TaxViews
A tax periodical for the private club community

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Social Clubs and the Coronavirus Pandemic – II
Qualified Disaster Payments under IRC Section 139

In our March 2020 TaxViews, *Social Clubs and the Coronavirus Pandemic*, we discussed Qualified Disaster Payments pursuant to Internal Revenue Code ("IRC") Section 139.

The coronavirus pandemic was designated as a disaster on March 13, 2020 which permits tax-free direct financial assistance by social club employers to employees as "Qualified Disaster Payments." Qualified Disaster Payments include payments by an employer, not otherwise reimbursed by insurance, to its employees, which are reasonably expected by the employer to reimburse, or pay, reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster, as further discussed in our March 2020 TaxViews.

The assistance provided will not be treated as income/wages to the employees, and the employer will be able to deduct those payments as ordinary and necessary business expenses. Wage replacement, including paid sick leave, is not covered by IRC Section 139 and would be taxable to the employee.

In our previous communication, we noted that the published guidance has been employer-employee centric.

Independent Contractors

Subsequent to our March 2020 TaxViews, we received inquiries regarding whether IRC Section 139 qualified disaster relief payments could be made to independent contractors who had previously provided services to a club, on a non-employee basis, who are in need because of the coronavirus pandemic. The question of whether a qualified disaster relief payment could be made to an independent contractor by an employee assistance fund established by an employer pursuant to IRC Section 139 is a challenging inquiry. The first obvious issue is that an independent contractor is not an employee of an employer.

Consistent with our prior research, the published guidance has been employer-employee centric. However, we identified the following in the Joint Committee Summary of P.L. 107-134 (Victims of Terrorism Tax Relief Act of 2001), Congress (United States):

Joint Committee Summary of P.L. 107-134 – Taxation of Disaster Relief Payments

As under the present law, the exclusion [from taxable income] 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.

Qualified disaster relief payments do not include payments for any expenses compensated for by insurance or otherwise. No change from present law is intended as to the deductibility of qualified disaster relief payments, made by an employer **or otherwise**, merely because the payments are excludable by the recipients. Thus, it is intended that payments excludable from income under the provision are deductible to the same extent they would be if they were includable in income. In addition, in light of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.

Particular payments may come within more than one category of qualified disaster relief payments; the categories are not intended to be mutually exclusive. Qualified disaster relief payments also are excludable for purposes of self-employment taxes and employment taxes. Thus, no withholding applies to qualified disaster relief payments.

Closing

We have not found anything on point addressing the payment of a qualified disaster relief payment to an independent contractor by an "employer." Yet, we note that IRC Section 139 is not limited to a certain type of payor (such as an employer), and the references in

1. IRC Section 139(d) to "earnings from self-employment," and
2. the *Joint Committee Summary of P.L. 107-134 – Taxation of Disaster Relief Payments* to qualified disaster relief payments not being subject to self-employment taxes,

anticipate the possibility that an independent contractor may receive a qualified disaster relief payment. In addition, *Internal Revenue Service Publication 3833* states that payments meeting the IRC Section 139 requirements are qualified relief payments "regardless of the source."

Admittedly, the law does not appear to be perfectly clear on qualified disaster relief payments made by a club to others, but the language in the Joint Committee Report may provide a reasonable basis for a qualified disaster relief payment to be made to an independent contractor under the federal tax law.

A club would need a business justification for paying an independent contractor in order to deduct the payment as a business expense. If worker classification is an issue (is the independent contractor really a contractor and not an employee), the payment of qualifying disaster relief payments to independent contractors, along with employees, may be an additional factor weighing in favor of classifying the relationship as an employer-employee relationship, or it may be an act of compassion during the coronavirus pandemic. With respect to worker/independent classification, we refer our clients to their legal counsel with respect to Department of Labor rules and regulations.

Stay healthy, stay strong.

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