

HR COMPLIANCE OVERVIEW

Employee Leave-sharing Programs and the Coronavirus

Employers seeking ways to help their employees during the coronavirus (COVID-19) pandemic may want to consider implementing a **leave-sharing program**. These programs allow employees to donate some of their accrued paid leave time, such as paid time off (PTO), vacation or sick leave, for the benefit of other employees who need additional paid leave. During the COVID-19 crisis, many employees may exhaust the leave available to them through illness, quarantine or isolation, or caregiving responsibilities.

Although the IRS has approved leave sharing in the context of medical emergencies and major disasters, it has not issued guidance on leave-sharing programs specifically for COVID-19, despite major disaster declarations for all 50 states due to the pandemic.

While these programs can be beneficial to both employers and employees, they need to be carefully structured in order to avoid negative tax consequences for the employees who donate their unused paid leave.

LINKS AND RESOURCES

- [IRS Notice 2006-59](#) (leave sharing for major disasters)
- [IRS private letter ruling](#) (opinion on a leave-sharing program not limited to helping employees adversely affected by a major disaster)

Highlights

- ✓ Employers may establish paid leave-sharing programs to allow employees to help those in need.
- ✓ Leave sharing allows employees to donate their paid leave to other employees.
- ✓ Leave-sharing programs can provide employees affected by the COVID-19 pandemic with critical needed leave.

Tax Issues

- Unless the program meets IRS guidelines, the donated leave will be taxable to the donor employees.
- The IRS has approved leave sharing for medical emergencies and major disasters.
- The IRS has not provided guidance for leave sharing during the COVID-19 pandemic.

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Leave-sharing Programs

Employer-sponsored leave-sharing programs provide employees with the opportunity to donate their accrued PTO, vacation or sick leave for the benefit of other employees who need additional paid leave time. Typically, an employer establishes a leave-sharing “bank” to track the donated employee leave. Employers should determine in advance what criteria must be met in order for an employee to use the donated leave. Employers should also require employees to submit an application to use the donated leave and implement a process for determining whether an employee’s application satisfies the program’s criteria.

Leave-sharing programs can be advantageous to both employees and employers by enhancing employee morale and camaraderie in the workplace while also reducing employee turnover and productivity losses. However, these programs must be carefully structured in order to avoid negative tax consequences for the employees who donate their accrued leave.

General Tax Rule: As a general rule, donating leave under an employer-sponsored leave-sharing program is treated as an assignment of income that is **taxable to the employee who is donating the leave** (that is, included in the donor employee’s wages on his or her Form W-2) and is subject to income tax and employment tax (that is, FICA and FUTA) withholding.

The IRS recognizes two types of leave-sharing programs where employees can donate their unused paid leave without incurring negative tax consequences—programs for **medical emergencies** and **natural disasters**. Under these programs, employees are not taxed on the leave that they donate to be used by their fellow employees. Rather, the donated leave is taxable to the employee who receives the leave. The donor employees may not claim a tax deduction or charitable contribution for any of the leave that they donate under one of these programs.

Leaving-sharing for Medical Emergencies

The IRS said in Revenue Ruling 90-29 that a leave-sharing program allowing donated leave to be used only for medical emergencies results in taxation to the leave recipients, and not to the leave donors. The leave-sharing arrangement that the IRS reviewed in the case involved these main components:

- ☑ Employees requesting the additional leave were required to submit a written application describing the medical emergency to the employer.
- ☑ After the application was approved and the employee exhausted all of his or her paid leave, the employee was eligible to receive paid leave (at his or her normal rate of compensation) donated by other employees.
- ☑ The arrangement restricted the amount of leave that could be donated and contained rules about how the leave would be granted to leave recipients.

“Medical Emergency” Definition

Under the program considered by the IRS, a “medical emergency” was defined as a medical condition of the employee (or family member of the employee) that would require the prolonged absence of the employee from duty and would result in a substantial loss of income to the employee because the employee would have exhausted all paid leave available (apart from leave available under the leave-sharing plan).

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The IRS concluded that amounts that the employer paid to a leave recipient under the program were includible in the **recipient's gross income** for federal tax purposes and also subject to income and employment tax withholdings. The IRS also cautioned that its guidance applied only to bona fide employer-sponsored leave-sharing programs.

