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Government Agencies Grant Employee-Benefits Relief for Harvey Victims

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September 06, 2017

In response to Hurricane Harvey and the catastrophic flooding in Texas, the IRS and U.S. Department of Labor have announced relief for those individuals and businesses in the affected disaster areas. The "covered disaster area" currently includes the following counties: Aransas, Bee, Brazoria, Calhoun, Chambers, Colorado, Fayette, Fort Bend, Galveston, Goliad, Hardin, Harris, Jackson, Jasper, Jefferson, Kleberg, Liberty, Matagorda, Montgomery, Newton, Nueces, Orange, Refugio, Sabine, San Jacinto, San Patricio, Victoria, Waller and Wharton. For a complete list of eligible counties, visit https://www.fema.gov/disasters.

Below is a summary of some of the employee benefits provided by the relief:

Form 5500 Deadlines Extended

"Affected Taxpayers" are provided an extension until January 31, 2018 for filing Forms 5500 which were due on or after August 23, 2017, and before January 31, 2018. The "Affected Taxpayers" who are eligible for this extension are businesses whose principal place of business is located in the "covered disaster area" described above. Taxpayers not in the covered disaster area, but whose necessary records are in the covered disaster area, are also entitled to relief.

Hardship and Loan Rules for Retirement Plans Relaxed

Harvey-impacted participants in 401(k) plans, 403(b) tax-sheltered annuities and 457(b) deferred-compensation plans may be eligible to take advantage of streamlined loan procedures and liberalized hardship distribution rules. Plans will be allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter. If a plan requires certain documentation before a distribution is made, the plan can relax this requirement as described in IRS Announcement 2017-11. Further, the six-month ban on 401(k) and 403(b) contributions, which normally affects employees who take hardship distributions, will not apply.

To qualify for this relief, hardship withdrawals must be made by January 31, 2018. However, the tax treatment of loans and distributions remains unchanged. Ordinarily, retirement plan loan proceeds are tax-free if they are repaid over a period of five years or less. Under current law, hardship distributions are generally taxable and subject to a ten percent early-withdrawal tax if the participant is under age 59 and one-half.

This relief is available to plan participants who (i) live or work in the "covered disaster area" or (ii) have a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

Leave Sharing

Many employees and employers have inquired about whether it is possible for employees to donate leave to those affected by Harvey as a charitable contribution or to share such leave with fellow employees. Before implementing these well-intentioned programs, employers would be wise to tread cautiously. As unlikely as it may sound, other than in certain circumstances described below, donating vacation or sick leave (together, paid time off or PTO) generally results in a taxable event for the donating employee. Under the assignment-of-income doctrine, the donating employee is generally required to recognize compensation income equal to the value of the donated PTO.

In certain approved programs, the IRS has waived the assignment-of-income doctrine rules. These programs include: (i) a leave donation program to a charitable organization for disaster relief, and (ii) a leave sharing program benefitting employees experiencing a "medical emergency" or who are affected by a "major disaster."

In Notice 2017-48, the IRS announced that the Hurricane Harvey disaster area will be eligible for the leave donation programs. Pursuant to this Notice, employers may establish a leave donation program to assist Harvey victims. Under a leave donation program, employees voluntarily surrender unused PTO and the employer contributes the value of the surrendered PTO to a "charitable organization" for the relief of victims of Hurricane Harvey. For these purposes, a "charitable organization" is one described in Internal Revenue Code Section 170 which includes corporations, trusts, community chests, funds or foundations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes.

In addition to the leave donation program, the IRS has approved two types of leave-sharing programs that allow employees to donate leave pre-tax. The two types of approved leave-sharing programs are for medical emergencies and major disasters. Each is discussed in more detail below.

1. Leave-Sharing Program for Medical Emergencies

An employer-sponsored leave-sharing program may permit an employee to donate excess paid leave to another in the event of a medical emergency. A medical emergency is defined as "a medical condition of the employee or a family member that will require the prolonged absence of the employee from duty and will result in a substantial loss of income to the employee because the employee will have exhausted all paid leave available apart from the leave-sharing plan." An employee who has exhausted his/her PTO may seek to draw from the leave bank if the employee needs more paid leave in the event the employee has a medical emergency, needs to tend to a parent, spouse or child who has experienced a medical emergency, or needs additional time off for bereavement in the event of the death of a parent, spouse or child.

2. Leave-Sharing Program for Major Disasters

The IRS has approved a tax-favored leave-sharing program to allow pre-tax leave sharing for those employees who experience a "major disaster" as declared by the President that warrants individual assistance or individual and public assistance from the federal government under that Act. The President has classified Hurricane Harvey as a major disaster. An employer-sponsored leave-sharing program for major disasters must comport with the following requirements:

The plan must allow a leave donor to deposit unused accrued leave in an employer-sponsored leave bank for the benefit of other employees who have been adversely affected by a major disaster. An employee is considered adversely affected if the disaster has caused severe hardship to the employee or family member that requires the employee to be absent from work.

- The plan may not allow a donor to specify a particular recipient of the donated leave.
- The amount of leave donated in a year may not exceed the maximum amount of leave that an employee normally accrues during that year.
- A leave recipient may receive paid leave from the leave bank at the recipient's normal compensation rate.
- The plan must provide a reasonable limit on the period of time after the disaster has occurred, during which leave may be donated and received from the leave bank, based on the severity of the disaster.
- A recipient may not receive cash in lieu of using the paid leave received.
- The employer must make a reasonable determination of the amount of leave a recipient may receive.

- Leave deposited on account of a particular disaster may be used only by those employees affected by that disaster. In addition, any donated leave that has not been used by recipients by the end of the specified time must be returned to the donor.

If you would like to discuss any of the relief issues discussed above, please contact Andrea Bailey Powers or any of the members of Baker Donelson's Tax Group.