CAPLAW FAQ

A series of common legal questions and answers for the CAA network

Administering Employee Leave-Sharing Programs

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March 2018

A popular workplace benefit offered by some employers is an employee leave-sharing program. These programs allow employees to donate accrued, paid leave to a general pool to be used by fellow employees who have exhausted all paid leave available to them but need additional leave. While altruistic and beneficial for improving workplace morale, employee leave-sharing programs can be complicated from an administrative perspective. This FAQ is intended to help Community Action Agencies understand the tax law and federal grant law requirements that apply to leave-sharing programs and to provide tips for administering such programs.

1. Can an employer such as a Community Action Agency (CAA) set up a leave-sharing program?
2. Must an employer receive approval from the IRS to set up a leave sharing program?
3. How do we calculate the value of donated leave?
4. Does an employee have to pay any taxes on the leave s/he donates?
5. What are "medical emergencies" and "natural disasters" under which an employee would not be subject to income tax on leave s/he donates?
6. Do federal grant rules permit the sharing of leave paid for with federal funds?
7. Can an employee whose salary is funded by one federal award donate leave to an employee funded by a different federal award?
8. Does CAPLAW have sample leave donation policies?

1 Can an employer such as a Community Action Agency (CAA) set up a leave-sharing program?

Yes. Properly structured and administered, an employee leave-sharing program that allows employees to donate unused, accrued leave to another employee who needs the leave but has exhausted his or her leave bank is permissible under both Internal Revenue Service (IRS) and federal grant rules.

2 Must an employer receive approval from the IRS to set up a leave-sharing program?

No. IRS approval is not required, but a CAA must follow certain guidelines to adopt and administer a leave-sharing program.

3 How do we calculate the value of donated leave?

Donated leave is paid to the recipient at his or her normal rate of compensation, not at the donor's rate of pay. For example, an employee who is paid $10/hour and donates one hour of time to a leave-sharing pool would only be donating 0.5 hours of leave to an employee who is paid $20/hour.

So long as the leave-sharing plan meets the "medical emergencies" or "major disasters" requirements approved by the IRS, only the recipient of the leave (and not the donor) will be taxed on the income received from the donated leave. These amounts are also considered wages for employment tax purposes, including the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). The leave donor may not claim an expense, charitable contribution, or loss deduction for the donated leave.

4 Does an employee have to pay any taxes on the leave s/he donates?

Under general tax law principles, an individual who assigns his or her right to receive compensation to another individual is still taxed on the value of the compensation assigned to the recipient.[1] However, the IRS has approved of two types of leave sharing programs where this general "assignment of income" rule does not apply: (1) medical emergencies; and (2) major disasters. If the plans are properly structured, the employee donating leave will not be subject to income tax on the donated leave (or its use by the recipient). Instead, the amounts paid to the recipient for the donated leave will be taxed as gross income to the recipient only.

5 What are "medical emergencies" and "natural disasters" under which an employee would not be subject to income tax on leave s/he donates?

Since 1990, the IRS has permitted employers to establish leave-sharing programs under which employees with medical emergencies apply for leave donated to an employer-sponsored leave bank.[2] The IRS has approved the definition of a "medical emergency" as a medical condition of the employee, or a family member of the employee, 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 has exhausted all other sources of paid leave.

The IRS has also approved leave-sharing plans for certain types of major disasters.

The IRS has also approved leave-sharing plans for certain types of major disasters.[3] An eligible "major disaster" is defined to include a major disaster, as declared by the President under Section 401 of the Stafford Act (42 U.S.C. § 5170), that warrants individual assistance or individual and public assistance from the federal government under that Act. Disasters that do not meet these criteria would not qualify for the favorable IRS tax treatment. In other words, organizations that allow employees to use donated leave for other types of catastrophes would subject both the donor and recipient employees to federal income tax on the amount of leave donated and used.

6 Do federal grant rules permit the sharing of leave paid for with federal funds?

The Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), 2 C.F.R. Part 200, apply to most federal funds received by grantees and subgrantees and governs how those funds may be used. The Uniform Guidance does not explicitly address donated leave programs. However, leave is an allowable fringe benefit cost under federal awards, and the Uniform Guidance defines leave broadly to include "regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, family-related leave, sick leave, holidays, court leave, military leave, administrative leave, ***and other similar benefits"*** (emphasis added). This open-ended definition is likely sufficiently broad to include a leave-sharing plan.

The Uniform Guidance does not explicitly address donated leave programs.

To be an allowable cost, a leave fringe benefit must be provided under established written leave policies, the costs must be equitably allocated to all related activities (including federal awards), and the organization must use a consistent accounting basis (cash or accrual) for costing each type of leave.[4] Under the cash basis of accounting, the cost of the leave is recognized in the period that the leave is taken and paid for, whereas under the accrual basis, the cost of the leave is recognized in the period in which the employee earns the leave.

7 Can an employee whose salary is funded by one federal award donate leave to an employee funded by a different federal award?

