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Using Qualified Disaster Relief and Employer-Assisted Charities to Aid Employees Impacted by Financial Hardship and Natural Disasters

Employers are in search of ways to help employees who have been severely and unexpectedly impacted in the wake of unprecedented hurricanes, floods and wildfires, pandemics and financial hardship. The process of rebuilding after a disaster or recovering from financial hardship is often slow and painful, as employees may be displaced from their homes, lack reliable transportation to work, and may even require medical care or psychological counseling. Affected employees may experience difficulty balancing their personal situations with their responsibilities at work, especially if the employees lack financial resources to meet their basic needs and those of their immediate family members.

The federal tax rules give employers several ways to make disaster-related payments to affected employees. If the natural disaster is a federally declared disaster under Section 139 of the Internal Revenue Code (“the Code”), the employer can make grants to employees from the employer’s general assets or from a dedicated fund. Because the grants are tax-qualified, they are not taxable income to the employees who receive them and the employer won’t be responsible for paying FICA and Medicare taxes on the grants.

Another option for employers looking to provide assistance in connection with natural disasters or financial hardship is to help create a 501(c)(3) employer-assisted public charity. By sponsoring a 501(c)(3) that has the charitable purpose of assisting employees and their families with unexpected financial hardships, an employer can provide direct access to financial assistance following a natural disaster or other hardship. Again, grants received by employees from the charity are not taxable income, and any donations made to the 501(c)(3) are tax-deductible, although the recent increase in the standard exemption amount means that many employees won’t itemize and deduct the contribution.

Employers can also assist employees through a private foundation, a donor-affiliated fund or by taxable direct grants and reimbursements. Employers should evaluate which approach might work best to help employees facing a hardship or crisis situation.

Qualified Disasters under Code Section 139

The IRS has deemed disaster-related assistance payments non-taxable when made to individuals affected by one of four types of qualified disasters. The most common type is a federally declared disaster, but payments can also be made in the event of a disaster that results from terroristic or military action, an accident involving a common carrier, or any other event that is deemed by the Secretary of State to be of a catastrophic nature (warranting assistance from the federal, state, or local government or agency or instrumentality thereof).

Qualified disaster relief payments are an exception to the rule that payments by an employer to or for an employee constitute taxable compensation income to the employee. Qualified disaster relief payments are not taxable to the employee and the employer is not required to withhold taxes on the payments. However, only certain expenditures qualify, including payments intended to reimburse an employee for reasonable and necessary personal, family, living and funeral expenses, and expenses incurred to repair a personal residence or to replace its contents if the need for such expenses resulting from a qualified disaster. A personal residence includes a residence rented by an employee.

Any employer or employer-sponsored organization may provide qualified disaster relief payments to affected employees or to their family members, regardless of whether the organization is a 501(c)(3). However, qualified disaster relief payments cannot be made for expenses that are otherwise paid for by insurance or other reimbursements. The qualified relief payments also can't replace sources of income, such as an employee's lost wages, lost business income, or unemployment compensation but must be for specific necessary expenses.

Employer-Assisted Public Charities

Establishing an employer-assisted public charity is an increasingly common way that an employer can help impacted employees. So long as the employee's need for financial assistance is the result of an extreme and unexpected hardship beyond the employee's control, the employee can receive tax-free grants directly from the charity. Assistance payments are nontaxable, so the employee will not have to recognize income from the payments. A few employer-assisted charities are now working to motivate employee to develop a habit of personal savings by matching savings in an initial participation period for employees with low income and assets, and structured properly these matching savings amounts can also be tax-free.

A public charity is permitted under IRS rules to provide employees qualified disaster relief assistance and help employees cope with other types of emergency hardships, such as a serious illness, a household wage-earner's loss of employment, or funeral expenses associated with the death of a loved one. These organizations enjoy tax-exempt status under Code Section 501(c)(3) and are classified as public charities under Code Section 170(b)(1)(A)(vi), allowing donors to deduct their contributions (subject to certain rules and limitations). Charities generally do not pay tax on their income.

