



What's News in Tax

Analysis that matters from Washington National Tax

Employers Get Credit for Paying Employees While on Family or Medical Leave

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Tax reform created a tax credit for employers that pay employees while on family and medical leave. This article provides an overview of the credit and explains why employers should review paid leave policies to determine eligibility for the credit and consider the benefits of amending policies to conform with the new law to become eligible for the credit.

The Tax Act¹ added Code section 45S,² the Employer Credit for Paid Family and Medical Leave, a general business credit, which allows a federal income tax credit to eligible employers that pay their employees while on family and medical leave. The amount of the credit is equal 12.5 percent times the hourly wages³ paid to the employee and, if the payments exceed 50 percent of an employee's wages, the credit percentage is increased by .25 percent for each percentage point above 50 percent. The percentage cannot exceed 25 percent of the employee's wages.⁴

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¹ Pub. L. No. 115-97, 131 Stat. 2054 (2017) (the "Tax Act"). See also, IRS News Release, *Section 45S Employer Credit for Paid Family and Medical Leave FAQs*, available at <https://www.irs.gov/newsroom/section-45s-employer-credit-for-paid-family-and-medical-leave-faqs> (Apr. 9, 2018).

² Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

³ Wages is defined in section 3306(b).

⁴ This is because .25 times 50 percent is 12.5, when added to the original 12.5 percent, the total percentage can never exceed 25 percent.

For example, if an employer paid 100 percent of the employee's hourly wage while on parental leave, the employer would be entitled to a credit equal to 25 percent of the wages paid. In the case of any employee who is not paid on an hourly wage rate, the wages may be prorated to an hourly wage rate as provided by Treasury regulations. The maximum amount of family and medical paid leave eligible for the credit cannot exceed 12 weeks.

Family and Medical Leave

Generally, the term "family and medical leave" is as defined under the Family and Medical Leave Act of 1993 (the "FMLA").⁵ Family and medical leave is leave for:

- ◆ The birth of a son or daughter of the employee and in order to care for the son or daughter
- ◆ The placement of a son or daughter with the employee for adoption or foster care
- ◆ The care of a spouse, son, daughter, or parent, of the employee, if the spouse, son, daughter, or parent has a serious health condition
- ◆ A serious health condition that makes the employee unable to perform the functions of the position of the employee
- ◆ Any qualifying emergency arising out of the fact that the spouse, or a son, daughter, or parent of the employee is on covered active duty (or has been notified of an impending call or order to covered active duty) in the Armed Forces
- ◆ The care of a service member who is the employee's spouse, child, parent, or next of kin

Eligible Employer and Added Employer

An eligible employer is one that has in place a written policy that:

- ◆ Allows a full-time employee at least two weeks of annual paid family and medical leave;
- ◆ Allows a part-time employee⁶ a ratable percentage of paid family and medical leave as that of a full-time employee based on the numbers of hours the part-time employee is expected to work over the number hours of a full-time employee is expected to work; and,
- ◆ The rate of payment under the employer's policy is not less than 50 percent of the wages normally paid to such employee for services performed for the employer.

⁵ Family and medical leave means leave for any one or more of the purposes described in subparagraph (A), (B), (C), (D), or (E) of paragraph (1), or paragraph (3), of section 102(a) of the Family and Medical Leave Act of 1993, as amended.

⁶ A part-time employee is defined by section 4980E(d)(4)(B) as any employee who is customarily employed for fewer than 30 hours per week.

The Tax Act provides special rules for an “added employer.” An added employer is defined as an eligible employer, whether or not covered under FMLA, who offers paid family and medical leave to “added employees.” Added employees are qualifying employees who are not covered by FMLA.

An added employer will be eligible for the credit if the employer provides paid family and medical leave under a written policy that ensures the employer—

- Will not interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the policy, and
- Will not discharge or discriminate against any individual for opposing any practice prohibited by the policy.

Paid vacation leave, personal leave, or medical or sick leave (other than leave specifically for one or more of the purposes stated above) is not considered family and medical leave. Any wages that are required by a state or local government to be paid by the employer to an employee while on leave are not taken into account in determining an employer’s amount of paid family and medical leave. Any wages that are paid by a state or local government are likewise ineligible.

Qualifying Employees

A qualifying employee means an employee ⁷ who:

- Has been employed by the employer for one year or more; and,
- For the preceding year, had compensation not in excess of an amount equal to 60 percent of the compensation threshold for highly compensated employees.⁸

For 2017, the threshold compensation for highly compensated individuals was \$120,000. Consequently, employees with compensation of up to \$72,000 during 2017 who were employed for one year or more are qualifying employees for purposes of calculating the credit for 2018.

Whether an employer or employee has satisfied the eligibility requirements is subject to a determination by the Secretary based on information provided by the employer. In addition, the credit is subject to section 280C (a), which denies a deduction for wages or salaries in an amount equal to the credit allowed. The employer may elect not to have the section 45S credit apply.

Finally, the credit is only available for wages paid during tax years beginning after 2017 and before 2019.

⁷ An employee is defined in section 3(e) of the Fair Labor Standards Act of 1938, as amended.

⁸ A highly compensated employee is defined in section 414(q)(1)(B)(i).

WNT Observation

For companies that already provide paid FMLA leave, it is worth considering whether the benefits may be eligible for the credit. However, even if benefits amounts provided appear to qualify for the credit, adjustments to the written plan document may still be necessary. For companies that do qualify for the credit, it is important to remember that a deduction is not allowed for the compensation that qualifies for the credit. Therefore, it is worth exploring whether the credit or deduction is more beneficial because an election can be made to not take the credit.



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