Bloomberg Tax

Tax Management
Compensation Planning Journal™

Taxation of Covid-19 Leave-Based Donation Program and Leave-Sharing Plans

By Marina Vishnepolskaya[*]
Marina Vishnepolskaya, Esq., P.C.
New York, NY

INTRODUCTION

Notice 2020-46

On June 11, 2020, the IRS issued Notice 2020-46 (the ''Notice'') permitting employers to claim a charitable contribution deduction under §170(c) for cash payments to charities amounting to leave donated by employees.[1] Alternatively, even if the requirements for a §170(c) deduction are met, an employer may deduct the payment as an ordinary and necessary business expense under §162(a).[2] Also, under the Notice, payment of donated leave to a §501(c)(3) tax-exempt organization will not be treated as wages subject to employment excise taxes, tax withholding, or wage reporting.[3]

The leave-based donation program established under the Notice is not statutory, and does not clarify tax authorities for excluding the payments from gross income of donor employees.[4] Generally, an election by an employee to forego sick, vacation, or personal leave provided by the employer would result in constructive receipt by the employee of the income equal to the value of the benefit.[5] Under general tax principles, an employee would have to include in gross income the value of accrued paid leave as wages.[6] Wages are subject to FICA and FUTA taxes, tax withholding, and reporting.[7]

In determining taxable income, an employee generally may take into account certain itemized deductions.[8] In transferring the cash equivalent of foregone leave directly to a tax-exempt organization, an employee would be eligible to claim a charitable contribution deduction.[9] However, a constructive transfer to a charity of the amount of foregone leave would not meet the §170(c) deductibility requirements.[10] There is lack of clarity regarding whether, in a leave-based donation program, an electing employee may avoid constructive receipt of the paid leave under §451, so that the employer is treated as a taxpayer eligible to deduct donated leave.

In addition, under the tax law doctrine of assignment of income devised by federal courts interpreting requirements of §61, a taxpayer who receives compensation for personal services may not avoid inclu-

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[*] Marina Vishnepolskaya is principal of Marina Vishnepolskaya, Esq., P.C., an international law firm specializing in domestic and cross-border corporate, tax, employee benefits, executive compensation, and exempt organization matters. She is a frequent author and speaker on developments in these practice areas. The firm has an active Coronavirus Resource Center.

[1] §170(c); Notice 2020-46. All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[2] §162(a), §170(c); Notice 2020-46.

[3] *See* §3121, §3306, §3401, §6051(a); IRS Form W-2, *Wage and Tax Statement* (2020).

[4] Notice 2020-46. *See* §61(a)(1).

[5] *See* §451(a); Reg. §1.451-2(a); Notice 2020-46.

[6] §61(a)(1) (inclusion in income of wages), §451(a) (constructive receipt principles), §3121(a) (defining wages for FICA purposes), §3306(a) (defining wages for FUTA purposes); Federal Insurance Contributions Act, §3101 *et seq.* (FICA); Federal Unemployment Tax Act, §3301 *et seq.* (FUTA). *See also* §3231(e) (defining compensation for purposes of employment taxes under the Railroad Retirement Tax Act, §3201 *et seq.* (RRTA)).

[7] §3111, §3302, §3401, §6051.

[8] §63(a), §63(d).

[9] §170(b)(1), §170(c), §501(a) (exemption from federal income tax for certain organizations or employee trusts), §501(c)(3) (describing charitable and certain other organizations that qualify for a tax exemption under §501(a)).

[10] *See* §170(b)(1)(A), §170(c)(2).

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sion of the amount in income via its payment to another person.[11] Thus, if a taxpayer or a third party transfers the amount of compensation in a charitable contribution, the taxpayer nevertheless must include the transferred amount in gross income.[12] Moreover, income inclusion is required if the taxpayer and service recipient are parties to an agreement or understanding, pursuant to which performance of services will be for the benefit of a tax-exempt organization to the extent of a donated amount of compensation.[13]

Article Summary

Due to Covid-19 restrictions, employee vacation leave balances have been accumulating. Reportedly, nearly half of employers have made or are planning to make changes to paid leave programs according to a U.S. consulting firm study.[14] Employers have considered to allow employees to carry over the leave to subsequent tax years, but some employers require employees to utilize available leave in the current year. Leave-sharing arrangements and leave-based donations programs sanctioned by the IRS are an option for employers during the pandemic to provide alternative use of the accumulated leave.

This article discusses the requirements and tax consequences of a leave-based donation program in the Notice and prior safe harbors, a qualified employer-sponsored medical leave-sharing plan, and a bona fide employer-sponsored major disaster leave sharing plan. Treasury and the IRS established the safe harbors to facilitate relief for employees with a medical emergency or assistance for major disaster victims. The article also analyzes the tax consequences of the arrangements under the general income tax rules of assignment of income and constructive receipt, from which Treasury and the IRS exempted each program.

The article concludes that there is limited authority in tax law for exempting either employer-sponsored program from assignment of income or constructive receipt income inclusion principles. The article discusses administrative authority of the IRS to establish the safe harbors or promulgate a nonenforcement policy. Also, a taxpayer may not rely on the IRS Revenue Ruling, PLRs, or Notices, which set forth the safe harbors, as binding authority in litigation.

Thus, Treasury and the IRS have significant discretion in overseeing the leave-based donation program and the sanctioned leave-sharing plans. Therefore, employers must comply strictly with the requirements of each program to ensure favorable taxpayer treatment. Accordingly, this article provides practical considerations for employers to ensure compliance with the criteria of each safe harbor in IRS guidance and with the ERISA[15] exemption requirements.

MEDICAL LEAVE-SHARING PLAN

Revenue Ruling 90-29

In Rev. Rul. 90-29, the IRS, citing generally Reg. §1.61-2, addressed the tax treatment of amounts paid by an employer pursuant to a leave-sharing plan, whereby employees donated accrued leave to another employee for a medical emergency. The program was similar to a subsequently authorized leave-based donation program. The ruling established criteria for a bona fide employer-sponsored leave-sharing arrangement.

The ruling implied the plan had to be written. An employee or representative had to submit an application for additional paid leave to the employer, describing the medical emergency. The employer had to approve the application. The employee had to have exhausted all available paid leave before receiving the additional leave pursuant to the program. The leave had to be paid at the normal rate of compensation of the employee.

Under the ruling, an employee could surrender the donated leave to the employer. Alternatively, an employee could deposit the leave in an employer-sponsored leave bank. The plan had to contain restrictions on the amount of leave that could be surrendered to the employer or deposited in the leave bank. Furthermore, the plan had to set forth rules as to the manner in which the surrendered or deposited leave would be granted to eligible leave recipients.

