

ATTACHMENT E

Memo

TO: Matthew Mears, General Counsel, Florida Department of Education

FROM: Eversheds Sutherland (US) LLP

DATE: DRAFT--May 10, 2021

RE: Section 139 Qualified Disaster Relief Payments

You have asked us to consider whether payments which may be made by the state of Florida to public school teachers, daycare workers and first responders may be treated as "qualified disaster relief payments" under section 139 of the Internal Revenue Code, which excludes such payments from an individual's gross income.¹ A qualified disaster relief payment does not constitute wages subject to income tax withholding and social security tax.²

I. General Section 139 Requirements

There are two requirements for exclusion of a payment from income under section 139: the payment must be made incident to a "qualified disaster" and the payment must be a "disaster relief payment."

A qualified disaster includes, as relevant here, a "federally declared disaster."³ As of January 20, 2020 and continuing to the present, COVID-19 is a federally declared disaster in every U.S. state and territory.⁴

As is discussed in more detail below, a disaster relief payment must be based on unreimbursed personal expenses caused by a qualified disaster. A disaster relief payment should not be a substitute for wages or for business income.⁵

Under section 139(b)(1), a qualified disaster relief payment may be made to "reimburse or pay reasonable and necessary personal, family, living or funeral expenses incurred as a result of a

¹ Section 139(a). Unless otherwise stated, all "section" references are to the Internal Revenue Code of 1986, as amended and currently in effect. All "Treas. Reg." references are to the current Treasury Regulations.

² Section 139(d) provides that qualified disaster relief payments "shall not be treated as ...wages or compensation subject to tax."

³ Section 139(c)(2). A "federally declared disaster" is defined in section 165(i)(5)(A) as "any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act."

⁴ The major disaster declarations for each state and territory can be found on the Federal Emergency Management Agency website. The major disaster declarations were issued on various dates, but all are effective as of January 20, 2020. <https://www.fema.gov/disasters/coronavirus/disaster-declarations>.

The State of Florida disaster declaration was released on March 25, 2020, but is effective as of January 20, 2020. <https://www.fema.gov/news-release/20200723/president-donald-j-trump-approves-major-disaster-declaration-florida>.

⁵ See Not. 2003-18, 2003-1 C.B. 699 (World Trade Center business recovery grant was not for personal, family or living expenses).

qualified disaster." The IRS has ruled specifically that an employer may make this type of payment, which is not included in wages.⁶

Under section 139(b)(4), a payor that is a state or local government (or agency or instrumentality thereof) may also make qualified disaster relief payments "to promote the general welfare."⁷

In addition to section 139(b)(4), a common-law doctrine, the "general welfare exclusion" provides that payments to individuals by governmental units are excludable from income if they meet certain requirements.⁸ Requirements for the general welfare exclusion are that payments must be: (i) made from a governmental fund; (ii) be for the promotion of the general welfare (i.e., generally based on individual or family needs); and (iii) not represent compensation for services.⁹

Because the general welfare exclusion under section 139(b)(4) and the common law largely overlaps with the "personal, family, living and funeral expenses" provision in section 139(b)(1), the two types of payments will be discussed together.

The IRS has ruled, and the legislative history of section 139 provides, that an individual who receives a qualified disaster relief payment is not required to account for actual expenses.

⁶ Rev. Rul. 2003-12, 2003-1 C.B. 283 (grants to employees to pay or reimburse reasonable and necessary medical, temporary housing, or transportation expenses incurred as a result of a flood); Not. 2006-10, 2006-1 C.B. 386 (Hurricane Katrina per diem evacuation allowances for federal government employees); IRS Info Letter 2009-0039, 2009 WL 873306 (special allowances paid to employees and their dependents to reimburse expenses incurred while evacuating Hurricane Ike).

A "Revenue Ruling" or "Rev. Rul." is a formal ruling by the IRS, which is approved by the Treasury Department and on which taxpayers may rely. An "Info Letter" indicates the IRS's view on an issue but is not a formal document on which taxpayers may rely.

⁷ Section 139(b)(4).

⁸ See, e.g., Rev. Rul. 98-19, 1998-1 C.B. 840 (payments made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is not includible in the individual's gross income); Rul. 76-144, 1976-1 C.B. 17 (grants to individuals unable to meet necessary expenses or serious needs as a result of a disaster are in the interest of general welfare and are not includible in the recipients' gross income).

⁹ Rev. Rul. 82-106, 1982-1 C.B. 16; Rev. Rul. 75-246, 1975-1 C.B. 24.

It also should be noted that, in certain circumstances, a government can be considered to give a nontaxable gift to certain citizens in recognition of their activities. For example, the IRS ruled that payments made by a state to qualified veterans of certain wars are gifts and are not included in income. Rev. Rul. 68-158, 1968-1 C.B. 47; see also Rev. Rul. 55-609 (death gratuity payments designated by Congress as gifts); *Dewling v. United States*, 101 F. Supp. 892 (Ct. Cl. 1952) (payments in recognition of services for construction of the Panama Canal, built 30 years prior to payment, were gifts). More recently, the IRS has ruled that the Minnesota Military Service Tax Credit, a refundable tax credit provided to state residents with respect to periods during which the resident was in military service in a designated area after September 11, 2001. The IRS ruled that, to the extent the credit was refunded to the individual, it was excludable from income as a gift, because the payment was not made pursuant to a governmental duty to relieve hardship caused by a natural disaster and was instead made in recognition of the individual's activities. CCA 200708003 (Jan. 9, 2007). A Chief Counsel Advice or CCA indicates the IRS's view on an issue but is not a formal document on which taxpayers may rely.