No. The Uniform Guidance requires that fringe benefits be assigned to cost objectives by identifying specific benefits to specific individual employees or by allocating on the basis of entity-wide salaries and wages of the employees receiving the benefits.[5] Thus, a CAA's leave donation pool should match recipient employees with donor employees whose salaries are funded by the same funding source(s). For example, an employee paid out of federal Weatherization Assistance Program (WAP) funds should only be allowed to take leave donated by another employee whose salary is paid with WAP funds.

Guidance from the federal Office of Head Start (OHS) has explicitly required such matching:

> Head Start employees may donate leave to other Head Start employees as long as such practice is documented in the grantee's personnel policies and procedures. Also there should be a system in place to ensure that leave is properly charged to the appropriate budget period. Non-Head Start employees would not be eligible to receive donated leave from Head Start Employees since such leave would be paid for with Head Start fund. The cost principles…require costs to be properly allocated to the program. If the cost does not benefit the program, it cannot be charged to the program.

OHS issued this guidance as a policy clarification (OHS-PC-A-069). Though OHS has removed all policy clarifications from public access since the publication of the new Head Start Performance Standards in 2016, it is likely that OHS would continue to abide by this policy clarification, as the new Performance Standards did not make any changes that would impact this analysis.

No other federal agency has issued similarly explicit guidance. It is possible that funding sources other than Head Start might be more flexible in permitting leave-sharing among employees funded by different federal awards. However, without written guidance specifically authorizing leave-sharing across federal awards, employers permitting this practice risk having the costs of the donated leave disallowed.

8 Does CAPLAW have a sample leave donation policy?

While CAPLAW does not have a sample leave donation policy, the following is an approach to developing a leave-sharing program based on IRS rules and federal grant law. When developing or revising a policy, your organization should work with an accountant and state law attorney to ensure compliance with any additional, applicable requirements.

1. **Require employees to donate to a leave pool rather than to a specific individual.** Donor employees should not be permitted to donate leave to a specific recipient. Rather, the donated leave should be placed in a pool and distributed based on the provisions of the leave-sharing plan. A one-to-one donation is more likely to be viewed by the IRS as a taxable gift.
2. **Match employees by funding source.** Donor and recipient employees should be paid out of the same federal or state grant, and donor employees should only be allowed to donate leave to employees funded under the same award (e.g., Head Start employees may only donate leave to other Head Start employees). This ensures that the leave costs charged to an award benefits the program funded by that award.
3. **Ensure proper accounting of donated leave.** The recipient must receive the paid leave at his or her normal rate of compensation (and not at the donor's rate). For example, an employee who is paid $10/hour can receive 2 hours of donated leave from an employee who is paid $20/hour and donated 1 hour of leave.
4. **Limit the amount of leave that can be donated.** Consider capping the amount of donated leave that an employee can contribute to the leave pool each year. For example, consider limiting the maximum amount to the amount of leave the donor accrues during a single year (rather than allowing donations of multiple years of accrued leave).
5. **Establish and follow a clearly-defined process for employees who apply for donated leave.**
   - Require that requests for paid, donated leave be:
     - ✓ made via a written application;
     - ✓ reasonable and based on need; and
     - ✓ granted after the recipient has exhausted his/her paid leave bank.
   - Only allow leave to be taken for purposes related to a "medical emergency" or "major disaster," as defined by IRS guidance.
   - Establish and administer a process for reviewing leave donation requests to ensure that applications are considered on a consistent, non-discriminatory basis.
   - Set a reasonable period of time after the medical emergency or major disaster during which leave can be used by recipients. Any leave not used during that period should be returned to the leave pool.
   - Do not permit recipients to receive a cash payment in lieu of donated leave. An employer may consider allowing recipients of donated leave to use the donated leave to offset a negative balance arising from the employer advancing leave to the recipient (if any).
6. **Ensure that any donated leave be taken in accordance with the organization's other policies on leave.** The use of donated leave should follow the organization's existing leave policies. For example, the policies may require that all paid leave run concurrently with other unpaid leave for which the employee may be eligible.
7. **Protect employee privacy.** Ensure that the recipient employee's privacy is protected. For example, the CAA should not reveal the identity of an employee who needs donated leave or provide details about his/her personal health condition without the employee's permission.

End Notes

[1] *Lucas v. Earl*, 281 U.S. 111 (1930); Helvering v. Eubank, 311 U.S. 122 (1940); 1940-2 C.B. 209.

[2] IRS Rev. Rul. 90-29; PLR-152644-06 (2007).

[3] Notice 2006-59 (2006-28 IRB 60).

[4] 2 C.F.R. § 200.431(b).

[5] 2 C.F.R. § 200.431(d).

This publication is part of the Community Services Block Grant (CSBG) Legal Training and Technical Assistance (T/TA) Center. It was created by Community Action Program Legal Services, Inc. (CAPLAW) in the performance of the U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services Cooperative Agreement – Grant Award Number 90ET0467-01-00. Any opinion, findings, conclusions, or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Health and Human Services, Administration for Children and Families.