

Steve Leimberg's Charitable Planning Email Newsletter Archive Message #294

Date: 31-Mar-20

Subject: Richard L. Fox on Employee Relief Funds Established at Section 501(c)(3) Tax-Exempt Organizations - Using Tax-Deductible Charitable Contributions to Provide Tax-Free Financial Assistance to Employees Affected by the COVID-19 Crisis

"In response to the COVID-19 crisis substantially affecting their workforces, many employers are considering programs to provide financial assistance to their employees, including those who have been furloughed or terminated. Under Section 139 of the Internal Revenue Code, employers can make grants directly to employees on a tax-free basis provided, however, they are used to pay or reimburse amounts that are reasonably expected to be incurred for incremental personal, family or living expenses as a result of the COVID-19 crisis. Section 139 does not require the employer to make a specific assessment of the financial need of the employee.

As an alternative or in addition to establishing a program under the Section 139 relief regime, an employer can establish an Employee Relief Fund as a charitable fund at a Section 501(c)(3) tax-exempt organization funded with tax-deductible charitable contributions made by the employer and others interested in supporting those employees in financial need as a result of the COVID-19 pandemic. These funds can make a broader array of tax-free distributions to employees than those payments allowable under Section 139. Unlike a Section 139 program, payments from an Employee Relief Fund must comply with various IRS requirements, including having a significantly large 'charitable class,' the selection of the recipients on an objective determination of need, and an independent selection committee selecting the recipients, payments to employees from the fund will not constitute taxable income and will be free from any Form W-2 reporting requirements.

Employee Relief Funds may be housed at a variety of tax-exempt organizations. While an employer may establish a new charitable organization and apply for tax-exempt status with the IRS, precious time and resources may be saved by using existing charities to operate the

fund. This may include using an existing employer-sponsored public charity and, because the COVID-19 crisis constitutes a ‘qualified disaster’ under Section 139 of the Internal Revenue Code, an employer-sponsored private foundation that has certain required safeguards in place. An alternative to an employer-sponsored charity is for an employer to partner with a third-party charity, such as a local community foundation or other public charity that offers Employee Relief Funds.”

Richard Fox provides members with important and timely commentary that reviews how Employee Relief Funds can be used to provide tax-free financial assistance to employees affected by COVID-19 crisis.

Richard L. Fox is an attorney and shareholder at **Buchanan Ingersoll & Rooney** (www.bipc.com). Richard is the author of the treatise, *Charitable Giving: Taxation, Planning and Strategies*, a Thomson Reuters/Warren, Gorham and Lamont publication, writes a national bulletin on charitable giving, and writes and speaks frequently on issues pertaining to nonprofit organizations, estate planning and philanthropy. Richard is also a Fellow of the American College of Trust and Estate Counsel (ACTEC).

Here is his commentary:

EXECUTIVE SUMMARY:

In response to the COVID-19 crisis substantially affecting their workforces, many employers are considering programs to provide financial assistance to their employees, including those who have been furloughed or terminated. Under Section 139 of the Internal Revenue Code, employers can make grants directly to employees on a tax-free basis provided, however, they are used to pay or reimburse amounts that are reasonably expected to be incurred for incremental personal, family or living expenses as a result of the COVID-19 crisis, without any requirement to make a specific assessment of the financial need of the employee.

As an alternative or in addition to establishing a program under the Section 139 relief regime, an employer can establish an Employee Relief Fund as a charitable fund at a Section 501(c)(3) tax-exempt organization funded with tax-deductible charitable contributions made by the employer and others

interested in supporting those employees in financial need as a result of the COVID-19 pandemic. These funds can make a broader array of tax-free distributions to employees than those payments allowable under Section 139. Unlike a Section 139 program, payments from an Employee Relief Fund must comply with various IRS requirements, including having a significantly large “charitable class,” the selection of the recipients on an objective determination of need, and an independent selection committee selecting the recipients, payments to employees from the fund will not constitute taxable income and will be free from any Form W-2 reporting requirements.

Employee Relief Funds may be housed at a variety of tax-exempt organizations. While an employer may establish a new charitable organization and apply for tax-exempt status with the IRS, precious time and resources may be saved by using existing charities to operate the fund. This may include using an existing employer-sponsored public charity and, because the COVID-19 crisis constitutes a “qualified disaster” under Section 139 of the Internal Revenue Code, an employer-sponsored private foundation that has certain required safeguards in place. An alternative to an employer-sponsored charity is for an employer to partner with a third-party charity, such as a local community foundation or other public charity that offers privately branded Employee Relief Funds.

