

SEPTEMBER 2007

An Analysis of Recent Developments & Trends

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An Employer's Guide to Employee Leave-Sharing Programs

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Summary: An employer-sponsored leave-sharing program allows an employee to donate accrued hours of paid vacation, or personal and potentially sick leave for the benefit of other employees who are in need of taking more paid leave than is available. This Insight provides a brief employer's guide to establishing and running a leave-sharing program, including establishing and maintaining such a plan in conformity with IRS requirements and various financial and administrative considerations for the employer, the donor and the donee employees.

A popular, and altruistic, employee benefit some employers provide is a leave-sharing program. An employer-sponsored leave-sharing program allows an employee to donate accrued hours of paid vacation, or personal and potentially sick leave for the benefit of other employees who are in need of taking more leave than they have available.

Of course, as with any employer-provided benefit, there are specific requirements and tax consequences associated with a leave-sharing program. There has been very little guidance issued by the IRS on the design of such plans, but experience has shown there are a host of design considerations. This Insight provides a brief employer's guide to establishing and running a leave-sharing program.

Typical Leaving-Sharing Programs

In a typical leave-sharing plan, an employee who has accrued more paid leave than she expects or wishes to take may choose to donate hours of paid leave to an employer-managed "leave bank." Under certain conditions, other employees who need to take more time than they have accrued may seek employer approval to draw from the leave bank.

What leave can be donated may vary from state to state. For example, different states have different rules regarding an employee's right to different kinds of leave, whether accrued, earned or unearned, or whether vacation pay, sick pay or generic "paid time off." Thus, what may be donated to a leave-sharing plan may also vary from state to state. To the extent an employer only provides sick leave to benefit employees who are sick and does not provide

for cashing out of sick leave upon termination, an employer will probably want to limit donations from available sick time to avoid claims that "unvested" sick leave is effectively vested.

Generally, the employee seeking to draw from the leave bank must provide the employer with a written application describing the need for such leave. Once the employer approves the application, the employee is eligible to receive additional leave, usually paid at his normal compensation rate, once his own accrued leave has been exhausted. In an IRS-eligible leave-sharing plan, special tax treatment applies to leave donors, recipients, and the employer.

There are two broad categories of approved leave sharing that have been approved for special tax treatment by the IRS: medical emergencies and major disasters. Each is discussed in more detail below.

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."¹ An employee who has exhausted his leave may seek to draw from the leave bank if the employee needs more paid leave in the event that he experiences a medical emergency, needs to tend to a parent, spouse, or child who has experienced a medical emergency, or needs

¹ Rev. Rul. 90-29, 1990-1 C.B. 11.

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additional time off for bereavement in the event of the death of a parent, spouse, or child.

Leave-Sharing Program for Major Disasters

An employee may also draw from an employee-sponsored leave bank in the event that the employee experiences a major disaster. A major disaster is defined as: “(a) a major disaster as declared by the President under § 401 of the Stafford Act, 42 U.S.C., section 5170, that warrants individual assistance or individual and public assistance from the federal government under that Act, or (b) a major disaster or emergency as declared by the President pursuant to 5 U.S.C., section 6391, in the case of employees described in that statute.”² The Stafford Act provides that the determination of whether an event shall be declared a major disaster shall be based “on a finding that the disaster is of such severity and magnitude that effective response is beyond the capabilities of the State and the affected local governments and that Federal assistance is necessary.”³

Section 6391 of Title 5 of the United States Code provides that the President, upon declaration of a major disaster or emergency, may direct the Office of Personnel Management to establish a leave-sharing program for employees of federal agencies.

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 does not allow a donor to specify a particular recipient of her 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 by only 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 within a reasonable time so that the donor may use the leave, except in the event the amount is so small as to make accounting for it unreasonable or impractical. The amount of leave returned must be in the same proportion as the leave donated.⁴

The IRS does not allow special tax treatment for major disaster leave-sharing plans that do not comply with the above requirements. For example, the IRS rejected special tax treatment for an employer-sponsored

leave-sharing program that allowed employees to draw from its leave bank in the event of a “catastrophic casualty loss.”⁵

Under the program rejected by the IRS, employees were allowed to donate hours of paid leave for the benefit of an employee who experienced severe damage to or destruction of his primary residence that requires immediate action by the employee to secure the residence or to those who were affected by a terrorist attack, natural disaster, or public health crisis that affects a considerable amount of employees. The IRS determined that a “catastrophic casualty loss” was too broad to be permitted as an eligible medical emergency plan since the plan may or may not involve a personal or family medical emergency. The IRS also found that the plan was outside the scope of an eligible major disaster leave-sharing plan because the plan was not “designed to be limited specifically to aid the victims of a ‘major disaster’ as declared by the President of the United States.”⁶

Employee Benefits of Participating in an Eligible Leave-Sharing Program

There are several reasons why an employee would choose to donate. Most importantly, the ability to donate accrued paid hours of leave allows an employee to help coworkers recover from family or personal medical emergencies in a manner that does not require a cash distribution. An employee who has been affected by a personal or family medical emergency or major disaster may not have enough accrued time to tend to the emergency. The ability to draw from a bank of paid leave donated by other employees gives a little extra time that otherwise would have to be taken unpaid, which would add to the already high burden of recovery.

² Notice 2006-59 (2006-28 IRB 60).

³ 5 U.S.C. § 5170.

⁴ Notice 2006-59 (2006-28 IRB 60).

⁵ Priv. Ltr. Rul. 200720017 (Feb. 9, 2007).

