



## SALUS GROUP

# Compliance Considerations for Unlimited PTO Policies

With employee leave laws continuing to expand in patchwork fashion across the country, employers may consider implementing an unlimited paid time off (PTO) policy for ease of administration and to avoid liability for unused accrued paid leave. Popular among employees, unlimited PTO can also act as a strong recruitment and retention tool.

However, employers thinking of adopting this emerging benefit must take care to avoid compliance violations. Among the issues that arise when designing an unlimited PTO plan, the following are addressed in this Compliance Overview:

- Compliance with state employee leave laws;
- Compliance with state requirements for payout of accrued leave; and
- Compliance with state rules on forfeiture of accrued leave.

### **Background: Employer-provided Leave Benefits**

In a growing minority of states, employers are required to provide PTO for illness and other specific reasons, such as bereavement, voting and organ donation. These employee leave requirements often come with obligations for employers such as notice, accrual, carryover, tracking and recordkeeping.

U.S. employers are not required to provide employees with paid vacation or personal time off (although Maine, Nevada and Illinois have laws mandating paid employee leave for any reason). However, some states impose requirements on voluntary paid leave once offered, mainly addressing payout and forfeiture of unused leave at the end of the year or on separation of employment.

This Compliance Overview does not cover the interplay of unlimited PTO with federal or state family and medical leave laws or leave under the Americans with Disabilities Act. Employers are encouraged to consider the implications of their leave policies on their obligations under these laws.

### **Unlimited PTO Policies Defined**

Faced with varying employee leaves to track and administer, some employers have turned to unlimited PTO policies as an administratively simpler alternative to standard leave policies.

#### **Traditional Leave Policies: Accrual, Carryover, Allocated Amounts**

Unlimited PTO plans represent a departure from standard employee leave policies that have employees earn ("accrue") amounts of leave at a set rate as they log hours worked. For example, employees under a traditional vacation leave policy might accrue paid vacation at a rate of .83 hours per month for an annual total of 10 vacation days. Sometimes, in lieu of an accrual schedule, employers make the full amount of annual leave immediately available to the employee at the beginning of the year, a practice known as "frontloading."

Generally, these standard paid leave policies separate the leave offered into different buckets—one for paid sick leave, one for vacation leave and one for personal leave, for example, with different amounts and procedures for each bucket.

Traditional PTO policies often include a carryover provision, where, at the end of the year, unused, accrued time off rolls forward into the employee's subsequent benefit year. PTO policies without a carryover provision are described as "use-it-or-lose-it," meaning the employee will not be able to take advantage of any leave time they accrued but did not take by the end of their benefit year. Depending on state law and employer policies, traditional vacation policies may compensate ("pay out") employees for their unused paid time at the end of the year or when employment ends.

#### **Unlimited PTO Policies: One Bucket, Frontloaded, No Cap**

In contrast to these more familiar types of leave policies, unlimited PTO combines all paid leave into one bucket, made available for employee use at the start of the benefit year with no maximum limit on the amount that may be used. There is no accrual, no carryover and no payout at separation of employment. Employees must still get their supervisor's or manager's approval to take the leave, and that approval may be limited based on factors like the ebb and flow of the organization's workload during the year and how many other employees are on leave.

## Benefits of Unlimited PTO

One of the main advantages of unlimited PTO plans is that they are easy for employers to administer. Because these plans make all of an employee's leave available from the start of the year, there is no accrual to monitor and calculate. Furthermore, with unlimited PTO, all types of leave are combined in one bucket, eliminating the need to keep track of limits and supporting documentation for different kinds of leave.

Employees appreciate the flexibility of unlimited PTO plans, which allow them to allocate leave days for the purposes they need most. In this way, unlimited PTO can be a strong recruitment and retention tool. Unlimited PTO is also a morale-booster for employees. Giving employees the independence to manage their own tasks, deadlines and time off imbues the employer-employee relationship with trust.

## Disadvantages of Unlimited PTO

While the ease of administering unlimited PTO is indisputable, there are challenges with the benefit. Unlimited PTO can present difficulties in ensuring an adequate workforce during an organization's busy times. Another concern is that, if not managed correctly, these policies can lead to inequities between employees who take large amounts of leave and those who feel pressured to take only a minimal amount. These inequities can lead to resentments, which undermine the benefit's goal of boosting morale.

Beyond these potential workforce management issues, major compliance obstacles to unlimited PTO include:

- State employee leave laws; and
- State rules on forfeiture and compensation of unused accrued PTO.

## Compliance With State Employee Leave Laws

Unlimited PTO plans run the risk of failing to comply with state and local employee leave laws, which, as noted above, usually contain specific provisions for requirements like notice, accrual, carryover, tracking and recordkeeping.

Some states provide guidance on integrating employer PTO plans with the requirements of the law, in statutory or regulatory language, or in official guidance like FAQs. In California, for example, [FAQs](#) from the Labor Commissioner's Office address how employer leave policies can comply with the [Healthy Workplaces, Healthy Families Act](#), the state's paid sick leave law. The FAQs note that employer policies that combine leave for vacation and illness are compliant if they provide the minimum required amount of paid leave that can be used for health care and meet other requirements in the law.

