

SPECIAL REPORT

TAX-FREE COVID-19 PAYMENTS TO YOUR EMPLOYEES

After the terrorist attacks on September 11, 2001, Congress added a little-known provision to the tax law. This little-known Tax Code provision exempts certain payments from taxation during a disaster or terrorist attack. President Donald Trump's national emergency declaration on March 13, 2020 triggered the disaster provisions of the tax law, including this one—where both you and your employees can reap benefits during this COVID-19 pandemic.

How This Works

Because of the pandemic, the Tax Code makes the following tax-free to your employees:

- Payments they receive from you for necessary personal, family, living, or funeral expenses incurred as a result of COVID-19
- Payments they receive from you for reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence, or for the repair or replacement of its contents, to the extent that the need for such repair, rehabilitation, or replacement is attributable to COVID-19

The qualified COVID-19 disaster relief payments are free of income tax, payroll taxes, and self-employment tax and deductible to you as a business expense.

Payments That Do Not Work

The exclusion from income does not apply to payments in the nature of income replacement, such as payments to individuals for lost wages, unemployment compensation, or payments in the nature of business income replacement.

Payments to business entities don't qualify, either.

Qualified disaster relief payments do not include payments for any expenses compensated for by insurance or otherwise.

Payments You Can Make

Here's an example: the IRS ruled that grants received by employees under an employer program to pay or reimburse reasonable and necessary medical, temporary housing, or transportation expenses

SPECIAL REPORT:

Tax-Free COVID-19 Payments to Employees

incurred as a result of a flood qualify for this benefit. With respect to the COVID-19 pandemic, you could reimburse or pay for the following employee expenses under this guidance:

- Out-of-pocket medical not covered by health insurance
- Teleworking costs, such as a computer, office equipment, telephone, and supplies
- Funeral costs for an employee or an employee's family member
- Childcare costs so that your employees can continue to work while children are home from school

Planning note. Because of the Tax Cuts and Jobs Act, employees may not deduct employee business expenses during tax years 2018-2025, so your reimbursement of such expenses under the disaster rules is extra valuable.

Documentation

Here's a surprise: Congress doesn't think taxpayers can account for their actual expenses because they are going through a disaster, so taxpayers are in the clear provided the payments received and treated as tax-free are reasonably expected to be commensurate with the expenses they incurred.

Even if the IRS is generous with documentation requirements, **we recommend you implement a formal, written plan** with

- starting and ending dates of the program;
- a listing of the expenses you will pay or reimburse;
- the maximum payment per employee;
- a procedure the employee will use to request funds, possibly requiring receipts for reimbursement.

You should also track the names and amounts provided to each employee under the program terms.

Example

During the COVID-19 pandemic, you establish a plan to help employees with telework expenses, allowing each employee to get a \$1,500 grant for equipment, supplies, and use of home utilities.

Your employees Sam and Helen each apply, and each estimate they will spend \$1,500 on a form you provide.

Sam and Helen each spend approximately \$1,500 on telework equipment and supplies.

The tax results are as follows:

SPECIAL REPORT:

Tax-Free COVID-19 Payments to Employees

- Sam gets \$1,500 completely tax-free.
- Helen gets \$1,500 completely tax-free.
- You get a \$3,000 tax deduction.

Good / Bad News for S-Corporation Owners/Employees

S-Corporation owners usually can't take advantage of tax-free fringe benefits and usually have to include their value as taxable income on their W-2.

The **Good News** about these disaster-related payments: None of the guidance issued about these payments denies their favorable tax treatment to the S corporation shareholder. In addition, the IRS doesn't mention such payments in Publication 15-B, *Employer's Tax Guide to Fringe Benefits*.

But we have some **Bad News** too: There is no guidance explicitly allowing the S-Corporation owner to take advantage of the tax-free disaster-related payments.

We believe that S-Corporation owners/employees qualify for these payments to be tax-free, but there is a chance that the IRS may issue contrary guidance down the road. If you choose to have your S-Corporation provide tax-free disaster-related payments to you, we recommend you implement a formal, written plan (as described above) and keep excellent documentation—even though such steps are not required by the law.

We recommend implementing a formal, written COVID-19 Disaster Reimbursement Policy before making any reimbursement payments, and we can help you establish such a Policy for your business.

As a part of our package, we can also provide a Reimbursement Request Form you can use to document these payments. Call us today to sign up for this service.

This Report was not intended to fully explain every aspect or discuss every detail of this program. We strongly urge you to discuss these provisions with your tax advisor before taking any action. If we can answer your questions about this or any other tax matter, please call us at 210.332.3672 or email us at Office@JHBTexasCPA.com