Separately, a leave-sharing plan is deemed a payroll practice, and therefore generally is excepted from ERISA requirements.[16] To qualify for this ERISA exception to the definition of an employee benefit plan, the arrangement may not provide for more than a regular rate of pay to the recipient employee, a criterion in Rev. Rul. 90-29.[17]

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[11] §61(a); Reg. §1.61-2(c).*See, e.g.*, *Lucas v. Earl*, 281 U.S. 111 (1930) (decision on the assignment of income doctrine).

[12] *See* §61(a); Notice 2001-69.

[13] *See* §61(a), §170(c); Notice 2001-69.

[14] Anne Steele and Chip Cutter, *Companies Fret As Vacation Days Go Unused*, Wall Street J. (Aug. 23, 2020).

[15] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (ERISA).

[16] 29 C.F.R. §2510.3-1(b)(2).

[17] ERISA §3(3); 29 C.F.R. §2510.3-1(b)(2).

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Tax Consequences of a Medical Leave-Sharing Plan

Section 61(a)(1) provides that gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.[18] Reg. §1.61-2(a)(1) provides generally that wages, salaries and similar items of compensation are gross income, unless excluded by law.[19] Reg. §1.61-2(c) excludes from gross income the value of services rendered directly and gratuitously to a charitable organization described in §170(c).[20]

In Rev. Rul. 90-29, the IRS ruled the donated paid leave amounts were not taxable income to donor employees.[21] However, the additional leave was taxable as wages paid to the recipient employee. The ruling did not address applicability of the constructive receipt doctrine to the medical leave-sharing arrangement. Likewise, the IRS did not set forth analysis of the assignment of income doctrine with respect to a medical leave-sharing plan.

MAJOR DISASTER LEAVE-SHARING PLAN

Notice 2006-59

In Notice 2006-59, the IRS addressed the tax consequences of a leave-sharing plan that permitted employees to deposit leave in an employer-sponsored leave bank for use by other employees who had been adversely affected by a major disaster, as defined in the plan. For a plan sponsored by an employer other than a federal employer, the triggering event had to be a major disaster as declared by the President pursuant to the Stafford Act.[22] The major disaster had to warrant federal assistance to individuals or the public under the Stafford Act.[23] Consistently, a major disaster leave-sharing plan had to be a written plan.[24]

Only current employees of a sponsoring employer could participate in the plan as either leave donors or leave recipients.[25] An employee effected the contribution of leave by ''depositing'' leave in a ''leave bank.''[26] The leave had to be accrued.[27] The contributing employee, or leave donor, had to submit a voluntary, written request to make the deposit, and the sponsoring employer had to approve the request.[28] Implicitly, the major disaster leave-sharing plan document had to include provisions regarding the employee request to deposit leave and the employer approval.[29] The donated leave could be for the benefit of the recipient employee or any family member, and an employer had broad discretion to define the term ''family member'' in the leave-sharing plan document.[30]

Notice 2006-59 contained additional eight requirements for a qualified employer-sponsored major disaster leave-sharing plan. Generally, Notice 2006-59 defined an eligible class of recipient employees and did not allow earmarking of a specific leave recipient. An employee could not donate more leave than normally accrued during the year. An employer had to determine reasonably the amount of donated leave an employee could receive.

Use of leave, calculated based on normal rate of compensation of recipient, was restricted to major disaster purposes. The deposit and use of leave had to be subject to reasonable timing limitation set forth in the plan in relation to the occurrence of the major disaster. A recipient employee could apply the leave in lieu of advance or unpaid leave but could not convert it to cash. Subject to a de minimis exception, unused leave had to be returned to leave donor after the expiration of the period for the use of leave. An employer had discretion whether to limit return of leave to donors who remained currently employed by the employer at the time of the reversion. Implicitly, if the employer chose to return leave to former employees, the returned amount had to bear the same proportion as the employee donation bore to the total leave for the major disaster.[31]

Tax Consequences of a Major Disaster Leave-Sharing Plan

In Notice 2006-59, the IRS stated it ''will not assert that a leave donor who deposits leave into an employer-sponsored leave bank under a major disaster leave-sharing plan that meets the requirements set forth in Notice 2006-59 realizes income or has wages, compensation, or rail wages with respect to the depos-

[18] §61(a)(1).

[19] Reg. §1.61-2(a)(1).

[20] Reg. §1.61-2(c).

[21] Rev. Rul. 90-29.

[22] Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §5170 (Stafford Act); Notice 2006-59.

[23] Notice 2006-59.

[24] Notice 2006-59.

[25] Notice 2006-59.

[26] Notice 2006-59.

[27] Notice 2006-59.

[28] Notice 2006-59.

[29] *See* Notice 2006-59.

[30] *See* Notice 2006-59.

[31] Notice 2006-59.

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ited leave.'' Generally, this guidance applied, provided that the plan treated payments made by the employer to the leave recipient as wages or compensation for employment tax and income tax withholding purposes.[32] Thus, the donor employee did not take into account the donated leave for income tax purposes, unless it was returned to the donor.[33] Therefore, the Notice advised a leave donor was not entitled to a corresponding expense, charitable contribution, or loss deduction on account of the deposit of the leave or its use by a leave recipient.[34]

Accordingly, Notice 2006-59 provided only that the IRS would not assert an income tax liability of a leave donor with respect to non-reverted, donated paid leave. This Notice did not cite any federal tax authorities for the position of the IRS. But this Notice was issued in response to a declaration of a major disaster pursuant to §401 of the Stafford Act.[35] Also, the 1997 Emergency Supplemental Appropriations Act authorized the President to direct the Office of Personnel Management (OPM) to establish a leave-sharing plan for certain affected federal employees.[36] The authorization applied in the event a declared disaster or emergency resulted in severe adverse effects for a substantial number of employees.[37]

The new federal leave transfer provision, 5 U.S.C. §6391, directed the OPM to establish the requirements and limitations for operation of the emergency leave transfer program.[38] A federal employer may use a leave bank described in related provisions, subject to OPM regulations, may donate annual leave to the emergency leave transfer program in 5 U.S.C. §6391.[39] In addition, an employee may receive and use leave under the program prior to exhausting any annual leave and sick leave credited to the employee.[40] Therefore, a major disaster leave program for federal employees warranted exclusion of leave from income or wages of any donor employee under a similar program prescribed by the IRS consistent with Rev. Rul. 90-29.[41]

PLR 200720017

In PLR 200720017, the IRS applied the common law assignment of income doctrine developed by the courts to proposed amendments to a medical leave-sharing policy.[42] The IRS described the doctrine as providing that assignment by a taxpayer of a right to receive compensation for personal services to another person does not relieve the taxpayer of tax liability on the income.[43] However, the IRS clarified that the general assignment of income rule did not apply to certain situations, including a bona fide employer-sponsored medical leave sharing arrangement.[44] A similar exception was a qualified employer-sponsored major disaster leave-sharing plan.[45]

In PLR 200720017, an employer proposed to amend the current leave-sharing plan to include catastrophic casualty loss as a condition for eligibility for donated paid leave.[46] The term included losses due to terrorist attack, fire, or other natural disaster, and severe damage to or destruction of the primary residence of employee, requiring immediate action to secure the premises.[47] The IRS concluded that the additional criteria for receiving surrendered paid leave would take the policy outside the limits of a medical leave-sharing plan in Rev. Rul. 90-29.[48] Likewise, a catastrophic casualty loss in the proposed amendment was outside the scope of a leave-sharing plan in Notice 2006-59 to aid victims of a major disaster declared by the President of the United States.[49]

Taxing Donor Employees Under a Bona-Fide or Modified Policy in PLR 200720017

Thus, the IRS found the proposed modifications did not comply with the terms and conditions of a bona fide employer-sponsored medical leave sharing plan or a qualified employer-sponsored major disaster leave-sharing plan, with certain exceptions in regard

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[32] *See* §3101, §3111, §3201, §3221, §3301, §3401; Notice 2006-59.