FACTS:

In response to the COVID-19 crisis, many employers are seeking to establish an employee relief program to provide financial assistance to their employees, including those who have been furloughed or terminated. Under Section 139 of the Internal Revenue Code, employers can make grants directly to employees on a tax-free basis provided, however, they are used to pay or reimburse amounts that are reasonably expected to be incurred for incremental personal, family or living expenses as a result of the COVID-19 crisis. Section 139 does not require the employer to make a specific assessment of the financial need of the employee.

As an alternative or in addition to establishing a program under the Section 139 relief regime, an employer can establish an Employee Relief Fund as a charitable fund at a Section 501(c)(3) tax-exempt organization funded with tax-deductible charitable contributions made by the employer and others interested in supporting those employees in financial need as a result of the

COVID-19 pandemic. These funds can make a broader array of tax-free distributions to employees although, unlike a Section 139 program, payments from an Employee Relief Fund must comply with various IRS requirements, including the selection of the recipients by an independent selection committee based on an objective determination of financial need.

Tax-Exempt Organizations Housing the Employee Relief Fund

Employee Relief Funds may be housed at a variety of tax-exempt organizations. While an employer may establish a new charitable organization and apply for tax-exempt status with the IRS, precious time and resources may be saved by using existing charities to operate the fund. This may include using an existing employer-sponsored public charity and, because the COVID-19 crisis constitutes a “qualified disaster” under Section 139 of the Internal Revenue Code, an employer-sponsored private foundation that has certain required safeguards in place.

An alternative to an employer-sponsored charity is for an employer to partner with a third-party charity, such as a local community foundation or other public charity that offers privately branded Employee Relief Funds. These organizations already have an established infrastructure in place and can generally quickly launch and mobilize these funds in a manner that aligns with the employer’s values and culture.

Charitable Income Tax Deduction for Contributions to Employee Relief Fund

Contributions to an Employee Relief Fund are eligible for a charitable deduction for federal income tax purposes. There are generally no limitations on who may contribute to a fund and receive this tax benefit. For example, the employer, its employees or the public at large can all contribute on a tax-deductible basis. Notably, the Coronavirus Aid, Relief, and Economic Security Act, the “CARES Act,” provides for the following new incentives for charitable giving for contributions paid during the year 2020:

- (1) an “above-the-line” charitable income tax deduction is allowed to all individuals up to \$300 for cash contributions to public charities (other than donor advised funds and supporting organizations) and private operating foundations;

- (2) the cap on annual contributions for individuals who itemize their deductions is generally raised from 60% to 100% of adjusted gross income for cash contributions to public charities (other than donor advised fund and supporting organizations) and private operating foundations; and
- (3) the cap on annual charitable contributions by corporate taxpayer is generally increased from 10% to 25% of taxable income for cash contributions to public charities (other than donor advised fund and supporting organizations) and private operating foundations.

Tax-Free Treatment of Distributions to Employees from Employee Relief Fund

Provided an Employee Relief Fund meets the applicable IRS requirements, including (as discussed further below) having a significantly large “charitable class,” the selection of the recipients on an objective determination of need, and an independent selection committee selecting the recipients, payments to employees from the fund will not constitute taxable income and will be free from any Form W-2 reporting requirements. Although the payments from an Employee Relief Fund are not excluded from taxable income under Section 139 of the Internal Revenue Code, they are considered to constitute gifts that are excluded from gross income under Section 102 of the Internal Revenue Code. In this context, distributions cannot be made solely on the basis of the COVID-19 crisis, but must be based up a specific assessment that the recipient is financially or otherwise in need. Individuals do not have to be totally destitute to be financially needy, but may merely lack the resources to obtain basic necessities.

Payments from an Employee Relief Fund would include those described as “qualified disaster relief payments” under Section 139, which include payments for the following expenses incurred by an employee as a result of the COVID-19 pandemic:

- Unreimbursed medical expenses and health-related expenses that do not constitute medical expenses.
- Home expenses due to telecommuting.

- Housing costs for additional family members.
- Increased childcare and tutoring costs due to school closings.
- Additional commuting expenses.
- Increased costs of home offices supplies.

