How to Create a Leave Donation Program

Leave donation or leave sharing programs allow employees to donate accrued paid time off (PTO), vacation or sick leave to a general pool to be used by fellow employees who experience medical emergencies or who are affected by major disasters and have exhausted all paid leave available to them. Leave donation programs may benefit the employer and enhance employee morale and camaraderie. These employee-friendly programs may also play a role in increasing productivity, reducing absenteeism, and improving recruiting and retention of quality employees.

There is a general tax law concept that the individual who earns paid time off, and has the choice to receive it as income (use the time) or dispose of it (donate it), is still obligated to pay taxes on it. Therefore, any leave earned by one employee and donated to another would be taxable income to both parties. However, the Internal Revenue Service (IRS) allows for two exceptions in which leave can be donated without negative tax consequences to the donor.

Medical emergency exception

A "medical emergency exception" is defined as a "medical condition of the employee or a family member that will require the prolonged/extended absence of the employee from duty and will result in a substantial loss of income to the employee due to the exhaustion of all paid leave available, apart from the leave-sharing plan." *See* Private Ruling Letter (http://www.irs.gov/pub/irs-wd/0720017.pdf), Rev. Rul. 90-29, 1990-1 C.B. 11.

Major disaster exception

A "major disaster exception" is defined as a disaster declared by the president under §401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act) or as a major disaster or emergency declared by the president pursuant to 5 U.S.C. §6391 (http://www.gpo.gov/fdsys/pkg/USCODE-2011-title5/pdf/USCODE-2011-title5-partIII-subpartE-chap63-subchapVI-sec6391.pdf) for federal government agencies. Once the president declares a major disaster as stated above, the IRS allows leave donations to employees affected by the disaster without negative tax consequences to the donor(s). *See* IRS Notice 2006-59 (http://www.irs.gov/irb/2006-28_IRB/ar10.html).

Employers must consider several factors before implementing a leave donation program, as described in the following steps.

Step 1: Decide Which Type of Leave Donation Program to Implement

Medical emergency leave

Employees who have exhausted all their available leave may be able to obtain additional paid time from a pool of donated leave if they experience a medical emergency or if they should need to care for a spouse, child or parent who experiences a medical emergency.

For a plan to be considered what the IRS characterizes as a "bona-fide employer-sponsored (medical) leave-sharing arrangement," the plan should:

1. Be in writing and be administered by the employer.
2. Be created as a leave bank or pool for employees to deposit donated leave, and from which, leave will be distributed to recipients who have a personal or family medical emergency.

3. State that employees should be eligible to receive leave only after their request has been approved and all other available paid leave has been exhausted.
4. Specify that leave is to be used only for medical emergencies. The plan should restrict these medical emergencies to major illnesses or medical conditions of employees or their family members that require extended absences. Under IRS regulations, employer plans may also include extended time off following the loss of a spouse, child or parent.
5. Outline and specify limits on the amount of leave that may be donated by an individual in any given year.
6. Have a detailed procedure in place for employees to submit a written request for leave that describes the specific medical emergency or medical condition.
7. Have processes in place to confirm that all leave transferred under the plan is actually being used for medical leave by the recipient.

A program that allows for the liquidation of leave and that pays out cash to the recipient will likely not be viewed as a qualified plan.

Major disaster leave

Once the president declares a major disaster, leave from an employer-sponsored leave bank or pool may be taken by an employee who is adversely affected by that major disaster.

1. To meet the IRS exception, major disaster plans must be in writing and must also meet the following requirements:
   "The plan allows a leave donor to deposit accrued leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster. For purposes of the plan, an employee is considered to be adversely affected by a major disaster if the disaster has caused severe hardship to the employee or to a 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 into cash in lieu of using the leave. However, a leave recipient may use leave received under the plan to eliminate a negative leave balance that arose from leave that was advanced to the leave 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 for 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 period specified in paragraph 5, above, 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 that the donor will be able to use the leave. The amount of leave returned to each leave donor must be in the same proportion as the amount of leave donated by the leave donor bears to the total amount of leave donated on account of that major disaster."

Under both medical emergency plans and major disaster plans, donor employees may not claim an expense, a tax deduction or a charitable contribution for any of the leave donated under the plans. Additionally, all paid leave granted to the recipient employee is considered wages and is subject to Federal Insurance Contributions Act (FICA) withholding, Federal Unemployment Tax Act (FUTA) withholding and other required tax withholdings.

Should a plan fail to meet the specified criteria to qualify for an IRS exception, leave donations paid out to a recipient are considered taxable wages to the donor as well. These types of plans are rare and should be implemented under the advice of legal and tax professionals.

