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Employer Considerations For Leave Donation Programs

Insight — 06/02/2022

Law360 – Expert Analysis

This article originally appeared in Law360 on June 2, 2022 and is reprinted with permission.

We are now several months into the "Great Return" — with employers declaring that employees must return to the workplace. To incentivize office engagement, employers are replacing COVID-19 testing, vaccination and mask mandates with everything from free lunches and in-house coffee bars to remodeled physical floor plans and conference room chair massages.

While burrito bars and mini spa appointments are welcome additions in the workplace, the pandemic has shifted how employers view and manage a more robust employee benefit program to better support their workforce.

Offering creative perks to ease the transition back might be a great short-term post-pandemic office strategy; however, employers must also critically examine their benefit strategies and resource offerings.

With the "Great Resignation," "Great Reshuffling" and the ensuing talent wars,[1] employers are intently focused on workers' needs, and are doubling down on efforts to increase retention, decrease absenteeism and support workers who have had to manage complex family matters that were unheard of just a little over two years ago.

Employers' Support During COVID-19

Back in March 2020, as we scrambled to digest the Families First Coronavirus Response Act — the coronavirus relief bill with paid-leave mandates — many employers considered adding flexible work and remote benefit options for their workforce.

As work-from-home arrangements became the norm, we saw employers offering remote assistance for benefits large and small, ranging from telemedicine to webinars on mental health topics, virtual yoga and meditation apps.

When employers began adding emergency leave options for employees who were unable to work because of COVID-19, they also considered whether employees could access and cash out accumulated sick vacation and personal leave time — paid time off, or PTO — if they needed to supplement their income on account of reduced work schedules or due to financial needs related to COVID-19.

Permitting employees' discretion to cash out an accrued PTO bank as a source of funds would normally convert that PTO bank immediately to taxable income under the principles of constructive receipt. This tax concept provides that an employee is constructively in receipt of income — and therefore, the income is currently taxable — as soon as the right to receive the cash becomes fixed.

For example, if an employee had the right to convert his or her PTO bank to cash, the constructive receipt rules would require the employee to take into current income the value of the PTO bank, regardless of whether the employee actually chooses to convert the bank to cash.

Because of these rules, an employer typically may only permit employees the right to convert PTO to cash for paid time off that has not yet accrued, e.g., PTO earned in a subsequent calendar year.

By making an election to cash out PTO before it is earned, the employee avoids the constructive receipt tax issue.

To help support employees during the height of the pandemic, employers considered offering employees a one-time window to make an accrued PTO bank accessible for cash out.

Given the unprecedented circumstances, practitioners had hoped the IRS would back away from the constructive receipt rule, and permit employees a one-time cash-out window in which they could convert all, or some portion of, a PTO bank to cash.

Unfortunately, the IRS did not budge on the constructive receipt rules applicable to PTO cash-outs, forcing employers to devise other creative solutions for accrued PTO banks.

What Are Leave Donation Programs?

Employers came up with alternative options, including implementation of a leave-donation program.[2] While not a new concept, PTO donation became more popular because of COVID-19, and continues to be attractive as an employer-sponsored program.

Leave donation allows employees to donate accrued PTO to a general leave bank, which can then be used by fellow employees who have exhausted all paid leave available to them.

PTO donation arrangements are employee-friendly programs that benefit both the sponsoring employer by getting accrued PTO off their books — a nice alternative to a "use it or lose it" rule, which requires employees to forfeit any unused accrued vacation — while creating an opportunity for employees to help their fellow employees.

Leave donation programs are simple in concept; however, many employers miss some of the program nuances that allow leave to be donated without negative tax consequences to the donating employee.

Generally, any leave donated by one employee to another would result in taxable income to both parties. The IRS allows two exceptions: leave used for either (1) a medical emergency or (2) by an employee affected by a major disaster. Both of these are terms defined in IRS guidance.

If leave is donated in either situation, there is no adverse tax consequence to the donor. However, the recipient employee will always be taxed on the leave received.

State Law Considerations

While federal law allows employees to donate either sick leave or vacation pay to be used as paid time off, state laws applicable to sick leave are complicated and vary nationally.

For example, in California, paid sick leave is a statutory benefit under the Healthy Workplaces, Healthy Families Act. This law applies to employees who work in California for 30 or more days in a year for the same employer, and who have satisfied a 90-day waiting period.

Because California's Healthy Families Act is intended to ensure that employees have sufficient sick time during the year to take paid leave for themselves or their family members, employers in California should be very careful to permit only the donation of sick leave accumulated in excess of mandated sick leave time.

California employers may also consider capping the number of hours of sick leave donation, ensuring that employees retain time off in the event an unexpected circumstance arises.

Additionally, some states, such as Idaho and Utah, consider both vacation leave and sick leave a creature of contract between the employee and employer. In those states, it likely would be permissible for an employee to voluntarily donate sick leave, subject to written direction and consent by the employee.

But even if state law permits donating sick time, there may be municipalities within a state with different rules. It is important for employers to conduct a sick leave survey in the applicable states and jurisdictions before deciding to implement a sick leave donation program.

Alternatively, to avoid entanglements with state sick leave rules, employers may consider permitting employees to only donate vacation time.

Keep in mind, however, that there are other states, such as Montana and Nebraska, that view vacation as wages that cannot be forfeited. An employer in one of these states will want to carefully document in writing that the employee has voluntarily agreed to the donation after full disclosure of the implications of the donation.

Do's and Don'ts for Employers

Employers interested in permitting leave donation should adopt a formal arrangement that complies with the IRS' specific requirements applicable to such programs.

The adopting employer should obtain written consent and authorization from employees interested in donating PTO, and the leave donation program should be structured in a manner that could not be construed as discriminatory.

The employer should never permit a leave recipient the ability to convert leave received under the arrangement to cash.

Finally, the leave program should address what happens when an employee contributes leave at one pay level, and the recipient uses the donated leave at a different pay level.

While leave donation programs are very well intended, they are complex, with many design issues to consider before a policy is formally adopted.

An employee who benefits from a leave donation program will surely remember the employer — and the fellow donor — well, but an employer establishing such an arrangement should take the time to protect the interests of all involved.

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[1] Record numbers of workers are leaving their jobs (the "Great Resignation") and more than half the workers who left their jobs are switching their field of work, rather than leaving the workforce altogether (the "Great Reshuffling"). This reshuffling is turning into a war for talent, with workers in the driver's seat, and able to demand higher salaries, sign-on bonuses and increased job flexibility. See Meister, J. (2022). The Great Resignation Becomes The Great ReShuffle: What Employers Can Do To Retain Workers. www.forbes.com. See also Christian, A. (2021). How the Great Resignation is turning into the Great Reshuffle: While the Great Resignation implies people are leaving the workforce, a large swath of workers are simply reconfiguring what their careers look like. www.bbc.com.

[2] Two examples of large employers who recently announced their leave donation policies include University of Alabama and MD Anderson Cancer Center.