Because public charities typically receive broad financial support from the "general public," their operations are generally considered to be more transparent. The sponsoring employer must not exercise excessive control over the organization, or the charity's tax-exempt status will be jeopardized. In addition, employer assistance organizations should generally avoid providing long-term financial assistance to individuals, as doing so increases the risk that the assistance benefits will be characterized as an ERISA plan. The opportunity to apply for aid should be open to all employees, and employment should not be more than an initial qualifier. Opening the application to current, future, and past employees (who were employed with the employer at the time of the qualified disaster) ensures that there is a charitable class of sufficient size and indefiniteness.

Private Employer-Assisted Relief

Employers who are not interested in establishing a public charity may provide assistance through a private foundation, a donor advised fund, or direct payments and reimbursements. The level of involvement the employer wants to play in the grant-making process will influence which structure is most desirable.

Private Foundations

- Typically have one major source of funding, such as the employer and/or an employer's key executives or investors.
- Often make grants to other charitable organizations and individuals, rather than dedicating funds to the direct operation of a charitable program.
- Qualified disaster relief payments are entitled to a presumption that such payments are consistent with the foundation's charitable purpose if IRS criteria are met.
- Employer contributions are deductible as charitable contributions subject to applicable limitations.
- Must benefit a charitable class of sufficient size and indefiniteness.

Donor Advised Funds (DAFs) with a Community Foundation

- Separate funds or accounts maintained by community foundations and other public charities that receive contributions from individual donors, such as the employer, its executives and/or employees.
- Individual donors often receive advisory privileges over investment or distribution of the donated funds.
- DAFs can make direct grants to employees and their family members who are victims of a qualified disaster or to charities.
- Must benefit a charitable class of sufficient size and indefiniteness.

Direct Payments and Reimbursements

- Direct payments and reimbursements can be made to employees in the event that the assistance won't qualify as Section 139 payments.
- Payments and reimbursements are taxable fringe benefits or compensation, so payments will be taxable income to the employee.
- The employer can deduct the payments as compensation and must pay FICA and Medicare tax on the amounts.

Financial Need Requirement for All Forms of Tax-Favored Assistance

Tax-favored assistance requires a determination of financial need and generally requires substantiation or proof of amounts needed unless the aid is provided in the context of an emergency. Employers can help needy individuals with personal, family, living or funeral expenses, or with repairing or rehabilitating a personal residence and its contents. However, an employer cannot pay lost wages or reimburse costs that are covered by insurance or otherwise. Although an individual may be a victim of a qualified disaster or an emergency hardship, he or she is not automatically financially needy in the eyes of the IRS. The IRS defines as financially needy individuals who lack the monetary resources to secure basic necessities of life, such as food, clothing, housing, transportation, and medical assistance. However, an individual does not need to be totally destitute to be financially needy.

Individualized Assessment

- IRS guidance requires an individualized assessment of need for each applicant.
- The decision of whether to award aid must be based on an objective evaluation of the individual's needs at the time the grant would be made.
- The scope of the individualized needs-assessment may vary depending on the circumstances, including the amount of time that has elapsed after the disaster.

Demonstration and Substantiation of Need

- In the context of requesting assistance with unexpected hardships, the individual is typically required to demonstrate his or her financial need on a formal application for aid subject to review by a committee.
- The application may ask the individual for recent paystubs, all current sources of income and/or an itemized list of household expenses.

Special Rule for Qualified Disasters

- The IRS recognizes that a needs-assessment for individuals in qualified disaster situations may vary based on the circumstances.
- Therefore, individuals requesting “short-term” aid in the wake of a disaster are not required to prove financial need to the same extent as individuals experiencing emergency hardships or those requesting long-term disaster-related aid.
- While the IRS has not precisely defined “short-term” aid, its examples in Publication 3833 suggest that charitable assistance lasting longer than three months constitutes long-term aid and would require a demonstration of need prior to awarding aid.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Resource Page](#). We have also convened a dedicated Coronavirus Response Team, with attorneys on hand to field questions concerning labor and employment matters, commercial contracts, litigation risks, as well as business succession, continuity and crisis response planning.

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