

Client Advisory

November 2001

Employers and Employees Benefit from Favorable Tax Treatment for Donated Vacation, Sick or Personal Leave

As a result of the tragic events of September 11, 2001, the Internal Revenue Service (IRS) has issued a notice about tax-favored means that employers and employees can use to support the relief effort. IRS Notice 2001-69 indicates that employers may introduce a program to employees whereby the employees may forego earned vacation, sick or personal leave time, and, in exchange, the employer will directly donate the foregone compensation to an organization described in Section 170(c) of the Code (i.e., a charitable organization). Under the IRS terms, any money donated by an employer under such a program would be deductible by the employer under Section 162 of the Code (rather than the more restrictive Section 170).

By permitting employees to utilize their untaken leave in such a manner, both the employer and employee realize tax benefits. In addition to the employer receiving a business expense (rather than charitable) deduction, both benefit from the fact that the payment will avoid employment taxes. Further, employees who do not itemize and therefore would not have been able to utilize a charitable deduction to offset the taxable income can now make the contribution without adverse tax impact. Be advised, however, that there may be some relatively minor downsides for employees participating in such a program. For example, because the foregone compensation is not included in the employees' income, participation may result in reduced benefits under income-dependent plans such as 401(k) and Social Security.

In order to qualify for the special tax treatment of IRS Notice 2001-69, contributions need to be made before January 1, 2003.

Employee Benefits and Executive Compensation

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