



# White Paper: Handling Disaster Relief Payments in Payroll

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# Introduction

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Disasters can strike anyone, anywhere, and at any time. It can devastate communities and individuals. The disasters can be man-made or natural and their effect on individual lives can be tremendous. It is human nature to want to help when someone is affected by a disaster. This could be especially true if that someone is a co-worker or an employee. But if that someone who wants to help is the employer does it change the rules? If an employer gives a grant to cover expenses to employees who have been ravaged by a natural disaster, would it have to report the money as wages and withhold taxes? In some cases the answer can be no.

## Disaster Relief Payments

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The Victims of Terrorism Tax Relief Act of 2001 added section 139 to the Internal Revenue Code (IRC). Section 139 provides that gross income does not include any amount received by an individual as a qualified disaster relief payment. A “qualified disaster relief payment” means 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 a qualified disaster;
- To reimburse or pay reasonable and necessary 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 such repair, rehabilitation, or replacement is attributable to a qualified disaster;
- By a Federal, State, or local government, agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare.



The term “qualified disaster” means:

- A disaster that results from a terroristic or military action;
- A Presidentially declared disaster ;
- A disaster resulting from any event that the Secretary determines to be of a catastrophic nature; or
- A disaster that is determined by an applicable federal, State, or local authority to warrant assistance from the Federal, State, or local government or an agency thereof.

## Taxable Wages?

So are payments made by an employer to its employees for disaster relief as listed above taxable wages? The IRS provides a hypothetical scenario to explain how the above rules would apply to



an employer's payments made for disaster relief to an employee. Basis for the scenario is as follows: An area within state "ST" was affected by a flood that was a Presidentially declared disaster as defined in the IRC. Acme, an employer in that state, makes grants to its employees who are affected by this flood. The grants will pay or reimburse employee for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or

otherwise. Acme does not require its employee to provide proof of actual expenses to receive the grant payments. Acme's program, however, contains requirements to ensure that the grant amounts are reasonable expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses that its employees incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury or decorative items and services. The grants are available to all of Acme's employees regardless of how long they have been with the company or the type of service they perform for the company.

The payments made by Acme to its employees in the above scenario, first of all, cannot be excluded from income because it is considered simply a gift from Acme to the employee. This type of payment made to an employee does not qualify as a gift under IRC §102. The payments cannot be excluded from income by being considered a type of general welfare payment. Acme, as an employer, is a non-governmental agency and cannot issue welfare payments.

The grants, however, are reasonably expected to be commensurate with the unreimbursed reasonable and necessary personal, living, or family expenses that Acme's employees incur as a result of a flood that is a qualified disaster. Moreover, they are paid to compensate individuals for expenses that are not compensated for by insurance or otherwise. Therefore, Acme's grants are qualified disaster relief payments that are excluded from the gross income of Acme's employees under § 139. As such, the grants are not subject to federal income tax, social security, Medicare, or FUTA tax. In addition they do not need to be reported on the Form W-2 nor any other reporting form such as a 1099-MISC.