[33] *See* §61(a)(1); Notice 2006-59.

[34] *See* §162, §170, §172; Notice 2006-59.

[35] 42 U.S.C. §5170; Notice 2006-59.

[36] An Act Making Emergency Supplemental Appropriations for Recovery from Natural Disasters, Pub. L. No. 105-18 §9004(a), 111 Stat. 197 (1997) (1997 Emergency Supplemental Appropriations Act) (amending chapter 63 of title 5 of the U.S.C. by adding §6391).

[37] 5 U.S.C. §6391(b).

[38] 5 U.S.C. §6391(c).

[39] 5 U.S.C. §6363 (leave banks under the federal voluntary leave bank program), 5 U.S.C. §6391(c).

[40] 5 U.S.C. §6391(b).

[41] *See* Notice 2006-59.

[42] PLR 200720017; *see, e.g.*, *Lucas v. Earl*, 281 U.S. 111 (1930).

[43] PLR 200720017.

[44] PLR 200720017*; see* Rev. Rul. 90-29.

[45] *See* PLR 200720017; *see, e.g.*, Notice 2006-59 (tax treatment of amounts paid pursuant to a leave-sharing plan to assist employees affected by a major disaster declared by the President of the United States). *Cf.* Notice 2005-68 (leave-based donation program, as opposed to a leave-sharing plan, to aid victims of Hurricane Katrina).

[46] PLR 200720017.

[47] PLR 200720017.

[48] PLR 200720017.

[49] PLR 200720017.

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to the assignment of income rule.[50] Therefore, the IRS ruled that, under the assignment of income rule, policy amendments would result in compensation income to the donor employee under §61 in the amount of the cash value of the accrued, and transferred leave.[51] The IRS also ruled the compensation would be treated as wages paid to donor employee for employment tax and tax withholding purposes.[52] But, the IRS ruled that surrendered leave pursuant to the policy currently in effect, deemed a bona-fide leave-sharing plan, would not be taxable to donor employee pursuant to Rev. Rul. 90-29.[53]

By contrast, the modified leave-sharing arrangement lacked a sanctioned policy justification embedded in Rev. Rul. 90-29 for exempting a donor employee from income or employment tax consequences with respect to surrendered or deposited leave payments. Thus, the IRS ruled in PLR 200720017 that the donor employee included in gross income the cash value of the surrendered paid leave under §61. Consistently, the donated paid leave was deemed wages subject to FICA and FUTA tax, and to withholding at the time of the payment.[54]

The IRS did not discuss tax authorities for exempting a donor employee participating in a medical leave-sharing plan or a similar major-disaster leave-sharing plan from tax consequences under the assignment of income doctrine.[55] The IRS cited Rev. Rul. 90-29 for the rule that a donor employee would not be subject to income tax on paid leave donated under a bona fide employer-sponsored medical leave-sharing plan described in that ruling.[56] But Rev. Rul. 90-29 likewise did not cite authorities for excluding donated paid leave from gross income of donor employee, other than referring generally to Reg. §1.61-2.[57]

Moreover, PLR 200720017 cited only Notice 2006-59 for excluding from gross income of donor employee paid leave donated under a qualified employer-sponsored major disaster leave-sharing plan.[58] Notice 2006-59 did not analyze the assignment of income doctrine nor the constructive receipt doctrine.[59] Accordingly, the IRS did not analyze applicability to donor employee in a medical leave-sharing plan or in a major disaster leave-sharing plan of either the assignment of income or the constructive receipt rules. Instead, the IRS assumed a nonenforcement position with respect to taxing a donor employee under a bona-fide program.[60]

Taxing Recipient Employees Under a Bona-Fide Policy in PLR 200720017

The IRS followed Rev. Rul. 90-29 in ruling on the tax consequences to participants in the current leave-sharing program of the employer.[61] In the Revenue Ruling, an employer had seemingly exclusive discretion over approval of an employee request for additional paid leave pursuant to the plan.[62] Likewise, donor employees were limited as to the amount of paid leave that could be surrendered.[63] Moreover, the employer made additional leave payments at the normal rate of compensation of the recipient employee.[64]

Rev. Rul. 90-29 did not specify whether any terms of the leave-sharing plan indicated that a donor employee did not realize compensation income from accrued or paid leave, which the employee surrendered or deposited into a leave bank. Therefore, the basis under general tax principles for exclusion of the donated leave amounts from gross income of a donor employee was not apparent under the facts in Rev. Rul. 90-29. However, as a policy matter, because the donor employee could not deduct the leave payments as a charitable contribution or employee expense, it seemed equitable to exempt the amount of the leave from tax to the donor employee.

In PLR 200720017, the IRS described the payment as being made by the taxpayer employer to the recipient employee with respect to paid leave time surrendered by donor employee under the policy. Thus, the IRS ruled that under the current, bona fide leave-sharing policy, deemed similar to the plan in Rev. Rul. 90-29, a recipient of surrendered or deposited leave included the payments in gross income under §61.[65] The amount of the payment would be deemed wages of recipient employee subject to FICA, FUTA, and

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[50] PLR 200720017; *see* Rev. Rul. 90-29; Notice 2006-59.

[51] §61; PLR 200720017; *Lucas v. Earl*, 281 U.S. 111 (1930).

[52] PLR 200720017; *see generally* §3101, §3111 (imposing an excise tax on employee and employer, respectively, on wages under FICA, §3101 *et seq.*); §3121 (defining wages for FICA purposes); §3301, §3302 (imposing creditable excise tax on employer on wages under FUTA, §3301 *et seq.*); §3401 (defining wages subject to income tax withholding by employer); §3402 (requiring income tax withholding of wages on actual or constructive receipt by employee). *See also* §3201, §3221 (imposing excise tax generally equivalent to FICA on employees and employers, respectively, on compensation subject to the RRTA, §3201 *et seq.*).

