Hidden Problems within Sabbaticals and Other Professional Development Leave Programs
By Tyrone P. Thomas*

From corporations to prestigious research universities, employers sometimes permit employees to take time away for extended periods. The names of these programs may vary, e.g., they may be related to a sabbatical or professional development leave. Benefits include improved employee morale, research development, and in some instances, cost savings if the employee is not paid at the full rate of pay for the entire leave period. The employee will often have greater discretion in determining their work-related activities during a sabbatical. The employee can also increase his or her value to the employer if the leave is used to conduct value-added activities, such as building credentials and authorship.

There are problems with these arrangements, however, that center upon how well the parameters for the leave period are defined. A poorly designed and managed professional leave program can create legal, tax, and financial issues that could have been prevented.

A sabbatical program which is ambiguous or silent on the post-termination rights of employees may yield a surprise for an employer contesting payment of the value of the benefit upon an employee's termination. A California appeals court recently evaluated this issue in the case of *Paton v. Advanced Micro Devices, Inc.*, 197 Cal.App.4th 1505 (Cal. App. 2011). The underlying facts addressed whether an employee who would vest in an eight week sabbatical after completion of seven years of service should have such period treated as vacation leave or a "true sabbatical." This distinction is material under California law, as an employer cannot force an employee to forfeit vested vacation pay, but no explicit protection is provided for a sabbatical. The court determined that the leave program was indistinguishable from a vacation benefit, in part due to the sabbatical's length and absence of conditions as to how the leave period would be spent.

The logic of the *Paton* decision is noteworthy because of the effect it would cause for employers operating in states which mandate payout of vacation leave upon termination of employment. Irrespective of intent, there could be parallel tracks of accrued wages payable to eligible employees upon termination in the form of accrued vacation and sabbatical leave. Depending on the length of service and compensation of the departing employee(s), these costs could be significant.

The Internal Revenue Service has taken an increased interest in certain employer-provided benefits, including sabbaticals. There are many reasons why. Several provisions of the Internal Revenue Code may be implicated by the design of a professional development leave program. These issues can include: Does the employee have work-related tasks while on leave or are they free to conduct whatever pursuit they choose, regardless of whether it provides a benefit to the organization? Is there a requirement (or even the reasonable expectation) that the employee will return to work at the sabbatical's conclusion? Is there a cap on the length of leave time that may accrue to employees under the program? The answers to these questions could lead to varying tax results.

As a general premise, the IRS will view with a jaundiced eye any sabbatical benefit which by design is scheduled to occur at the conclusion of employment. The underlying issue is the appearance of the arrangement as deferred compensation. This is especially problematic for large non-profit organizations, such as hospitals and universities, which are subject to certain rules for non-qualified deferred compensation plans under Sections 409A and 457(f) of the Internal Revenue Code. If the IRS were to review a one year sabbatical granted to a chief executive upon her completion of employment, which was without obligation to provide meaningful services or tasks during the leave period, the executive may be surprised to find she has incurred a tax bill for the full value of this benefit on the day the employment contract was signed (and potentially years

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before the sabbatical actually occurs).

Unfortunately, the IRS has not yet published guidance on sabbaticals or similar "bona fide leave of absence" programs. However, employers are well served to note certain areas of concern that commonly arise with these programs from a tax perspective. For instance, a sabbatical program without duties or a reasonable expectation to return to employment may be deemed a "separation from service" and cause the unintended consequence of vesting certain deferred compensation programs. If the sabbatical program is intended to be treated as an extended vacation, it should have limitations on its accrual to qualify as a "bona fide leave of absence" in accordance with the exclusions provided to such leave programs under Section 409A. A professional development leave program that is only open to certain senior executives could present an issue if the arrangement essentially functions as a deferred compensation incentive.

Public employers have their own separate concerns with extended leave programs. The Attorney General of Arkansas provided a noteworthy opinion on sabbatical programs in 2009, which asserted that sabbatical pay, which is not granted to an outgoing employee pursuant to contract, is an impermissible gratuity. The basis of this opinion is that publicly funded institutions cannot provide compensation to someone who does not provide services. As other states are carefully conducting audits of their budgets for waste in this economic environment, any program which has the appearance of "extra compensation" will need to be structured properly to reflect the respective values paid for past and future services.

A tax audit is not the ideal time for an employer to learn the IRS has a different view of their existing sabbatical program. In fact, given that the Department of Labor and the state agency responsible for wage payment may also be implicated, as was the case in California, compliance for tax and wage purposes is critical. Therefore, as the calendar year turns to 2012, employers would be wise to assess the status of the sabbatical or professional development leave program they will bring with them into the New Year. ■