Provided by SIMA Benefits Consulting Group

Employer Tax Credit for Paid Family and Medical Leave

The Tax Cuts and Jobs Act, which was signed into law on Dec. 22, 2017, creates a general business tax credit for eligible employers that provide **paid family and medical leave** to their employees. The tax credit, which applies to employer taxable years beginning in 2018 and 2019, is equal to a percentage of wages paid to qualifying employees who are on family and medical leave.

To be eligible for the tax credit, an employer must have a written policy in place that provides at least two weeks of paid family and medical leave at a payment rate that is at least 50 percent of an employee's normal pay rate. The tax credit only applies to leave that is taken for a reason permitted under the federal Family and Medical Leave Act (FMLA). Paid leave that is provided as vacation leave, personal leave or sick leave is not taken into consideration.

Employers that want to take advantage of the new tax credit should review their leave policies and work with their tax advisors, as necessary, to make sure they satisfy all of the applicable requirements for the tax credit.

LINKS AND RESOURCES

- IRS Notice 2018-71, which provides detailed guidance on the employer tax credit for paid family and medical leave
- IRS FAQs on the employer tax credit for paid family and medical leave.

HIGHLIGHTS

TAX CREDIT

- Employers of all sizes may qualify for the credit, even employers that are not subject to the federal FMLA.
- Employers must adopt leave policies that satisfy specific criteria in order to be eligible for the tax credit.
- Amounts paid by a state or local government (or required by state or local law) do not qualify for the credit.

TAX YEARS

The tax credit applies to wages paid in taxable years of the employer beginning after Dec. 31, 2017. It does not apply to wages paid in taxable years of the employer beginning after Dec. 31, 2019.

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ELIGIBLE EMPLOYERS

To be eligible for the tax credit, an employer must have a written policy in place that meets the following requirements:

- ✓ **Qualifying employees** – The employer must provide paid family and medical leave for all qualifying employees. A qualifying employee is an employee who has been employed by the employer for one year or more and, for the preceding year, had compensation not in excess of a specified amount ($72,000 for 2017).

- ✓ **Amount of paid leave** – For full-time employees, the leave policy must provide **at least two weeks** of annual paid family and medical leave. For part-time employees, who are defined as employees who are customarily employed for fewer than 30 hours per week, the leave policy must provide an amount of paid leave that is proportionally equal to the amount provided to full-time employees. Any leave that is paid by a state or local government or required by state or local law cannot be considered in determining the amount of paid family and medical leave provided by the employer.

- ✓ **Payment rate** – The policy must require a rate of payment for paid family and medical leave that is not less than 50 percent of the employee's normal wages.

- ✓ **No retaliation or discrimination** – For any non-FMLA eligible employees, the policy must ensure that the employer will not interfere with, restrain or deny the exercise of (or attempt to exercise) an employee's right to paid leave under the policy. It also must ensure that the employer will not discharge or in any other manner discriminate against any individual for opposing a practice that is prohibited by the policy.

In general, an employer's written policy must be in place before the paid family and medical leave for which the employer claims the tax credit is taken.

A special transition rule applies for the employer's first taxable year beginning after Dec. 31, 2017. Under this rule, an employer's written leave policy (or an amendment to a policy) can be **adopted retroactively** if the policy is adopted on or before Dec. 31, 2018, and the employer brings its leave practices into compliance with the terms of the retroactive policy (or retroactive amendment), including making any retroactive leave payments, no later than the last day of the taxable year.

Also, an employer is not required to notify its employees about its written policy for paid family and medical leave. However, if an employer provides this notice, it must communicate the information in a manner reasonably designed to reach each qualifying employee. This may include, for example, email communication, use of internal websites, employee handbooks or posters in employee work areas.

> **Key point:** Any leave paid by a state or local government (or required by state or local law) is not taken into account in determining the amount of paid family and medical leave provided by the employer, the rate of payment under the employer's written policy or the determination of the tax credit.

AMOUNT OF TAX CREDIT

The amount of the credit is calculated based on a **percentage of wages** that are paid to qualifying employees for paid family and medical leave. The percentage amount, which begins at 12.5 percent and is capped at 25 percent, increases by .25 percent for each percentage point by which the rate of payment for paid family and medical leave exceeds 50 percent of the employee's normal wages.

The amount of an employee's paid leave that may be used to calculate the credit for a taxable year cannot exceed 12 weeks. Also, the tax credit with respect to an employee for a taxable year cannot exceed an amount equal to the employee's normal hourly wage rate multiplied by the number of hours for which family and medical leave is taken. If an employee is not paid an hourly wage, the employee's salary must be prorated to an hourly wage rate.

The credit is claimed on Form 8994, Employer Credit for Paid Family and Medical Leave, and reported on IRS Form 3800, General Business Credit. An employer must reduce its deduction for wages or salaries paid or incurred by the amount determined as a credit.

FAMILY AND MEDICAL LEAVE

As a general rule, paid leave can be used for claiming the tax credit only if it:

- ✓ Is for one or more FMLA purposes;
- ✓ Cannot be used for any other reason (such as vacation or personal leave); and
- ✓ Is not paid by a state or local government (or required by state or local law).

For purposes of the tax credit, family and medical leave means leave for one or more purposes permitted under the FMLA, regardless of whether the leave is provided under the FMLA or an employer's leave policy. If the paid leave is provided for other reasons (such as vacation leave, personal leave, or medical or sick leave), then it is not considered paid family and medical leave for purposes of the tax credit.

Qualifying Reasons for Family and Medical Leave
• Birth of an employee's child and to care for the child

- Placement of a child with the employee for adoption or foster care
- A serious health condition that makes the employee unable to perform the functions of his or her position
- To care for the employee’s spouse, child or parent who has a serious health condition
- Any qualifying exigency due to an employee’s spouse, child or parent being on covered active duty (or having been notified of an impending call or order to covered active duty) in the Armed Forces
- To care for a service member with a serious injury or illness who is the employee’s spouse, child, parent or next of kin