Step 2: Consider Budget Implications

Employers should consider certain plan design features such as eligibility that will help assist in later budget planning with information on cost control options. Some design factors to consider are:

- **Donor eligibility.** Who can donate to the leave bank? Is there a minimum length of service or minimum leave balance required? Are any classes of employees excluded from eligibility (e.g., executives)?
- **Donation amounts.** Is there a minimum or maximum an employee can donate? Does an employee have to maintain a minimum balance in his or her own leave account?
- **Recipient eligibility.** Who is eligible to receive leave from the bank? Is there a minimum length of service? Are any classes of employees excluded from eligibility (e.g., executives)?
- **Recipient amounts.** Is there a minimum or maximum an employee may receive from the bank? Is there a waiting or elimination period before eligibility? Will employees be required to exhaust other types of paid leave prior to receipt?
- **Value of donated leave.** Will leave always be valued at the recipient's rate of pay or converted to a comparative dollar rate? *See* How do employers account for salary differences in donated leave programs? (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/donatedleavedifferences.aspx)

Feedback

Step 3: Review and Set Budget

It is important for employers to work with their finance teams just as they do for other budgeting issues as the finance team will need to understand the impact on leave cost projections and any accounting liability involved. Employers should review the criteria in step 2 and be prepared to discuss the anticipated costs with finance. Some issues that employers will want to consider when budgeting for a leave donation program include the following:

- A leave donation program may result in an overall increase in the use of paid leave that may have otherwise been forfeited in years past, thus creating potential cash flow issues and increased payroll expenses. Employees who use very little leave and have large leave balances are more likely to donate leave to be used by others, which can throw off cost projections. An employer cannot always anticipate natural disasters and significant medical emergencies; however, identifying risks, such as employees located in disaster-prone areas, can help predict how employees may use the leave donation program. Placing a cap on the amount of leave that can be donated as well as on the amount of leave that may be received can also help an employer's budget.
- Financial issues for an employer can potentially arise when lower-paid employees are a larger part of donating employees and higher-paid employees are more frequently the recipients of the leave benefits. Paying the leave benefits at employees' current and regular rate can increase the cost of benefits for the organization. A comparative dollar value approach may help avoid this issue by valuing the leave at the rate it was donated rather than at the rate it is used.
- Employers may want to consider and discuss with the finance team the worst-case scenario(s) for budgeting purposes to avoid financial hardship and cash flow issues.

Step 4: Design the Program

Once a budget is established, employers will need to develop the actual leave donation program. Some common considerations include:

- Implementing clearly stated, neutral eligibility criteria applied equally across all employee groups to avoid claims of discrimination and unfair treatment, unless there is a legitimate business reason not to do so.
- Understanding how distributions from the leave bank may affect short-term disability (STD) or long-term disability (LTD) benefits. Will the receipt of distributions from the leave bank potentially delay or reduce STD/LTD benefits, or may the donated leave be used to supplement the disability benefits once the employee has exhausted all of his or her available paid leave?
- Ensuring that employees' privacy will be protected. An example of protecting an employee's privacy would be to omit the employee's medical condition when informing the workforce of the employee's need for leave donation. Although the Health Insurance Portability and Accountability Act (HIPAA) generally does not apply to information obtained in the administration of a leave donation program, the confidentiality requirements of the American's with Disabilities Act (ADA) does.
- Understanding any state regulations that govern what leave may be donated in the states in which the employer does business. For example, different states have specific rules regarding an employee's right to various types of leave, whether accrued, earned, unearned, vacation, paid time off or sick. Employers should consult with legal counsel for state law implications when implementing a leave donation plan.

Leave donation policies should be in writing, and employers should ensure that the policies include the following details:

- Indicate that there will be a leave bank or pool for employees to deposit donated leave and from which leave will be distributed to recipients.
- Explain that the leave can be used only for medical emergencies or major disasters.
- Define who is eligible to donate or receive leave.
- Provide specific limits on the amount of leave that may be donated by an employee or the amount of leave that may be received by an employee.
- Provide reasonable time frames for the use of the leave.
- Provide procedures for donating and applying for leave donation.
- Indicate what will be considered "proof" of how leave was used.
- Indicate that the recipient will receive paid leave at his or her normal rate of pay.
- State that donor employees may not claim an expense, a tax deduction or a charitable contribution for any of the leave donated under the plans. All paid leave granted to the recipient employee is considered wages and is subject to appropriate tax withholding.
- Specify that liquidation of leave for cash is not permissible.
- Specify that all other available paid leave must be exhausted before being considered for leave donation.
- Indicate that donors may not specify who will be the recipient of donated leave.

Feedback

Step 5: Implement and Roll Out the Plan

An employer should designate personnel to monitor and administer the leave donation program, including processing donations and leave requests and tracking the leave under the program. The plan administration will also include managing the monetary transfers of the leave benefits—such as from department to department or from different levels of employment and salaries—and managing return-to-work programs. Employers may want to consider the use of available software systems to monitor donations and requests.

Finally, employers electing to implement a leave donation or leave sharing program should create and execute a robust communications campaign to ensure that both the employee and employer receive the maximum value from the program. A communication plan should clearly identify qualifying events and circumstances, leave donation and leave request processes, and eligibility criteria for both donors and recipients. A well-designed and effective program may become a valuable tool in building employee morale, enhancing camaraderie, reducing turnover and absenteeism, and positively affecting overall productivity. *See* How to Develop and Implement a New Company Policy (www.shrm.org/ResourcesAndTools/tools-and-samples/how-to-guides/Pages/howtodevelopandimplementanewcompanypolicy.aspx).

Templates and Tools

Sample policy

Leave Sharing/Donation Policy (www.shrm.org/ResourcesAndTools/tools-and-samples/policies/Pages/cms_016303.aspx)

Sample forms

Leave: Donation Application (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/cms_010490.aspx)

Leave: Donation Authorization (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/1cms_019326.aspx)

Leave: Donation Request (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/1cms_016293.aspx)