With respect to the law's rules for tracking sick leave accrual and use, the California FAQs state that unlimited PTO plans satisfy these requirements if a notice, itemized pay stub or separate written statement provided with the payment of wages indicates the paid sick leave is "unlimited." The statute itself excuses employers that frontload leave from the carryover requirement.

As another example, New York's paid sick leave [statute](#) provides that employer time off policies that meet or exceed the law's requirements relating to leave amount, accrual, carryover and use comply with the law. The New York law, like the California paid sick leave law, allows employers to frontload paid sick leave; however, unlike California, New York does not excuse employers that frontload paid sick leave from the statute's carryover requirement, a serious impediment to implementing unlimited PTO.

Some states expressly require that where an employer has its own combined plan that provides more leave than the paid sick leave law, the excess leave is still subject to the law when used for paid sick leave purposes. Minnesota, for instance, has issued proposed [regulations](#) for its paid sick leave law requiring that any additional paid sick leave provided by the employer must adhere to the law on provisions like notice and documentation. Employers with unlimited PTO plans in jurisdictions with similar requirements must be sure to administer paid sick leave in accordance with the rules.

In states that have not addressed the interplay between employer policies and employee leave law requirements, and even in states that have, there may be undefined legal areas that make compliance tricky to navigate.

## State Rules on Accrued Leave Forfeiture and Compensation

In addition to employee leave laws, state rules about what happens to an employee's unused paid leave at the end of the year or on separation of employment pose another potential obstacle to unlimited PTO policies. Some states require payout or carryover of unused leave at the end of the year, and some require compensation for unused accrued paid leave when an employee leaves the job. These requirements can complicate employer efforts to implement unlimited PTO, which does not provide carryover or payout.

Colorado is one of the states that treats accrued PTO as a wage that must be paid on termination of employment. However, Colorado does not apply its payout rule to unlimited PTO on the ground that the amount of paid leave earned under these policies cannot be "determinable." The state's official [guidance](#) on this point adds that where unlimited PTO is not truly unlimited (for example, where the employer describes its paid leave policy as unlimited but limits leave to 120 hours per year), the exception to the payout rule does not apply, and departing employees must be compensated for their unused, accrued paid leave.

By contrast, Illinois [regulations](#) treat PTO policies that combine sick and vacation leave in one bucket as vacation leave, which does have to be paid out at termination. [FAQs](#) from the Illinois Department of Labor further explain that where an employer policy provides an undetermined amount of vacation leave (as with an unlimited PTO policy), on separation of employment, the employer must pay out the monetary equivalent of the amount of vacation the employee would otherwise have been allowed to take. Unfortunately, the guidance does not explain how the monetary equivalent or amount of vacation should be calculated.

Unlike some states, Illinois does allow use-it-or-lose-it vacation policies, which include unlimited PTO policies and others that require employees to take their accrued paid leave within a defined period. Illinois regulations recognize the policies as [valid](#) as long as the employer gives the employee:

- A reasonable opportunity to take the vacation; and
- Notice that leave will be forfeited if not used by a certain date.

Thus, the lack of carryover with unlimited PTO is not an issue in Illinois, even if payout is.

Use-it-or-lose-it policies are prohibited in California, which further requires that vested vacation time provided under an employment contract or employer policy be paid at termination of employment. In 2020, a California appellate court [ruled](#) that the payout law applied to an employer's purported unlimited leave policy. However, the court limited its ruling to the particular facts of the case, in which the employer's unlimited policy was not included in the employee handbook, was not communicated to the employees (who were not aware of the policy) and was not unlimited in practice. The judge stated that the law requiring payout would not necessarily apply to unlimited PTO that is truly unlimited, that is in writing, and that:

- Clearly states that employees' ability to take PTO is not a form of additional wages for services performed but perhaps part of the employer's promise to provide a flexible work schedule—including employees' ability to decide when and how much time to take off;
- Spells out the rights and obligations of both employee and employer and the consequences of failing to schedule time off;
- Allows sufficient opportunity for employees to take time off or work fewer hours in lieu of taking time off; and
- Is administered fairly so that they neither become a de facto use-it-or-lose-it policy nor result in inequities, such as where one employee works many hours, taking minimal time off, and another works fewer hours and takes more time off.

This discussion of a sample of state laws, regulations, guidance and legal cases on paid leave payout and forfeiture demonstrates how much they can vary from state to state. Employers must pay close attention to the way their states view paid leave and design unlimited paid leave policies carefully to ensure compliance.

## Recommendations

Unlimited PTO plans provide appealing benefits to employers, such as administrative ease, popularity with employees and the avoidance of financial liability for unused leave. However, employers considering unlimited PTO must examine whether their proposed policy complies with laws, regulations, agency guidance and case law in the jurisdictions where they operate. Among the considerations employers must weigh is whether their plan satisfies complex and nuanced state requirements for:

- Paid leave laws such as paid sick leave;
- Payout of accrued paid leave; and
- Forfeiture of accrued paid leave.

In addition, employers should ensure that any unlimited PTO plan is administered in a way that ensures adequate staffing for the organization and equity among employees.

## LINKS AND RESOURCES

- California frequently asked questions ([FAQs](#)) on the Healthy Workplaces, Healthy Families Act
  - New York paid sick leave [law](#)
  - Illinois [FAQs](#) on vacation leave
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