

Providing Charitable Hardship Payments to Employees During COVID-19

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COVID-19 is presenting novel challenges for employers across the globe. Last week, we issued a general advisory that provides guidance to employers on how to navigate these challenges. One issue facing employers is how to manage and lessen the hardships that employees and their family members are dealing with as a result of the virus.

On March 13, President Trump declared the COVID-19 pandemic a national emergency that warrants assistance by the federal government. [1] This declaration opened the doors for employers to utilize certain charitable vehicles, such as corporate foundations, to provide financial assistance to employees experiencing hardships because of the outbreak. If certain requirements are met, these hardship payments will not be subject to federal income tax for the recipients and they won't adversely affect the charitable organization's tax exemption.

The Role of Employer-Sponsored Charitable Organizations in National Emergencies

Providing aid to relieve the hardships of disasters and emergencies is inherently charitable. Society has looked to charitable organizations to provide assistance to victims of disasters such as floods, fires, and storms and public health emergencies throughout recent history, including the September 11th terrorist attacks and Hurricane Katrina. In the wake (or in the midst) of one of these national emergencies, many employers seek out ways to do their part in alleviating the impact of such emergencies on their employees. One way to do this is to form employer-sponsored charitable organizations that focus on disaster relief.

Tax law imposes restrictions on charitable organizations to ensure that individuals and insiders (e.g., a company that formed the corporate foundation and those with substantial influence over the company) do not improperly benefit from charitable funds that are dedicated to charitable causes. These restrictions apply to employer-sponsored charitable organizations to prevent the sponsoring employers from improperly benefiting from charitable funds. To protect against unduly benefiting the company that created the charitable entity and to ensure that payments from these funds are tax-free to the recipient (and not disguised compensation to employees), the following parameters must be met:

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1. The class of beneficiaries eligible to receive the hardship payments must be large or indefinite – making assistance available to employees and their family members who may be victims of current or future disasters generally suffices.
2. The recipients must be selected based on an objective determination of need, typically financial. Note, however, that meeting short-term, immediate needs, such as food and clothing, do not require a determination of financial need.
3. The recipients must be selected by an independent selection committee or adequate substitute procedures must be in place to ensure that the fund is operated for the benefit of the distressed employees and their families and not for the benefit of the employer. Company board members and executives are not independent for this purpose.

Charitable organizations are also required to adhere to certain record-keeping requirements to show that these requirements were met.

Differences Between the Various Charitable Organizations

Depending on the type of charitable organization being used by employers, additional requirements and restrictions may be applicable. We discuss the relevant rules for three of the most popular charitable giving vehicles below. Regardless of the type of charitable organization, however, the three requirements discussed above must be satisfied.

Employer-Sponsored Private Foundations

Because public charities (discussed below) typically solicit funds from the general public and are generally subject to more public oversight in their daily operations, they are less restricted than private foundations in the types of disaster assistance and emergency hardship relief they may provide. Employer-sponsored private foundations may only make payments to employees affected by a “qualified disaster,” as defined in section 139 of the Internal Revenue Code. Section 139 was added to the Code in the wake of the September 11th tragedy. President Trump’s national emergency declaration last Friday designates the COVID-19 pandemic as a “qualified disaster” under sections 139(c) and 165(i)(5)(A) of the Code, thereby permitting employer-sponsored private foundations to make payments to employees affected by the virus.

Financial assistance paid by employer-sponsored private foundations may address immediate needs and needs arising from the hardship but cannot be for expenses that are otherwise paid for by insurance and they cannot be income replacement payments. The payments for personal expenses must be reasonable and necessary and objectively based on need.

If the requirements outlined above are satisfied, hardship payments made by employer-sponsored private foundations to employees and their family members in response to the COVID-19 pandemic will:

1. be presumed to be made for charitable purposes; and

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2. not result in excise taxes applicable to private foundations, such as the self-dealing excise taxes under section 4941 of the Code.

Employer-Sponsored Donor Advised Funds

Another popular charitable giving vehicle is the donor advised fund (a “DAF”). A DAF is a separate fund or account maintained by a community foundation, federation, or public charity that receives contributions from donors, who then get advisory privileges over the investment or distributions of those funds. Generally, DAFs cannot make grants to individuals, but there is an exception for certain employer-sponsored DAFs organized to benefit employees and their family members who are victims of a qualified disaster.

An employer-sponsored DAF may make hardship payments to employees and their family members if the following requirements (in addition to the three general requirements and the recordkeeping requirements discussed above) are met:

- The DAF must serve the single identified purpose of providing relief from one or more “qualified disasters.”
- No payment may be made from the DAF to or for the benefit of any director, officer, or trustee of the sponsoring community foundation or public charity, or members of the DAF’s selection committee.

Employer-Sponsored Public Charities

As mentioned above, since public charities are typically more transparent and are subject to a greater amount of public scrutiny due to their broad sources of financial support, they have more flexibility with the assistance they may provide to employees. Employer-sponsored public charities may assist in any type of disaster or hardship situation (not only in “qualified disasters”) and may provide a broader range of assistance to employees than can be provided by employer-sponsored private foundations or DAFs.

Payments Made Directly by the Employer

In certain instances, employers may provide assistance directly to their employees (and their relatives) without the assistance being treated as compensation. Generally, payments made by an employer to an employee are taxable – unless they are “qualified disaster relief payments,” which is defined to include, for purposes relevant to the COVID-19 pandemic, any amount paid to an employee “to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster.” Payments that are reimbursed by insurance or otherwise and income replacement payments do not constitute “qualified disaster relief payments.” Examples of payments that may fit the definition of “qualified disaster relief payments” are unreimbursed medical and health-related expenses, like co-pays, that result from the virus, and childcare and tutoring expenses incurred because of school and daycare closings.

In the recent past, after a qualified disaster occurs, the Department of Treasury has issued guidance on how the relevant Code provisions will apply to such disaster or national emergency. No such guidance has been issued to-date regarding COVID-19, but we expect it will be issued and will continue to monitor the situation.

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This advisory was prepared principally by Erin Whitney, a member of Nutter’s Tax Department and Nonprofit and Social Impact practice group, with the assistance of Melissa Sampson McMorrow, chair of Nutter’s Tax Department and co-chair of the Nonprofit and Social Impact practice group. If you would like to inquire about establishing such a fund or simply would like additional information, please contact Melissa, Erin, or your Nutter attorney at 617.439.2000.

This update is for information purposes only and should not be construed as legal advice on any specific facts or circumstances. Under the rules of the Supreme Judicial Court of Massachusetts, this material may be considered as advertising.

[1] This declaration was made under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.