



PTO CASH-OUTS AND CONSTRUCTIVE RECEIPT

April 18, 2024

For many years, employers have implemented paid time off ("PTO") cash-out arrangements. If not constructed properly, PTO cash-out arrangements can raise constructive receipt issues resulting in unexpected taxation. In this newsletter, we will briefly cover PTO cash-out arrangements, the IRS' position regarding constructive receipt and the potential tax consequences.

The constructive receipt doctrine requires that if an employee is given the option to receive cash compensation or another benefit, the employee is required to recognize the cash compensation that is made available as income, regardless of whether the employee actually takes the cash compensation when it becomes available. In applying the constructive receipt doctrine to PTO cash-out arrangements, the IRS has consistently taken the position that an employee will be taxed on the value of the accrued PTO days that an employee may elect to cash-out under the arrangement in lieu of taking or carrying over the accrued PTO days. This position is illustrated by the following example:

Ann has accrued 15 days of unused 2023 PTO in December 2023. Her employer permits her to cash-out up to 10 days of accrued PTO in December of each year. Ann chooses to carryover all 15 days of her unused PTO from 2023 to 2024. According to the IRS position, Ann will be taxed in the 2023 tax year on the value of the 10 days of unused PTO that she could have cashed out but elected to carry over to 2024. She will not be taxed on the additional 5 days of PTO that she is carrying over to 2024, because these 5 days were not available for cash-out.

If Ann's employer did not allow any cash-outs of accrued PTO, Ann could have elected to carryover all 15 days of her unused PTO from 2023 to 2024 without including any amount in income for the 2023 plan year. Alternatively, if the employer did not give Ann a choice and instead had a policy of cashing out a certain number of hours of PTO without an election from the employee, there would be no constructive receipt considerations.

The good news is that the IRS has issued several private letter rulings that provide the parameters for establishing a PTO cash-out arrangement that does not fall under the constructive receipt doctrine. While the private letter rulings issued by the IRS can only be relied on by the party that received the ruling, the letters provide insight into the IRS' position as to how they apply constructive receipt to PTO cash out arrangements. The IRS

has indicated in these rulings that the constructive receipt doctrine will not apply to a PTO cash-out arrangement that requires an employee to make an election in the current year to cash-out PTO that accrues in the following year. This can be accomplished through a stand-alone policy or, in some cases, through a Section 125 plan. This type of arrangement is illustrated by the following example:

In December of each year, Jim's employer permits employees to elect to cash-out up to 10 days of PTO that will be accrued in the subsequent year. Jim accrues 15 days of PTO each year. In December 2023, Jim elects to cash-out five days of the PTO that he will accrue in 2024. Because the election is for amounts that will accrue in a future year, the constructive receipt doctrine should not apply based on the position taken by the IRS in the private letter rulings.

Given the increasing complexity of PTO arrangements now involving buying, selling, cash-outs, and carryovers, consultation with counsel is recommended when constructing a PTO arrangement.

If you have any questions or would like additional information, please contact a member of our Employee Benefits & Executive Compensation Practice Group.



Al Ward
al.ward@hwlaw.com
813.222.8703



Kirsten Vignec
kirsten.vignec@hwlaw.com
813.222.8731



Bret Hamlin
bret.hamlin@hwlaw.com
813.222.8717



Tim Zehnder
timothy.zehnder@hwlaw.com
813.222.3113



DISCLAIMER: This newsletter was created by Hill Ward Henderson for informational purposes only. It discusses legal developments and should not be regarded as legal advice for specific situations. Those who read this information should not act upon it without seeking legal advice. Neither prior

results described herein, nor any other representations contained herein guarantee a similar outcome.

CONFIDENTIALITY NOTE: The information contained in this transmission may be privileged and confidential information, and is intended only for the use of the individual or entity named above. If the reader of this message is not the intended recipient, you are hereby notified that any dissemination, distribution or copying of this communication is strictly prohibited. If you have received this transmission in error, please immediately reply to the sender that you have received this communication in error and then delete it. Thank you.

Hill Ward Henderson | 101 East Kennedy Boulevard, Suite 3700, Tampa, FL 33602

[Unsubscribe stephanie.hughes@hwhlaw.com](mailto:stephanie.hughes@hwhlaw.com)

[Constant Contact Data Notice](#)

Sent by info@hwhlaw.com