[53] PLR 200720017.

[54] PLR 200720017.

[55] PLR 200720017; *see generally* §61(a)(1); Reg. §1.61-2(a).

[56] PLR 200720017; *see* Rev. Rul. 90-29.

[57] *See* Reg. §1.61-2(a)(1); Rev. Rul. 90-29.

[58] *See* PLR 200720017; Notice 2006-59.

[59] *See* Notice 2006-59.

[60] *See* PLR 200720017.

[61] Rev. Rul. 90-29; PLR 200720017.

[62] Rev. Rul. 90-29.

[63] Rev. Rul. 90-29.

[64] Rev. Rul. 90-29.

[65] §61; PLR 200720017.

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withholding requirements.[66] Consistent with the implicit policy objective in Rev. Rul. 90-29, the cash value of the payment was excluded from gross income and not deductible by a donor employee.[67]

Taxing Recipient Employee Under Modified Policy in PLR 200720017

With respect to the modified policy in the PLR, the IRS declined to rule on the income tax consequences of payments of surrendered paid leave to recipient employees.[68] The IRS stated the income tax treatment of recipient employees would be primarily a determination of fact, and therefore, outside the scope of a letter ruling pursuant to predecessor to Rev. Proc. 2020-3.[69] In this manner, the IRS did not clarify whether a recipient employee would be subject to income or employment tax or withholding on surrendered paid leave payments.

LEAVE-BASED DONATION PROGRAM

Notice 2001-69

In the aftermath of the September 11, 2001 terrorist attacks, employers sought to establish leave-based donation programs, whereby an employee would forego accrued vacation, sick, or personal leave in exchange for employer contribution of the value of the leave to a relief fund.[70] On October 24, 2001, the Treasury announced issuance of interim guidance on federal income tax consequences for employees for donated leave under these programs.[71] Notice 2001-69 provided generally that an employee would not be taxable on donated leave, and the donated leave would not constitute wages to the employee subject to employment taxes and withholding, under the following conditions in the below paragraph.

First, the payments by an employer sponsoring the leave-based donation program had to be made prior to January 1, 2003.[72] Second, an employee would elect to forego vacation, sick, or personal paid leave accrued by the employee in exchange for the payments by the employer.[73] Finally, the employer had to make the payments in the amount of foregone leave to a §170(c) organization.[74]

Notice 2014-68

Subsequently, Notice 2014-68, which set forth requirements for leave-based donation programs in response to Ebola virus outbreaks in West Africa, narrowed the relief to donations to §170(c) organizations for the relief of victims of the outbreak in such countries.[75] Notice 2014-68 also specified that the payments to the §170(c) organizations under the leave-based donation program had to be made in cash.[76] Finally, Notice 2014-68 applied to cash payments made before January 1, 2016.[77]

Tax Consequences of a Leave-Based Donation Program

Similarly to the language in subsequent Notice 2006-59, in Notice 2001-69, the IRS stated it ''will not assert'' that the payments made by an employer constitute gross income or wages of an employee.[78] Notice 2001-69 stated additionally that the IRS ''will not assert'' that the opportunity to make an election to forego leave results in constructive receipt of gross income or wages for employees.[79] Consistently, an employee would not claim a charitable contribution, or ordinary and necessary business expense deduction for the donated leave.[80]

Section 170(c) Deduction Planning Under Leave-Based Donation Program, CARES Act

Notice 2001-69 provided, ''the Service will not assert'' that an employer must claim any deduction for the charitable contribution under §170(c).[81] Thus, the IRS would permit an employer to deduct the contributed paid leave under §162(a) as an ordinary and nec-

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[66] §3121, §3306, §3401; PLR 200720017.

[67] PLR 200720017; *see* Rev. Rul. 90-29.

[68] *See* PLR 200720017.

[69] *See* Rev. Proc. 2006-3, §4.01(2) (no-ruling list), *superseded by* Rev. Proc. 2020-3; PLR 200720017.

[70] *See* Treas. News Rel. PO-720, *Treasury Issues Guidance on Charitable Leave-Based Donation Programs* (Oct. 24, 2001), https://www.treasury.gov/press-center/press-releases/Pages/po720.aspx.

[71] Treas. News Rel. PO-720; Notice 2001-69.

[72] Notice 2001-69.

[73] Notice 2001-69.

[74] §170(c)(2) (describing certain charitable organizations, to which a contribution deductible under §170(a) may be made); Notice 2001-69.

[75] *See also* Notice 2012-69 (Hurricane Sandy leave-based donation program); Notice 2016-55 (Louisiana storms leave-based donation program); Notice 2016-69 (Hurricane Matthew leave-based donation program); Notice 2017-48 (Hurricane and Tropical Storm Harvey leave-based donation program).

[76] §170(c); Notice 2014-68.

[77] Notice 2014-68.

[78] *See* Notice 2006-59.

[79] *See generally* §451; *Cf.* Notice 2006-59.

[80] §162, §170; Notice 2001-69.

[81] Notice 2001-69.

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essary business expense.[82] The benefit would be greater to an employer to the extent the deduction would not be subject to a percentage limitation set forth in §170(b).[83]

For a corporation, the deductibility ceiling for cash contributions generally is 10% of taxable income for the tax year.[84] By contrast, for an employer subject to contribution limits for individuals, such as a sole proprietorship, an entity disregarded for tax purposes as separate from the owner or a partner in a partnership, the cash contribution limit generally is 50% of the contribution base for the tax year.[85] However, the value of foregone paid leave may be relatively minor as a percentage of adjusted gross income of an individual taxpayer or taxable income of a corporate taxpayer.

Thus, an employer would prefer a deduction under §162 primarily to maximize the tax benefit of charitable contributions for which a deduction is allowable under §170(a).[86] To the extent applicable under Notice 2020-46, §2205 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) suspended the contribution limit for qualified cash contributions made beginning on March 14, 2020, and before January 1, 2021.[87] In addition, Notice 2001-69 provided that amounts subject to the notice did not have to be reported as wages or compensation in boxes 1, 3, or 5 of Form W-2.

