



TAX AND EMPLOYEE BENEFITS ALERT

September 6, 2005

DISASTER RELIEF PAYMENTS TO WORKERS

Many employers are seeking to help their Gulf Coast employees devastated by Hurricane Katrina. In considering how to provide financial assistance, employers should consider the following general federal tax guidelines.

Direct Payments From Employers

Section 139 of the Internal Revenue Code allows individuals to exclude from gross income (as well as from payroll taxation if they are employees and self-employment taxes if they are independent contractors) any "qualified disaster relief payment." Qualifying payments may be from any source -- including an employer -- to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses. The payments also may be provided to reimburse or pay reasonable and necessary expenses for the individual's repair or rehabilitation of a personal residence or for the repair or replacement of the residence's contents, to the extent attributable to the qualified disaster.

In Rev. Rul. 2003-12, 2003-1 C.B. 283, the IRS confirmed that section 139 allows employees to exclude from gross income (and for payroll tax purposes) qualifying payments received directly from their employers. Specifically, Scenario 3 of the ruling concludes that grants for medical, temporary housing, and transportation expenses made to employees by an employer, following a flood, are excludable under section 139 of the Code, provided the expenses are not compensated for by insurance or other sources. The employer in Scenario 3 does not require employees to provide proof of actual expenses to receive a grant payment; however, according to the facts of the ruling (but with no explanation of any details), the employer's program contains requirements in the program documents that

ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses the employees incur as a result of the flood. The grants approved in Scenario 3 are available to all employees without regard to length or type of service and are not intended to provide relief for all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services. The ruling concludes that the employees may exclude these payments from gross income (and for payroll tax purposes) under section 139.

The legislative history of section 139 confirms that the employees' ability to exclude the payments from gross income does not affect the employer's entitlement to deduct the payments as a business expense. The long-standing position of the IRS is that an employer may deduct "amounts expended by way of rehabilitation of employees for injuries and damages sustained in a major disaster." Rev. Rul. 131, 1953-2 C.B. 112, *modified by* Rev. Rul. 2003-12, *supra*.

Payments by Employer-Sponsored Private Foundations

An employer seeking to assist its employees through its company-sponsored private foundation must keep in mind the special tax rules applicable to private foundations. The legislative history of section 139 as well as IRS Publication 3833, *Disaster Relief: Providing Assistance Through Charitable Organizations*, indicates that an employer may provide disaster relief through its private foundation, but cannot limit that relief to its own employees unless it meets various requirements. For example, the private foundation's disaster-relief program

must benefit a class of employees that is sufficiently indefinite so as to constitute an appropriately “charitable” class (e.g., a program that benefits current and future employees of the company who are the victims of current and future disasters). Furthermore, beneficiaries of disaster relief must be selected by an appropriately constituted selection committee according to established selection criteria designed to ensure that, among other things, certain highly compensated employees are not eligible recipients and any grants made are not used to reimburse an employee’s disaster-related expenses that are compensated for by insurance or otherwise.

Before any disaster-relief grants are made to employees from a company private foundation, the foundation should be sure to formally adopt a disaster-relief program that satisfies all of the necessary requirements. The IRS recently warned that employer-sponsored private foundations that choose to provide disaster relief to employee victims of the Indian Ocean tsunamis “like all organizations described in section 501(c)(3), ... should exercise due diligence when providing disaster relief as set forth in Publication 3833.” Notice 2005-23, 2005-11 I.R.B. 732. This publication can be downloaded directly from the IRS website at <http://www.irs.gov>. In addition, Miller & Chevalier assists clients in drafting tax-compliant disaster-relief programs for their company private foundations.

For further information about this Alert, please contact the following attorneys in Miller & Chevalier’s Tax Department.

Fred Oliphant	202-626-5834	foliphant@milchev.com
Marianna Dyson	202-626-5867	mdyson@milchev.com
Shane Hamilton	202-626-5873	shamilton@milchev.com
James Atkinson	202-626-5880	jatkinson@milchev.com
Michael Lloyd	202-626-1589	mlloyd@milchev.com