To the extent payments are made in recognition of services for which the recipient would ordinarily earn wages, and are paid close in time to the services, it is not clear that there is a tax position that the payment constitutes a gift rather than wages. The IRS has generally limited "gifts" by employers to certain de minimis items not convertible into cash, such as a holiday turkey or ham. See section 132(e); Rev. Rul. 59-58, 1959-1 C.B. 17. The IRS takes the position that cash or cash equivalent items provided to an employee by an employer are not excludable from income as gifts.

Rather, a payment is considered to be a qualified disaster relief payment if "the amount of the payments can be reasonably expected to be commensurate with the expenses incurred."¹⁰

Accordingly, to the extent the payments to be made by the state are intended to pay or reimburse personal, family, living or funeral expenses incident to the COVID-19 disaster, such payments should constitute "qualified disaster relief payments."

II. Types of Expenses That Can Be Paid or Reimbursed Under Section 139

The legislative history of section 139 provides that "personal, family and living expenses" for section 139 purposes is intended to have the same meaning as under section 262.¹¹ The items specifically provided for in section 262 include the following, if incident to a qualified disaster:

- Residential local telephone service¹²
- Household expenses (rent, water, utilities, domestic services)¹³
- Travel expenses (transportation, meals, lodging), commuting costs, local lodging¹⁴
- Education costs¹⁵
- Funeral expenses¹⁶

Although not specifically mentioned in the legislative history or enumerated in section 262, in our experience, the following types of payments have been considered by employers to be disaster relief payments incident to COVID-19, especially to the extent such payments are personal in nature and not linked to equipment necessary for employment. The IRS has not specifically ruled with respect to any of these costs:

- Unreimbursed costs of home wifi (considered analogous to residential telephone service)
- Medical expenses not covered by insurance (e.g., co-pays, alternative treatments)
- Health-related but nonmedical expenses (e.g., fitness, yoga, meditation)
- Unreimbursed costs of protective equipment for personal use such as gloves, masks, face shields, etc.
- Unreimbursed costs of cleaning supplies for personal use, such as hand sanitizer, soap, paper towels, etc.
- Childcare or tutoring expenses due to closure of schools or daycares or to assist children with virtual instruction
- Certain unreimbursed work-from-home expenses or personal expenses, including costs of home furniture, or other inexpensive work-from-home equipment owned by the employee (webcams, footrests, mice, ergonomic keyboards etc.)

¹⁰ Rev. Rul. 2003-12, 2003-1 C.B. 283; Staff of the Joint Comm. on Tax'n, *Technical Explanation of the "Victims of Terrorism Tax Relief Act of 2001," as Passed by the House and Senate on December 20, 2001*, 107th Cong., 1st Sess. 16 (2001).

¹¹ Staff of the Joint Comm. on Tax'n, *Technical Explanation of the "Victims of Terrorism Tax Relief Act of 2001," as Passed by the House and Senate on December 20, 2001*, 107th Cong., 1st Sess. 3 (2001).

¹² Section 262(b).

¹³ Treas. Reg. § 1.262-1(b).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Section 139(b)(1).

Qualified disaster relief payments do not include

- Payments for expenses otherwise paid for by insurance or other reimbursements such as employer reimbursements¹⁷
- Income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation¹⁸

III. Recommendations Regarding Documentation

To the extent the state anticipates making qualified disaster relief payments, the state should document that: (1) the purpose of the payments is to assist the recipients with unreimbursed personal, family, living and funeral expenses incurred by reason of the COVID-19 disaster, and (2) that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred by the individuals incident to the COVID-19 disaster. The COVID-19 disaster occurred as of January 20, 2020 and continues to the present.

We recommend that the state collect and maintain documentation noting the types and amounts of unreimbursed personal, family, living or funeral expenses that could be reasonably expected to be incurred by teachers, daycare workers and first responders due to COVID-19, such as letters from affected individuals (or from school districts, charter schools, etc.) noting their increased personal expenses, ideally including illustrative amounts of such expenses.

The total amount of such expenses should be reasonable considering the length of the disaster. For example, the state could estimate that it is reasonable to assume that a typical teacher, daycare worker or first responder incurred at least \$100 a month (or some other amount) for increased personal, family, living or funeral expenses during the 16 months of the COVID-19 disaster, or that the individual can reasonably be expected to incur such expenses during future periods when the disaster will still be in effect.

The determination of whether a payment is a qualified disaster assistance payment is a facts-and-circumstances determination. If the state collects and maintains documentation regarding the purpose of the payments and its reasonable estimation of the types and amounts of increased personal expenses by the recipients, it should not be a barrier to section 139 treatment that the Grants and Aids Budget initially referred to these funds as "bonuses" and also made reference to social security tax. However, because these references have been made, the change in purpose of the payment should be clearly documented.

¹⁷ See section 139(b)(1).

¹⁸ See Staff of the Joint Comm. on Tax'n, *Technical Explanation of the "Victims of Terrorism Tax Relief Act of 2001," as Passed by the House and Senate on December 20, 2001*, 107th Cong., 1st Sess. 3 (2001) (the exclusion does not apply to payments in the nature of income replacement, such as payments to individuals of lost wages, unemployment compensation, or payments in the nature of business income replacement); see also Not. 2003-18, 2003-1 C.B. 699 (World Trade Center business recovery grant replaced lost business income rather than personal, family or living expenses).