Authority for Exclusion of Donated Leave from Gross Income of Donor Employee

A Treasury press release accompanying Notice 2001-69 stated that this particular IRS notice ''eliminates uncertainty regarding the Federal income tax treatment of payments by employers'' under leave-based donation programs.[88] But Treasury and the IRS implicitly acknowledged the issue of appropriate authority for excluding donated leave from gross income or from wages of donor employee.[89] The press release noted Treasury and the IRS were soliciting ''comments as to the taxation of leave-based donation programs and whether the existing tax rules should be modified with regard to such programs.''[90]

In Notice 2001-69, Treasury and the IRS requested comments on ''the taxation of leave-based donation programs, including comments on whether [Reg.] §1.61-2(c) should be modified to except certain leave-based donation programs from the assignment-of-income doctrine, and on appropriate limitations to any such exceptions.''[91] Treasury and the IRS also requested comments ''on the application of constructive receipt principles in connection with these programs.''[92] But, in Notice 2003-1, Treasury and the IRS, referencing the request, stated that ''the Service and Treasury have reviewed the comments received and determined not to amend the regulations under [§] 61.''[93]

In 2005, a Congressional Research Service Report, authored by a legislative attorney on tax relief in response to Hurricane Katrina, addressed leave donations.[94] The report described the donations as ''programs where employees donate vacation, sick or personal leave, which is then converted to cash and paid by the employer to a qualified tax-exempt organization.''[95] The report stated that, with respect to leave donations, the IRS announced that contributing employees will not have to include donations made to §170(c) Katrina relief organizations in income.[96]

The report said, ''While the tax consequences of the donation to the employees are arguably unclear, it

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[82] *See* §162(a); Notice 2001-69.

[83] *See* §170(b)(2) (charitable contribution deduction by a corporate taxpayer generally not allowed to exceed 10% of the taxable income of the taxpayer).

[84] §170(b)(2)(A).

[85] §170(b)(1)(A) (cash contribution percentage limitation for individuals), §170(b)(1)(G) (defining contribution base generally as adjusted gross income without taking into account certain net operating loss carryback under §172 to the tax year of the deduction).

[86] *See* §162(a), §170(b).

[87] Pub. L. No. 116-136, CARES Act, §2205(a)(1), §2205(a)(2)(B), §2205(c) (generally suspending limitation on deductible cash contributions to certain charitable organizations; setting forth the deductibility limit with respect to qualified contributions for a corporate taxpayer as 25% of taxable income; stating the effective date of the section). *See also* §170(b)(1)(A).

[88] Treas. News Rel. PO-720, *Treasury Issues Guidance on Charitable Leave-Based Donation Programs* (Oct. 24, 2001), https://www.treasury.gov/press-center/press-releases/Pages/po720.aspx.

[89] *See* Treas. News Rel. PO-720, *Treasury Issues Guidance on Charitable Leave-Based Donation Programs* (Oct. 24, 2001); Notice 2001-69.

[90] Treas. News Rel. PO-720, *Treasury Issues Guidance on Charitable Leave-Based Donation Programs* (Oct. 24, 2001).

[91] Reg. §1.61-2(c) (excluding from gross income the value of services rendered directly and gratuitously to a charitable organization described in §170(c)).

[92] §451; Notice 2001-69.

[93] Notice 2003-1; *see* Notice 2001-69. The status of public comments, if any, on Notice 2001-69 is unclear. The comments were not available through research tools or the web, and were not located in response to a FOIA request.

[94] Erika Lunder, CRS Report No. RS22261, *Hurricane Katrina: The Response by the Internal Revenue Service* (Sept. 14, 2005).

[95] CRS Report No. RS22261.

[96] CRS Report No. RS22261.

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appears that the IRS generally takes the position that the employees must include the amount of the donated leave in their income.''[97] The Congressional report stated further, ''However, in response to Hurricane Katrina, the IRS has announced that contributing employees will not have to include the donations in income if the donations are made to organizations that provide relief to the victims of Hurricane Katrina and are made prior to January 1, 2007.''[98] The report concluded, citing Notice 2001-69, ''It is not clear whether the IRC provides the authority to take this action, although the IRS took similar action after the terrorist attacks on September 11, 2001.''[99] Accordingly, Notice 2001-69 did not analyze the applicability of the assignment of income or constructive doctrines to donated leave amounts in a leave-based donation program.

LEAVE PROGRAMS UNDER ASSIGNMENT OF INCOME AND CONSTRUCTIVE RECEIPT DOCTRINES

Assignment of Income Doctrine

The assignment of income doctrine determines which taxpayer takes the income into account, not whether an amount received is an item of gross income under §61.[100] Under the assignment of income doctrine, assignment by taxpayer of right to receive compensation for personal services does not relieve the taxpayer of the tax liability on the assigned income.[101] In the seminal case, *Lucas v. Earl*,[102] the Supreme Court held that the taxpayer could not shift income tax on future salary payments by contracting to pay a portion of the salary to his wife. The taxpayer and his wife entered into a joint tenancy agreement to treat the personal earnings as joint property of the spouses, held valid under the laws of California, a community property state.[103]

The Supreme Court stated, ''the basic purpose of the tax law is to tax income beneficially received.''[104] The Supreme Court imparted further, ''the tax could not be escaped by anticipatory arrangements and contracts however [skillfully] [sic] devised to prevent the salary when paid from vesting even for a second in the man who earned it.''[105] Thus, the Supreme Court held the earnings were taxed as joint income of both spouses pursuant to the joint tenancy agreement.[106]

Constructive Receipt Doctrine

Section 451 codified the constructive receipt doctrine.[107] Under §451 and Treasury regulations, an employee includes compensation in gross income in the tax year in which the amount is actually or constructively received.[108] A taxpayer is in constructive receipt of income for a taxable year, ''during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.''[109] But under this rule, control by taxpayer of receipt of income must not be subject to substantial limitations or restrictions.[110]

In *Palmer v. Commissioner*, the issue before the Tax Court was, whether the petitioner taxpayers constructively received taxable income in the form of nonemployee compensation.[111] The Tax Court stated, under the constructive receipt doctrine, a taxpayer on the cash method of accounting must recognize income ''when the taxpayer has an unqualified, vested right to receive immediate payment of income.''[112] The Tax Court noted that the determination of whether a taxpayer has constructively received income is a question of fact.[113]

The Tax Court found that a modification of a consulting agreement failed to impose a substantial limitation or restriction on control of taxpayer to receive

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[97] CRS Report No. RS22261 (citing Notice 2003-1); Notice 2001-69.

[98] CRS Report No. RS22261.

[99] Notice 2001-69; CRS Report No. RS22261.

[100] *Pillsbury Co. v. Franchise Tax Bd.*, 124 Cal. App. 4th 892, 900 (Cal. App. 1st Dist., 2004) (albeit of limited persuasive authority in a federal jurisdiction, California state appellate court holding a prohibition in a federal law against the application of the assignment of income doctrine is not an amendment to §61); *Rubin v. Commissioner*, 56 T.C. 1155, 1161 (1971) (stating §61 ''subsumes the assignment-of-income principles established by *Lucas v. Earl* . . .'').

[101] *See Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Eubank*, 311 U.S. 122 (1940); PLR 200720017.

[102] 281 U.S. 111.

[103] *See Lucas,* 281 U.S. at 114–115; *Wood Harmon Corp. v. U.S.*, 311 F.2d 918, 921 (2d Cir. 1963).

[104] *Lucas*, 281 U.S. at 111.

[105] *Lucas,* 281 U.S. at 114 – 115.

