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IRS Issues Q&As on the Paid Family and Medical Leave Business Tax Credit

Included in the 2017 Tax Cuts and Jobs Act is a provision that establishes a business tax credit for 2018 and 2019 for employers offering paid family and medical leave under certain conditions. To claim the credit the employer must:

- Have a written policy that satisfies certain requirements,
- Provide a benefit of at least 50% of a qualifying employee's normal wages for a minimum of two weeks, and
- Ensure non-interference protections are in place for taking of leave for qualifying employees not covered by the Family Medical Leave Act ("FMLA").

The IRS has issued Notice 2018-71 to provide employers with initial guidance about this new credit in the form of 34 Questions and Answers. The IRS intends to publish proposed regulations and has established a public comment period for this Notice through November 23, 2018.

Of particular interest, if an employer provides paid leave as vacation, personal leave, or medical and sick leave (other than *specifically* for one or more of the leave options under the FMLA[1]), that paid leave is not considered family and medical leave eligible for the new credit under IRC Section 45S. Furthermore, any leave paid by a State or local government or required by State or local law is not taken into account for *any purpose* in determining the amount of paid family and medical leave provided by the employer.

Employers that offer paid family and medical leave should review this initial guidance with counsel and tax advisors to determine if the leave program being offered to employees may qualify for the credit for 2018 and/or 2019. Employers subject to state and/or local leave laws will need to carefully examine their leave policies to determine what, if any tax credit may be available.

The following are highlights and examples from Notice 2018-71:

- The credit is available to any employer including those not subject to the FMLA, provided all leave program requirements are satisfied.
- A *written policy* must be in effect that provides *all qualifying employees* with a minimum of **two weeks** of paid family and medical leave (pro-rated for part-time employees defined as an employee who customarily is employed for less than 30 hours per week) at a rate of at least **50% of normal wages** and includes non-interference language if any qualifying employee is not covered by the FMLA. Transition relief for 2018 is available if the written policy (or amendment) is adopted on or before December 31, 2018 and the employer makes applicable retroactive payments before the end of the tax year.
- If the written policy provides paid leave for FMLA purposes and additional paid leave for other reasons, only the leave *specifically designated* for FMLA purposes would be eligible for the credit. The IRS provides the following examples:
  - **Facts1:** Employer's written policy provides three weeks of annual paid leave that is specifically designated for any FMLA purpose and may not be used for any other reason. No paid leave is provided by a State or local government or required by State or local law. **Conclusion1:** Employer's policy provides three weeks of family and medical leave under section 45S.
  - **Facts2:** Employer's written policy provides three weeks of annual paid leave for *any* of the following reasons: FMLA purposes, minor illness, vacation, or specified personal reasons. No paid leave is provided by a State or local government or required by State or local law. **Conclusion2:** Employer's policy does not provide family and medical leave under section 45S because the leave is not *specifically designated* for one or more FMLA purposes and can be used for reasons other than FMLA purposes. *This is true even if an employee uses the leave for an FMLA purpose*.
- For 2018, a qualifying employee for whom the employer may claim a credit is an employee (as defined in section 3(e) of the Fair Labor Standards Act of 1938, as amended)[2] who has been employed for at least one year and had compensation in the prior year (i.e. 2017) not greater than $72,000 (indexed for the 2019 credit).
- Leave paid pursuant to a short-term disability plan (insured or self-funded) may qualify as leave however; if the policy contains certain pre-existing condition limitation restrictions, this may disqualify benefits paid under the plan from being considered for the credit.

- To be eligible to claim the credit, an employer must *independently* satisfy the minimum paid leave requirements (exclusive of benefits paid due to state/local law), including providing a rate of payment of at least 50% of wages normally paid to an employee. The IRS provides the following example:
    - **Facts:** Under State law, an employee on family and medical leave is eligible to receive six weeks of benefits paid by a State insurance fund at a rate of 50% of the employee's normal wages. Additionally, Employer's written policy concurrently provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 30% of the wages normally paid to the employee for services performed for Employer. Consequently, in the aggregate, a qualifying employee can receive six weeks of annual paid family and medical leave at a rate of payment of 80% of the wages normally paid to the employee. **Conclusion:** Employer's policy does not independently satisfy the requirement that the rate of payment be at least 50% of the wages normally paid to an employee.
- The credit is determined as the amount of normal wages (excluding discretionary bonuses and overtime) paid to qualifying employees on family and medical leave multiplied by a percentage equal to 12.5% increased by .25% for each percentage point by which the employer's rate of payment exceeds 50%. The maximum percentage is 25%. Therefore, an employer that pays full wages under a family and medical leave policy (that otherwise satisfies all criteria) could claim a credit of 25% [12.5% + .25% x 50] of wages normally paid to a qualifying employee for a period of up to 12 weeks. Wages generally means FUTA wages without regard to the $7,000 FUTA wage limitation. An employer that does not pay FUTA wages is not eligible for the family and medical leave credit.
- A credit may only be claimed with respect to wages paid to an employee on paid family and medical leave only when the employee is considered a qualifying employee. Any wages paid to an employee before becoming a qualifying employee (i.e. before one year of service) are not taken into account in determining the credit.
- Employers that claim the credit will be denied a deduction for wages or salaries paid for the taxable year equal to the amount of the credit.
- Employers will claim the credit by filing IRS Form 8994, *Employer Credit for Paid Family and Medical Leave*, and IRS Form 3800, *General Business Credit*, with its tax return. The IRS intends to issue Form 8994 later in 2018.
- Employer members of a controlled group of corporations will make separate elections to claim or not claim the paid family leave credit.
- The credit is available for taxable years beginning after December 31, 2017 and before January 1, 2020.

[1]The FMLA purposes for which paid family and medical leave may be provided to a qualifying employee include: (a) birth, adoption or placement in foster care of a child of the employee, (b) care for the spouse, child, or parent of the employee with a serious health condition, (c) an employee's own serious health condition that makes the employee unable to perform the functions of the employee's position, (d) any qualifying exigency arising out of the fact that the spouse, or a child or parent of the employee is a member of the Armed Forces (including the National Guard and Reserves) who is on covered active duty (or has been notified of an impending call or order to covered active duty), and (e) caring for a covered service member with a serious injury or illness if the employee is the spouse, child, parent, or next of kin of the service member. The FMLA purposes are the purposes for which an employee may take leave under the FMLA. The terms used in this Q&A have the same meaning as defined in section 825.102 of the FMLA regulations, 29 CFR § 825.102.

[2]An "employee," as defined in section 3(e) of the FLSA, "means any individual employed by an employer." The employer-employee relationship under the FLSA is tested by "economic reality" rather than "technical concepts." It is not determined by the common law standards relating to master and servant. DOL Fact Sheet #13: Employment Relationship Under the Fair Labor Standards Act (FLSA).