In addition to the foregoing incremental expenses incurred as a result of a disaster, Employee Relief Funds may also provide assistance in the form of funds, services, or goods to ensure that employees have the basic necessities, such as food, clothing, housing, transportation, and medical assistance. The type of aid that is appropriate depends upon an individual's needs and resources. The IRS has indicated that disaster relief organizations are generally in the best position to determine the type of assistance that is appropriate. For example, immediately following a devastating flood, a family may be in need of food, clothing, and shelter, regardless of their financial resources. However, they may not require long-term assistance if they have adequate financial resources. Individuals who are financially needy or otherwise distressed are appropriate recipients of long-term assistance.

The IRS has indicated that the following type of assistance provided on account of a particular disaster, if based on individual need, would be permissible:

- Assistance with rent, mortgage payments or car loans to prevent loss of a primary home or transportation that would cause additional trauma to families already suffering.
- Assistance with elementary and secondary school tuition and higher education costs to permit a child to attend school.
- Assistance to provide food or shelter.

Payments for these expenses, even though not constituting “qualified disaster relief payments” under the purview of Section 139, are nonetheless allowable, again provided that the Employee Relief Fund meets the applicable IRS requirements.

Group of Individual Eligible to Receive Relief Must Be Sufficiently Broad to Constitute a “Charitable Class”

The IRS requires the pool of eligible recipients of an Employee Relief Fund to be broad enough to be considered indeterminable and, therefore, considered to be a “charitable class.” Otherwise, the class will be considered too small and the fund will be deemed to be serving private rather than public interests. If the group of eligible recipients is limited to a smaller group, such as the employees of a particular employer, the group of persons eligible for assistance must be indefinite. In this context, to be considered to benefit an indefinite class, the proposed relief program must be open-ended and include employees affected by the COVID-19 crisis and those who may be affected by a future disaster. Accordingly, if a charity follows a policy of assisting employees who are victims of all disasters, present or future, it would be providing assistance to an indefinite charitable class.

Recipients of Relief Must be Selected on an Objective, Needs-Based Basis

The Employee Relief Fund must select recipients based on an objective determination of the recipient’s need. It is vital that the Employee Relief Fund establish a specific, written list of criteria for the selection of recipients before it begins administering aid. A best practice would be for the fund to require an application from the employee describing need and available resources to meet the need. The IRS has recognized that the standards for immediate emergency relief can be more lax than longer-term assistance. For example, it would be inappropriate to require exhaustive documentation from an applicant who provides reasonable evidence that they are homeless due to an eviction or hospitalized due to COVID-19.

The personal circumstances of each potential recipient must be considered in the selection process. Merely being negatively affected by COVID-19 in some way is not enough. For example, a laid off worker who is independently wealthy may qualify for emergency relief in the short-term

but is likely not an appropriate recipient of long-term financial assistance. It would also be unreasonable to require a recipient to be completely destitute before they can qualify for relief. The physical and emotional well-being of a potential recipient may be considered, but care should be taken to ensure this criteria is evaluated in an objective manner.

Recipients of Relief Payment Must Be Selected by Committee That is Independent from the Related Business

Because an Employee Relief Fund is typically associated with a business (i.e., the employer), the IRS requires the fund to be sufficiently independent from the business. It is acceptable for individuals associated with the business to serve on the selection committee, but the IRS requires that a majority of committee members not be in a position to exercise substantial influence over the affairs of the business, *e.g.*, directors or officers of the business. Involving rank-and-file employees of the business to serve on a selection committee is not only permissible, but frequently a best practice to demonstrate the integrity of the decision-making process.

The Employee Relief Fund Must Maintain Proper Documentation

An Employee Relief Fund must maintain adequate records to show that its payments further its charitable purposes and that the employees receiving payments are needy or distressed. Generally, the best practice is for an Employee Relief Fund is to keep records of its charitable purposes and how the relief program achieves them, the criteria for relief, the selection process, the type of relief actually provided, and the name, address, and amount distributed to each of recipients. More-detailed documentation is required for the provision of longer-term assistance as opposed to short-term emergency relief.

COMMENT:

As the COVID-19 pandemic continues to substantially affect companies and their workforces, employers are seeking to provide financial assistance to their employees. Provided the IRS requirements are met, an Employee Relief Fund established as a charitable fund at a Section 501(c)(3) tax-exempt organization can be a powerful tool to provide tax-free financial assistance to employees in need by using tax-deductible charitable

contributions. These funds can be used as an alternative or in addition to a program established by an employer under the Section 139 relief regime.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard L. Fox

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IRS Publication 3833 (Rev. 12-2014); IRC §§ 102 and 139; Rev. Rul.
2003-12, 2003-1 CB 283; CARES Act, §§ 2204 and 2205.