[106] *Lucas,* 281 U.S. at 111.

[107] §451(a).

[108] §451(a); Reg. §1.451-2(a).

[109] §451(a); Reg. §1.451-2(a).

[110] §451(a); Reg. §1.451-2(a).

[111] T.C. Memo 2000-228. *See also Ross v. Commissioner*, 169 F.2d 483, 490 (1st Cir. 1948) (stating the constructive receipt doctrine).

[112] *Palmer*, T.C. Memo 2000-228 at 108.

[113] *Palmer*, T.C. Memo 2000-228.

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the amount of consulting fees with respect to approved monthly invoices.[114] A taxpayer could receive payment within 30 days of the invoices or direct the company to defer the payments at his discretion to a date selected by the taxpayer.[115] Thus, the Tax Court held petitioner had constructively received the compensation income in the tax year the invoices were issued.[116] Therefore, petitioner had to include the amounts paid on the invoices and other nonemployee compensation in gross income for the tax year of constructive receipt, and not in a subsequent tax year when the amounts actually were paid.[117]

Medical Leave-Sharing Plans and Major Disaster Leave-Sharing Plans

This section discusses the tax consequences under leave-sharing plans to participating employees and sponsoring employers under both the general tax principles and, in certain situations, under the applicable safe harbors. Donated leave is distinguished from unused leave that may be applied under a cafeteria plan, or paid sick leave or family leave taken by an employee as provided under FFCRA.[118] In addition, design of leave programs must conform to applicable state and local leave laws. Another requirement for leave program sponsors to keep in mind is the ERISA payroll practice exemption.

Employers should ensure that leave-sharing plans comply with the applicable requirements to avoid adverse tax consequences under constructive receipt or assignment of income principles subject to the IRS non-enforcement policy within the safe harbors. Leave-sharing arrangements outside the safe harbors would be governed by the general income tax, employment tax, and withholding rules applicable to donor employees, leave recipients, and sponsoring employers. In particular, employers should consult with tax counsel on potential tax consequences with respect to recipient employees if a leave-sharing plan falls outside a safe harbor and donor employee has constructive receipt of donated leave.

Consequences to Donor Employee

Outside the safe harbor, under the assignment of income doctrine, a donor employee would realize compensation income in the amount of the cash value of donated leave surrendered or transferred to a leave bank.[119] Under a medical leave-sharing plan that complies with Rev. Rul. 90-29, there is no option for either donor employee or recipient of donated leave to convert the leave into cash. the anticipatory assignment of income doctrine would not apply to the donor employee in a leave-sharing arrangement that does not permit cashing out the leave.[120]

A major-disaster leave-sharing plan generally requires the donated leave to have been accrued as of the date of the donation. The issue is, whether unused accrued leave would be taxable to the donor employee under the doctrine of constructive receipt. In *Acquisto v. Commissioner*, accrued, unused sick leave was not accounted for separately by the employer school board and was not in a separately maintained fund, but rather was accounted for as a general budgetary item to be met out of the general wage fund. Thus, the Tax Court held that the sick leave was not constructively received by the employee. Therefore, the sick leave was not taxable income until the employee was paid the value of the unused leave as a lump sum in cash upon retirement.[121]

In a situation in Rev. Rul. 75-539, a retiring employee could receive a cash payment for accumulated sick leave or elect to have an equivalent amount applied to the cost of accident and health insurance.[122] The IRS ruled that the value of the unused sick leave time was includible in gross income whether the retiree received such amount in cash or elected to have such amount applied to pay premiums for insurance.[123] However, in this case, a conversion to cash would have occurred upon the election.

On the other hand, a mere promise to pay, not represented by notes or secured in any way does not con-

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[114] *Palmer*, T.C. Memo 2000-228.

[115] *Palmer*, T.C. Memo 2000-228.

[116] *Palmer*, T.C. Memo 2000-228.

[117] *Palmer*, T.C. Memo 2000-228.

[118] *See* Pub. L. No. 116-127, §3102, §5102; §125(d)(1)(B); Reg. §1.125-3, Q&A 5.

[119] §61(a); Reg. §1.61-2(a)(1); *Lucas*, 218 U.S. 111 (1930).

[120] See PLR 200027044 (ruling, *inter alia*, assignment of income would not apply to proposed conversion of accumulated unused sick leave credits to additional benefits under a defined benefit plan), PLR 9827040 (concluding that ''an employee cannot voluntarily forego future taxable income for consideration, and the plan contributions will not be a substitute for amounts the employee would otherwise receive as current compensation;'' ruling, *inter alia*, the anticipatory assignment of income doctrine does not apply to proposed mandatory conversion of unused sick leave to a plan contribution); GCM 37014 (Feb. 25, 1977) (advising that, ''The significant element in the anticipatory assignment of income cases is also the substantial degree of dominion and control exercised by the taxpayer over his earned compensation''). *Cf.* PLR 9227035 (ruling that employee election in December of each year to convert excess sick leave in following year and a one-time election to convert accumulated excess sick leave credits from prior years into cash used to fund a medical reimbursement plan would result in inclusion in income by electing employee of cash value of excess sick leave in the year the amount is paid over to the plan under the anticipatory assignment of income doctrine).

[121] *Acquisto v. Commissioner*, 44 T.C. Memo 1991-293.

[122] Rev. Rul. 75-539.

[123] Rev. Rul. 75-539.

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stitute receipt of income within the meaning of the cash method of accounting.[124] In PLR 200351002, a proposed amended leave program provided for automatic and mandatory conversion of unused annual vacation leave accumulated by state employees into contributions to a qualified plan or 457(b) plan. The IRS determined employees were not eligible under any circumstances to cash out any of the unused vacation leave credits before separation from service or retirement.[125] Therefore, the IRS ruled that accumulated vacation leave was not constructively received in the tax years of contribution or deferral of converted amounts.[126]

Similarly, in PLR 199940043, a bank sought to amend an annual leave policy to permit excess paid leave credits at the end of a year to roll over as contributions to a qualified governmental plan sponsored for employees of the federally chartered bank. The plan contributions were treated as employer contributions under the proposed amendment.[127] Employees could not receive cash in lieu of contributions of excess paid leave amounts.[128] The IRS ruled that contributions of excess leave to the qualified plan were nonelective employer contributions not includible in gross wages of employees under FICA.[129] The IRS also ruled the contributions did not result in constructive receipt of the value of excess leave amounts to plan participants.[130]

Subsequently-issued PLR 200202027 concerned a revised paid time off (PTO) plan and policy sponsored by a tax-exempt entity, which also maintained a 457(b) plan and a 403(b) plan for employees.[131] The revised document provided that, prior to the beginning of a calendar year, in which services for which compensation was paid were provided, employees could make an irrevocable election of one or a combination of three options for the next year.[132] An employee could elect to apply accrued leave toward an employee elective deferral under the 403(b) plan, actually use the accrued leave, or take a wage distribution of the cash equivalent.[133]

