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COVID-19: Special Disaster Benefits for Employees

Under current law and the proposed Coronavirus Aid, Relief, and Economic Security (CARES) Act, employers can offer a cluster of special benefits to employees in the event of a disaster such as the COVID-19 pandemic. Available disaster benefits discussed below include:

- Tax-free emergency payments under Code section 139,
- Leave cashouts and leave sharing programs,
- Hardship withdrawals from 401(k) plans, and
- Loans from 401(k) plan accounts.

Defining “Disaster”

Surprisingly, a viral pandemic like COVID-19 does not automatically qualify as a “disaster.” The applicable benefits provisions reference a “federally declared disaster” as defined in Code section 165(i)(5)(A) (casualty losses), which in turn requires a presidential declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (“Stafford Act”).

On **March 13, 2020**, the President declared a national emergency for the COVID-19 public health crisis under section 501(b) of the Stafford Act, which authorizes federal funding to state and local governments. But he didn’t declare a “major disaster” under section 401 of the Stafford Act, which would enable federal assistance to individuals. The distinction between these terms has led many employers and practitioners to question whether COVID-19 would qualify as a disaster for benefits purposes.

The IRS bridges this gap in Notice 2020-17. This guidance extends individual income tax payment deadlines under Code section 7508A, as a result of the COVID-19 emergency. The statutory basis for this payment extension is sourced in Code section 165(i)(5)(A), the same section referenced in applicable benefits rules discussed below. As a result, the IRS seems to bypass the emergency-versus-disaster distinction.

Tax-Free Disaster Assistance to Employees

Employers can already provide tax-free reimbursement of reasonable business expenses that employees incur working from home, such as home office supplies and added utility costs, under Code section 162. (Some states and districts – such as CA, IL, and DC – may even require reimbursement of these expenses.) Now, the **March 13, 2020** presidential emergency declaration should allow employers to provide tax-free payments for unreimbursed "personal, family, living or funeral expenses" associated with COVID-19, under Code section 139.

According to the legislative history for Code section 139, such payments cannot cover lost wage payments – which means they can't be used to cover a new paid leave program. However, tax-free payments might be used to compensate employees for any added childcare costs that are "reasonable and necessary" due to school or daycare closings. Unlike an ordinary and necessary business expense under Code section 162, a disaster-related payment under section 139 does not require that employees substantiate their expenses, so long as the payments reasonably approximate the costs. Nondiscrimination rules under Code section 105(h) do not appear to apply.

IRS guidance would be helpful to understand how broadly to read section 139. Do "personal, family, living" expenses related to COVID-19 include the added costs of (ravenous) children being home from college? What about the cost of stocking up on necessary goods (e.g., coffee and wine), or arranging for grocery delivery? Survival necessities for families with young children might include a tablet and a Disney+ subscription; parents of teenagers might need earplugs, Xanax, and Amazon Prime.

Leave-Sharing Plans

The **March 13, 2020** presidential emergency declaration should enable employers to set up a leave bank, to allow employees to donate unused vacation and personal leave to their coworkers "adversely affected" by the COVID-19 disaster. An employee is considered to be adversely affected if the disaster has caused "severe hardship" resulting in an absence from work. *See, e.g.*, IRS Notice 2006-59, 2006-28 I.R.B. 60. Leave-sharing plan designs can vary widely, but a qualifying arrangement will be treated as exempt from assignment of income principles. *Id.* Accordingly, the employees who donate leave would exclude this pay from income, while the leave recipient would treat this pay as taxable wages for purposes of income and employment taxes. *Id.*

A leave-sharing program must be established in writing, and it cannot allow a donating employee to designate a specific recipient. Other conditions and limitations also apply.

Disaster Distributions

The proposed CARES Act, introduced by Senate Republicans on **March 19, 2020** would allow "qualified disaster distributions" similar to those allowed by past legislation. These are withdrawals up to $100,000 from an eligible retirement plan that escape the 10% tax on early distributions under Code section 72(t). A qualified disaster distribution would be taxable, but plan participants could elect to spread the income taxes over three years, or to take the amount into income more quickly. These withdrawals would not be eligible for rollover. Even though these are not loans, participants could elect to repay the withdrawal to an eligible retirement plan or IRA within three years, without regard to that year's cap on contributions. The repayment would be treated as a timely trustee-to-trustee transfer into the plan or IRA (i.e., a rollover).

Qualifying withdrawals would be limited to those made by a participant: (i) who has been diagnosed with the virus by a CDC-approved test, (ii) whose spouse or dependent has been so diagnosed, or (iii) who experiences adverse financial consequences due to quarantine, furlough, layoff, reduction in hours, or other factors to be determined by Treasury. The $100,000 limit applies to all plans within the employer's controlled group.

Absent this legislation, many 401(k) plans might be able to offer hardship withdrawals for expenses and losses (including loss of income) resulting from COVID-19. This option could be available to plans that rely on the IRS safe harbor definition of "hardship," which was expanded by the Bipartisan Budget Act of 2018 to include financial need caused by disasters recognized by FEMA *for individual assistance*, such as hurricanes and tornados. *See* Treas. Reg. section 1.401(k)-1(d)(3)(ii)(B)(7). It would be useful for the IRS to confirm that the COVID-19 pandemic is covered by this standard. As discussed above, the Stafford Act only authorizes individual assistance for a major disaster, not an emergency. Indeed, FEMA has only been directed to offer public assistance – not individual assistance – for COVID-19. *See* FEMA News Release HQ-20-017 ("Today's declaration does not make direct financial assistance available to individuals"). At the same time, IRS Notice 2020-17 seems to indicate that the IRS will disregard the distinction between these two categories for tax purposes.

As currently drafted, qualifying distributions must be made *before* December 31, 2020.

Disaster Loans

The proposed CARES Act introduced on **March 19, 2020** would also expand loan opportunities in 401(k) plans, similar to disaster relief offered in the past for discrete events. For a six-month period beginning upon enactment, eligible plan participants would be allowed to borrow up to $100,000, or up to 100% of their vested account balance. Qualifying loans would be limited to a participant: (i) who has been diagnosed with the virus by a CDC-approved test, (ii) whose spouse or dependent has been so diagnosed, or (iii) who experiences adverse financial consequences due to quarantine, furlough, layoff, reduction in hours, or other factors to be determined by Treasury. Loans would need to be initiated within 180 days of enactment of the legislation.

In addition, repayment would be extended by one year for any participant with an outstanding loan payoff date scheduled between enactment and December 31, 2020. Subsequent repayments would be adjusted to reflect interest accrued during this delay. This one-year extension would be disregarded for purposes of determining compliance with the loan term limits under Code section 72(p).

If you have any questions about impacts on your employees or plans, please contact a member of our Benefits Team.