⁶ *Id.*

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In addition, donated hours of paid leave pursuant to an eligible medical emergency or major disaster leave-sharing program are not included in the donating employee's income for tax purposes. Thus, for employees in states that allow companies to have "use-it-or-lose-it" policies, employees that might have unused leave that would be lost can instead donate it without any adverse tax consequences. However, employees are also not entitled to claim charitable contributions for income tax purposes for making such donations. Also any wage-based benefits such as disability, retirement or life insurance may be affected negatively for donor and positively for recipient employee.

In contrast to the donor employee, the employee who receives paid leave pursuant to an eligible plan realizes the amounts received in his gross income and the amounts of paid leave received are considered "wages" for employment tax purposes.

Therefore, it is important for employees to know whether their employer's leave-sharing program meets the eligibility requirements explained by the IRS. In cases where a leave-sharing program does not qualify, the donor employee will be subject to payroll taxes on the leave as if he were using the leave himself. IRS eligible leaving-sharing programs avoid that unjust result.

Employer Considerations for Leave-Sharing Programs

While a leave-sharing program may be beneficial for employees, employers should carefully consider implementing such programs. Employers should be aware that such programs have the potential to generate a variety of issues, including administrative complexity, potential cash flow implications, privacy issues and discrimination claims from disgruntled employees. For example, leave programs can create situations where claims of discrimination arise because some employees were granted leave from the bank while others were not. Thus, it is important

to recognize this possibility and have stated neutral criteria in place to make sure all applications for leave are treated equally.

Also, most companies plan for and expect that a certain amount of vacation pay, sick pay or PTO will be used in any particular year. A major disaster, or even several medical emergencies, can cause a large spike in the amount of claimed benefits beyond those anticipated by the employer as employees donate leave that might have gone unused by historical standards during the calendar year. This can have an unplanned for financial impact upon the employer as the accrued but unused benefits are funneled through certain high-need employees. Further, in states that allow use it or lose it policies, benefits that the company may not otherwise have paid may end up as a liability to the company.

In addition, anecdotally at least, lower paid employees are more likely to donate time while higher paid employees are more likely to draw benefits, so paying benefits at recipient employee's regular wage could increase the cost of the benefit over what it would have cost had the employee whose time it was had actually taken it. There are also certain administrative costs associated with any program or benefit offered by an employer, and Human Resources will need to be involved in administering the program.

Employers can mitigate some of the impact of these potential issues by capping donations. Employers may also want to consider whether there may be alternative options, such as establishing a short-term disability program.

Of course, for the reasons stated above regarding why employees benefit from leave-sharing programs, an employer may want to implement a leave-sharing program as a benefit for employee morale purposes. Nevertheless, employers should carefully consider all implications before implementing such a plan.

Tips for Developing an Eligible Leave-Sharing Plan

The following is a checklist of items an employer should consider when establishing and maintaining a leave-sharing program:

Drafting a Leave-Sharing Plan

- The employer should have a written policy that outlines all aspects of the leave-sharing program as well as the application process. A form is recommended for the application process so that all applicants are required to supply the same information.
- A leave-sharing program should not be created on an ad hoc basis only when an individual has a medical emergency or when a natural disaster occurs. The IRS's limited guidance suggests that medical programs should not be for the benefit of a single employee. This helps avoid accusations of discrimination by creating and maintaining an independent policy.
- The situations when an employee may donate accrued paid leave should be limited to situations in which other employees have experienced a personal or family medical emergency or a major disaster in accordance with IRS guidance.

Considerations for Donees of Leave Under a Leaving-Sharing Plan

- Receipt of paid leave should only be allowed when the requesting employee has exhausted all of his own accrued paid leave.
- The employer should require a written application form that includes the specific reasons why the donee employee is requesting additional paid leave from the leave bank.
- Employers should ensure that donee employees' privacy is respected. For example, the employer cannot state:

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“Jane Smith has breast cancer and has used up all of her paid leave. She needs to borrow from the leave bank because she is taking intermittent leave as a reasonable accommodation.”

Considerations for Donors of Leave Under a Leave-Sharing Program

- The donor employee should not be allowed to designate a specific individual for whom the donated leave shall benefit.
- The donor employee should donate no more leave than that normally accrued during the year.
- Reasonable limits should be placed on the amount of hours of paid leave an employee may donate so that an employee has some amount of leave available for his or her own use.
- Reasonable limits should be placed on the amount of hours of paid leave an employee may receive and on the amount of time between when an employee can receive donated hours of paid leave and when the medical emergency or major disaster was experienced.
- In the event donated leave has not been used within a reasonable time set by the employer, the program can provide for the hours of paid leave to be returned to the donor employee.
- Employers should ensure that donor employees' privacy is respected.
- Employers should consider the impact that donated leave may have on other wage-based benefits such as life and disability insurance. In other words, employer (and donee employees) should consider whether receipt of donated leave would raise the employee's wages used to calculate other wage based benefits.
- Employers should consider the costs and staff time necessary to implement the leave-sharing program and how multiple applications will be processed.
- While leave is donated by the employee, employer is actually paying the leave so it should consider the impact of leave-sharing programs upon operations.
- If employers have concerns or questions about whether their program qualifies for special tax treatment under the IRS guidelines, they should contact counsel.

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Financial Considerations When Offering a Leave-Sharing Program

- When receiving paid leave, the leave must be paid at the recipient's normal compensation rate.
- A recipient may not receive a cash payout in lieu of paid time off. In such a case the donor and donee will both be treated as having received taxable wages.