In PLR 200202027, the IRS ruled the leave amounts were not constructively received in the year in which an employee made the election. Instead, an employee included the cash equivalent of paid leave in gross income for the tax year in which the leave was accrued.[134] However, any leave that was converted to a compliant elective employee contribution to the 403(b) plan was not includible in gross income for the year the contribution was made.[135]

By contrast, in PLR 200720017, to be eligible to receive surrendered leave under the current policy of the employer, an employee had to be employed by the taxpayer for at least 90 days and had to have been eligible to accrue paid leave time under the applicable paid leave program. Generally, leave-sharing plans apply the participation requirements to an electing employee with respect to both donating and receiving leave under the plan. Thus, the same requirement would appear to apply to an employee to be eligible to donate leave. In that case, PLR 200720017 would have circumvented general constructive receipt principles observed in letter rulings discussed above. Accordingly, under the safe harbor, it appears unnecessary to require an employee to elect into the leave-sharing plan before the tax year donation in which the donated leave is surrendered or deposited.

However, the IRS has not clarified its nonenforcement stance under Rev. Rul. 90-29 or Notice 2006-59 with respect to donated leave accrued before the election. Leave accrued prior to an election to donate would be deemed constructively received under the general rule. The safe harbors do not apply expressly to previously accrued leave but also do not exclude it from the nonenforcement policy. Thus, an election may be made prior to the beginning of the tax year, in which the paid leave is earned by the employee with respect to all or part of the vacation leave or sick leave credit that will be earned in the next year, and the election does not result in taxable income to the employee under the general rules.[136] Rather, outside of a safe harbor, an employee will have constructive receipt of the unused leave in the tax year, in which the amounts are deducted from the leave balance.[137]

This principle is relevant for leave-sharing plan sponsors that unwittingly failed to comply with a safe harbor. The rule also is significant for employers seeking to comply with general constructive receipt rules

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[124] §446, §451(a); PLR 200450010; *see* Rev. Rul. 69-650.

[125] PLR 200351002*; see also* §401(a), §457(b).

[126] PLR 200351002. The IRS also ruled that the leave program was a bona fide leave program under the exception in §457(e)(11), the contributions of converted leave amounts were not subject to economic benefit or anticipatory assignment of income rules, were not wages within the meaning of §3121 at the time of contribution, and unless an employee took an unpaid leave of absence other than approved leave during a time when paid leave was available, the contributions of converted leave were nonelective qualified plan contributions.

[127] PLR 199940043.

[128] PLR 199940043.

[129] PLR 199940043. *See* §3121(a).

[130] PLR 199940043; *see* §401(a), §451(a).

[131] *See also* §403(b).

[132] PLR 200202027.

[133] PLR 200202027.

[134] PLR 200202027.

[135] PLR 200202027.

[136] PLR 200450010.

[137] PLR 200450010.

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absent further clarification of tax consequences to employees and plan sponsors under safe harbors. However, with respect to a Covid-19 or other major disaster leave-sharing plan, such advance planning may be of limited import due to timing restrictions.[138]

Practical Implications of Constructive Receipt in Designing Leave-Sharing Plans

Notice 2006-59 implies that leave must be accrued at the time of deposit in an employer-sponsored leave bank under a major disaster leave-sharing plan. Under Rev. Rul. 90-29, the pro-forma medical leave-sharing plan contained restrictions on the amount of leave that could be surrendered by the donor employee or deposited in the leave bank. The plan also set forth rules as to the manner in which the surrendered or deposited leave would be awarded to donee employees. But, by contrast to Notice 2006-59, Rev. Rul. 90-29 does not specify any other factors that would create substantial limitations or restrictions on employee control of the leave.

An employee may have an unrestricted right to choose whether or not to donate the accrued, unused paid leave in the amount allowable under the terms of the medical leave-sharing plan. Under §451, such control by a donor employee would trigger inclusion in gross income for the tax year in which the paid leave accrued the value of the amount of the unused leave. Accordingly, Rev. Rul. 90-29 departs from general constructive receipt principles that would apply to an election made by donor employee after donated leave had accrued. The IRS has not clarified the scope of any required timing restrictions on donor employee under a medical leave-sharing plan.

Specifically, the IRS has not clarified tax treatment of leave amounts that an employee elected to donate under a medical leave-sharing plan after the leave credits had accrued. A medical leave-sharing plan may allow a donor employee to elect to participate in the medical leave-sharing plan prior to the beginning of the tax year, in which the paid leave would accrue. The paid leave would be a mere promise to pay not subject to current taxation under the constructive receipt doctrine. During the tax year, donated leave could be deducted from the paid leave balance of the donor employee on a rolling basis as leave accrues.

In this manner, a prior year irrevocable election would subject the right of the employee to use the amount of donated leave to substantial limitations or restrictions in subsequent tax years of accrual. IRS guidance on the scope of the constructive receipt safe harbor is limited. Therefore, a prior year election would avoid current taxation to donor employees of accrued, donated leave.

Reversion to Donor Employee

Under Notice 2006-59, one of the requirements of a major disaster leave-sharing plan is return to donor employees of any unused leave within a reasonable time after reaching the time limit for donating and using the leave under the plan. There is an exception for a de minimis amount of unused leave. Notice 2006-59 does not clarify that a donor employee would avoid inclusion in gross income of returned leave amounts. However, Notice 2006-59 does not require explicitly a written plan to state in writing that unused leave would be returned to donor employees.

Thus, the reversion requirement in Notice 2006-59 is operational. Returning donated leave to donor employees may result in adverse income tax, employment tax, or withholding consequences for donor employees or sponsoring employers.[139] Therefore, leave-sharing plans, especially hybrid plans for sharing of both medical leave and major disaster leave, generally may provide that leave donations are irrevocable for donor employees. Likewise, such plans generally may provide that any unused leave reverts to the leave bank, and not to donor employees. Accordingly, employees affected by the major disaster may use timely most of the leave donated under a major disaster leave-sharing plan to ensure compliance with the Notice 2006-59 safe harbor. Alternatively, a leave-sharing plan may provide that leave may be returned to donor employees subject to substantial limitations or restrictions that conform to the constructive receipt rules. [140] Any mechanism for returning leave also must comply with the ERISA payroll practice exception.

Consequences to Donee Employee

Absent a safe harbor, if a donor employee is not in constructive receipt of donated leave, the donor employee must include the accrued donated leave in gross income under the assignment of income doctrine.

The Sixth Circuit Court of Appeals concluded in *Estate of Clarks v. United States*, in ''*Lucas* and *Horst,* the assignees were the object of gifts and not subject to income taxation themselves if the income was taxed to their assignor or donor. The IRS chose

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[138] *See* Notice 2006-59; IRS FAQ, *Leave Sharing Plans Frequently Asked Questions* Q&A 1 (Sept. 19, 2020), https://www.irs.gov/newsroom/leave-sharing-plans-frequently-asked-questions.

