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. Our international team of lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—more than 1,600 legal professionals total—serves clients from locations in Almaty, Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Morgan Lewis

Houston, Irvine, London, Los Angeles, Miami, Moscow, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, Washington, D.C., and Wilmington. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

IRS Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend, please see http://www.morganlewis.com/circular230.