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IRS Okays Funding Employer COVID-19 Charitable Contributions from Employee Leave Donations

In a recent announcement (Notice 2020-46), the Internal Revenue Service (“IRS”) provided guidance to employers for how to exchange employee elections to forego vacation, sick, or personal leave for cash payments that the employer makes to charitable organizations for COVID-19 relief.

THE GROUND RULES

An employee who elects to give up paid leave will not be taxed on the value of the leave if the payments in exchange for the leave are made by the individual’s employer prior to January 1, 2021 to a tax code section 170(c) organization that provides “relief to victims of the COVID-19 pandemic.” A section 170(c) organization includes, among other recipients, charities and governmental units that use the donation solely for a public purpose. Although not explicit in the IRS notice, the use of the phrase victims of the COVID-19 pandemic can be read to mean that the permissible use of the donations extends not only to assist people who contract the disease, but also to people who lose their jobs or are otherwise financially harmed by the pandemic.

The employee who elected to forego leave may not claim a charitable contribution for the payment made by the employer. Employers will have the choice to deduct these contributions

either under the rules of tax code section 170, which relates to contributions to charitable organizations, or tax code section 162, which relates to the deduction for ordinary and necessary business expenses. The benefit of taking a deduction under tax code section 162 as opposed to tax code section 170 is that the employer will not be subject to certain limitations that section 170 imposes on the amount of the payment that is deductible in the year of the payment.

SOME THINGS FOR EMPLOYERS TO THINK ABOUT

- Paid leave that an employee foregoes does not translate to immediate cash, but rather to future potential savings, assuming the employee would otherwise use the paid leave.
- In light of the uncertainties created by the pandemic, employees may be reluctant to give up paid sick leave or leave under a paid time off policy that an employee can use as sick leave.

- Employers desiring to implement a leave-donation policy need to be careful to comply with laws that might either place restrictions on giving up paid leave or require that employers provide minimum amounts of paid sick leave.

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