[139] *See generally* §61, §451, §3121, §3402, §6651, §6656, §6672.

[140] *See, e.g.*, PLR 9009052 (no constructive receipt of excess accrued paid leave unless a minimum accumulated leave balance during a year is maintained and the excess leave is over a specified minimum number of hours).

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to tax the assignors, not both the donors and donees. By having the income taxed to the donor, the donee escapes income taxation."[141] Thus, under the general assignment of income doctrine, the donor was taxed.

In addition, in PLR 200720017, under the modified policy, donated leave was surrendered to a recipient employee or deposited in a leave bank. The IRS ruled that under the modified leave-sharing program, a donor employee would be taxed on the value of donated leave under the assignment of income doctrine.

Thus, the IRS has taken the position that assignment of income would require a donor employee to include the amount of leave surrendered or deposited in a leave bank in gross income outside a safe harbor.[142] In that case, the donated leave may be treated for income tax purposes as a gift to recipient employee rather than an item of gross income taken into account as wages paid to recipient employee. Consistently, the employer could not claim a double §162 deduction in the amount of leave donated to an employee. However, absent actual or constructive receipt of donated leave by donor employee, recipient employee would have to include the donated leave in gross income as wages or compensation under both the general rules and each safe harbor. Further IRS guidance could clarify tax treatment of an employer and employees under these circumstances in the event of noncompliance with Rev. Rul. 90-29 or Notice 2006-59.

Leave-Based Donation Program

By contrast to more elaborate operational requirements of a medical or major disaster leave-sharing plan, the criteria for a sanctioned leave-based donation program in the Notice are broad. Thus, by comparison to a leave-sharing arrangement, there are fewer defining characteristics of a leave-based donation program that would determine whether the program deviated from general income tax principles. A summary analysis of a leave-based donation program under the constructive receipt and assignment of income rules are set forth below.

Under the Notice, an employee merely has to elect to forego paid leave in exchange for cash payments by employer to §170 organizations for Covid-19 relief made before January 1, 2021. There is no timing restriction on making the election in the Notice. The Notice also does not require explicitly that leave be accrued at the time the election is made. Due to the limited time frame of relief under the Notice, an employee technically could not elect into the leave-based donation program prior to the beginning of the calendar year in which foregone leave is accrued. Implicitly, an employee can donate unused paid leave that accrued before or after the date of the election.

Thus, absent the safe harbor in the Notice, an employee would be in constructive receipt of the value of leave transferred pursuant to a leave-based donation program. In certain cases, an employer may fail to make the required cash contributions before January 1, 2021, or ensure that proper employee elections were made with respect to accrued but unused paid leave. In such an instance, an employee would have an income inclusion and employment tax liability with respect to the value of the donated leave for calendar year 2020. Likewise, the employer would be subject to employer portion of employment taxes, withholding, and reporting requirements with respect to the value of donated leave.

In addition, similarly to the IRS position with respect to a leave-sharing arrangement outside a safe harbor, the IRS may deem a contribution under a leave-based donation program subject to the assignment of income doctrine if the Notice requirements are not met. In PLR 200720017, donated leave could not be converted to cash. However, in a leave-based donation program, a cash contribution is made by the sponsoring employer to a §170 organization. Thus, there is amplified reason, absent the safe harbor, to treat the cash value of donated leave under a leave-based donation program as anticipatory assignment of income by donor employee.

Therefore, absent compliance with the Notice, both the donor employees and the employer may incur penalties, interest and additions to tax for failure to treat the donated leave as wages or compensation.

Absent a safe harbor, an employer generally would deduct the payment of donated leave amounts included in gross income by donor employee as wages or compensation under §162. An employer generally would not be allowed a double benefit with respect to donated leave amounts by deducting the amounts as both wages and a charitable contribution. In addition, under the Notice, an employee donates leave to the employer rather than to a §170 charitable organization by payroll deduction. Donation by a donor employee of unused leave to an employer would not meet §170(f)(8) substantiation requirements of §170(f)(17) record-keeping requirements.

Thus, generally, a donor employee would not be eligible to claim a §170(c) deduction for donated leave if the program failed the safe harbor in the Notice, unless applicable requirements were met. Accordingly, employers should consult with tax counsel

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[141] *Estate of Clarks v. United States*, 202 F.3d 854, 857 (6th Cir. Mich. 2000) (holding donor was not taxed on the income because there was no vested right to contingency fees; instead, donee had inclusion). *See Lucas*, 281 U.S. 111; *Helvering v. Horst*, 311 U.S. 112 (1940).

[142] PLR 200720017.

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regarding compliance with the requirements in the Notice to avoid adverse tax consequences to participating employees. Employers should advise participating employees in the leave-based donation policy document of any potential tax liability as a result of failure to comply with the safe harbor in the Notice.

CONCLUSION

A contributing employee may exclude paid leave amounts for income or employment tax purposes under a leave-based donation program. However, Notice 2001-69, and subsequent guidance, generally provided only a one-year safe harbor for not imputing income to contributing employee, subject to compliance with requirements for leave donations. The IRS waived raising the unfavorable income or employment tax issues on charitable contributions of forfeited leave. Instead, the IRS applied ''wash'' treatment for employees who participated in leave donations.

Treasury and IRS guidance stated or suggested a disaster relief PTO arrangement was only an exception to general tax treatment of donated leave outside of a leave-based donation program. Thus, the IRS effectively suspended applicability of constructive receipt and assignment of income doctrines with respect to donated leave subject to a safe harbor in Treasury and IRS guidance. The authority to establish the safe harbor was questioned after issuance of Notice 2003-1.

Therefore, there is no express authority in the tax law for excluding from taxable income of an employee paid leave contributed under a medical or disaster leave-sharing plan or leave-based donation program. Treasury granted the IRS non-enforcement authority with respect to the general tax rules applicable to the leave arrangements, and thus, broad discretion to reject a leave-sharing plan or leave-based donation program as failing to meet the applicable safe harbor requirements. Accordingly, exclusion of leave by contributing employee from income tax, employment tax, or withholding under a PTO leave donation program is solely at the discretion of the IRS. And, tax relief for the cash payments in calendar year 2020 is limited to the safe harbor in Notice 2020-46.

By contrast to the safe harbors for leave-sharing plans, requirements for a leave donation program are broadly outlined in Treasury and IRS guidance. Employers must ensure strict compliance with the requirements of leave-based donation programs and leave-sharing plans to avoid adverse income or employment tax consequences for donor employees, or employer FICA tax or withholding liability. Drafting and implementing a Covid-19 leave-based donation program as a payroll practice also would avoid noncompliance with ERISA employee benefit plan rules.

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