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Employee Benefit Strategies to Aid Workers During 2025 California Wildfires

Article By:

Lucas Peterhans

Samuel C. Nolan

Tzvia Feiertag

The wildfires moving through Southern California have destroyed communities and displaced countless individuals.

While the nation's first responders are tirelessly working to contain and neutralize the devastation, many employers are grappling with how best to provide support for their affected employees.

Disaster Assistance to Employees

Employers may consider offering the following disaster assistance directly to employees:

- **Qualified Disaster Relief Payments:** Under Section 139 of the Internal Revenue Code of 1986, as amended (the "Code"), employers operating in states such as California, receiving FEMA assistance can make tax-free qualified disaster relief payments directly to impacted employees. The payments can be made for reasonable and necessary personal, family, or living expenses as a result of a qualified disaster. Funeral expenses as a result of a qualified disaster will also qualify under these payments. However, employers should be aware that these payments do not cover income replacement payments or expenses reimbursed through insurance of FEMA grants.
- **Charitable Emergency Funds:** Employers may provide tax-free emergency funds to employees through related 501(c)(3) charities and foundations. The specific rules and requirements for these 501(c)(3) entities, including whether and to what extent contributions are deductible, differ depending on whether the entity is an employer-sponsored public charity, an employer-sponsored private foundation, an employer-sponsored donor advised fund, or an unrelated public charity.

Distributions from 401(k) Plans and 403(b) Plans

Depending on the terms of an employer's plan, which may be amended subject to coordination with the plan’s recordkeeper, impacted participants may be eligible to withdraw funds from their retirement plans to assist with the wildfire-related expenses.

- **Hardship Distributions:** Participants may be able to take in-service distributions from their 401(k) or 403(b) plan to cover certain hardships that create an immediate financial need that cannot be met from other assets reasonably available. This could include expenses and losses related to the wildfires if the participant either worked or lived in the wildfires’ designated disaster areas and repairs to the participant’s residence or the costs involved with purchasing a new residence. A hardship distribution is typically subject to income tax plus an additional 10% early withdrawal penalty if the impacted participant is under age 59 ½.
- **Qualified Disaster Recovery Distributions**: Under the SECURE 2.0 Act, participants may take in-service Qualified Disaster Recovery Distributions from their 401(k) or 403(b) plan account in an amount up to $22,000. To qualify for this distribution, a participant’s principal residence must be in a qualified disaster area, and the participant must have sustained an economic loss due to the disaster. These distributions are not subject to the 10% early withdrawal penalty, which distinguishes them from the Hardship Distributions discussed directly above. These distributions must be requested within 180 days of the disaster’s declaration. For the Southern California wildfires, which were declared emergencies in early January, participants will have until early July to request a Qualified Disaster Recovery Distribution.

In order to offer Qualified Disaster Recovery Distributions as a distribution option from a 401(k) plan or 403(b) plan, employers must adopt provisions for their plans specifically permitting these types of distributions. However, if an employer does not do so, affected participants may still be able to take another type of distribution (e.g., a hardship distribution or other in-service distribution) and treat it as a Qualified Disaster Recovery Distribution by using Form 89150F to report the distribution. This would allow participants to avoid the 10% early withdrawal penalty for up to the $22,000 limit. Employers who are not able to adopt the Qualified Disaster Recovery Distribution option in a timely manner may wish to communicate this alternative option to employees.

- **Emergency Personal Expense Withdrawals:** Participants may also make emergency withdrawals from their 401(k) or 403(b) plan account to cover unforeseeable or immediate financial needs required for personal or family expenses. These distributions are limited to the lesser of $1,000 or the participant’s vested balance minus $1,000 and may only be taken once per calendar year. These distributions are exempt from the 10% early withdrawal penalty, but are generally subject to income tax in the year of distribution.
- **Plan Loans:** Participants may be able to take loans from their 401(k) or 403(b) plan. The maximum loan is the lesser of $50,000 or 50% of the participant’s vested account balance, reduced by any outstanding loans the participant may have. The SECURE 2.0 Act’s disaster relief sections provide that participants residing in a qualified disaster area may have this loan limit increased to the lesser of $100,000 or 100% of their vested balance, reduced by any outstanding loans the participants may have. Affected participants may also be granted an additional year to repay their loans. As with the Qualified Disaster Recovery Distributions, these expanded plan loan options are only permitted if the terms of the plan specifically allow for them, meaning that employers may need to adopt an amendment to offer these options.

Deadlines and Other Relief

In response to previous disasters, the Department of Labor and other federal agencies have released guidance extending certain deadlines (e.g., COBRA continuation coverage election) to aid those most severely impacted. The extensions can also apply to businesses operating in the affected areas (e.g., Form 5500 filings). On January 10, 2025, the Internal Revenue Service issued a press release, "IRS: California wildfire victims qualify for tax relief; various deadlines postponed to Oct. 15," extending various deadlines for individuals and businesses impacted in Southern California. The press release notably extends the deadline for 2024 contributions to IRAs and health savings accounts to October 15, 2025 for eligible taxpayers. Employers should work with their counsel to monitor for similar extensions and may consider voluntarily extending deadlines (subject to insurer/stop loss carrier approval) for directly impacted employees.

Next Steps

Employers should work with counsel when offering any qualified disaster relief payments or charitable emergency funds to ensure that requirements are met for such payments to remain tax-free.

Employers should also review their current retirement plans to see what options for employee relief are available, amending plans as necessary. Employers should also coordinate with their retirement plan recordkeepers to implement any distribution options and ensure that participants are notified of the options available to them.

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