Leave Sharing for Major Disasters

As with leave-sharing programs for medical emergencies, the IRS has also indicated, in [Notice 2006-59](#), that a leave-sharing program that allows donated leave to be used only for employees adversely affected by major disasters results in taxation to the leave recipients, and not to the leave donors. A "major disaster" means a major disaster that is declared by the president of the United States. Currently, President Donald Trump has declared a major disaster in all 50 states as a result of the COVID-19 pandemic.

According to the IRS, a major disaster leave-sharing program is a written program that meets all of the following requirements:

1

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

2

The plan does not allow a leave donor to deposit leave for transfer to a specific leave recipient.

3

The amount of leave that may be donated by a leave donor in any year generally does not exceed the maximum amount of leave that an employee normally accrues during the year.

4

A leave recipient may receive paid leave (at his or her normal rate of compensation) from leave deposited in the leave bank. Each leave recipient must use this leave for purposes related to the major disaster.

5

The plan adopts a reasonable limit, based on the severity of the disaster, on the period of time after the major disaster occurs during which a leave donor may deposit the leave in the leave bank, and a leave recipient must use the leave received from the leave bank.

6

A leave recipient may not convert leave received under the plan to cash instead of using the leave. However, a leave recipient may use leave received under the plan to eliminate a negative balance that arose from leave that was advanced to the recipient because of the effects of the major disaster. A leave recipient also may substitute leave received under the plan for leave without pay used because of the major disaster.

7

The employer must make a reasonable determination, based on need, as to how much leave each approved leave recipient may receive under the leave-sharing plan.

8

Leave deposited on account of one major disaster may be used only by employees affected by that major disaster. Except for an amount so small as to make accounting for it unreasonable or administratively impracticable, any leave deposited under a major disaster leave-sharing plan that is not used by leave recipients by the end of the time period described

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above (requirement number 5), must be returned within a reasonable period of time to the leave donors (or, at the employer's option, to those leave donors who are still employed by the employer), so the donor will be able to use the leave. The amount of leave returned to each leave donor must be in the same proportion that the amount of leave donated by the leave donor bears to the total amount of leave donated on account of that major disaster.

Programs that do not meet these specific requirements may cause the donated leave to be taxable to the leave donor (and not the recipient). For example, in a [private letter ruling](#) from 2007, the IRS ruled that an employer's program that allowed leave donations for employees who experience "catastrophic casualty losses" due to a terrorist attack or natural disaster would result in taxable income to the leave donors because the program was not limited to helping employees adversely affected by a major disaster.

Other Design Considerations

In addition to the tax issues associated with employee leave-sharing programs, employers that are considering these types of programs should also take into account the following design issues:

- **State leave laws:** When structuring an employee leave-sharing program, employers should also consider any state or local leave law requirements that may impact the program's design. These laws may affect an employee's right to various types of paid leave (for example, sick leave). Employers should consider consulting with legal counsel on the implications of state and local leave laws.
- **Increased costs:** Employers should consider the possible cost increases associated with employee leave-sharing programs. For example, if an employer has a "use-it-or-lose-it" policy for paid leave, and an employee donates leave that would otherwise have been forfeited under that policy, another employee's use of the leave will add to the employer's costs. There are also cost implications if higher-paid employees use more of the donated leave time (which has been donated by lower-paid employees), and the leave is paid at the recipient employee's pay rate.

To help control costs, employers should consider their options for valuing donated leave, including an approach that values leave at the rate it is donated rather than at the rate it is used. Under this type of approach, for example, if an employee who has an hourly rate of \$30 donates two hours of paid leave, that leave is valued at \$60. It would equal, for example, four hours of paid leave for an employee who makes \$15 per hour, but just one hour of paid leave for an employee who has a rate of \$60 per hour.

- **Donation limits:** Employers often place caps on the amount of unused paid leave that can be donated and the amount of donated leave that an employee may use. These caps can help control costs, while also ensuring that donor employees still have enough paid leave for their own purposes.
- **Discrimination claims:** To help avoid discrimination claims, employers should make sure that a leave-sharing program's eligibility criteria are applied uniformly to all employees in a nondiscriminatory manner.
- **Privacy concerns:** Employers should also make sure that employees' privacy is protected when health or medical issues are involved. Leave-sharing programs are not subject to the privacy rules under the Health Insurance Portability and Accountability Act (HIPAA). However, employers with 15 or more employees are subject to the [confidentiality requirements](#) of the Americans with Disabilities Act (ADA).