

Federal Tax Credit for Employer-Provided Paid Family and Medical Leave

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In December 2019, the [Further Consolidated Appropriations Act, 2020](#) included a one-year extension of the federal tax credit for employers that provide paid family and medical leave (FML) to their employees.

As background, in December 2017, the [Tax Cuts and Jobs Act](#) (Act) included the new federal tax credit. To be clear, the Act does not require employers to provide paid leave. However, eligible employers are allowed a tax credit based on wages paid to employees on FML. If the employer provides paid leave as vacation leave, personal leave, or medical or sick leave, then that leave will not be considered FML for purposes of the tax credit.

The tax credit applies to employers who have a written policy that provides:

- Qualifying full-time employees with at least two weeks of annual paid FML;
- Qualifying part-time employees with an annual paid FML amount that is at least proportionate to the full-time employees' annual paid FML amount; and
- A rate of pay not less than 50 percent of the wages normally paid to employees for services performed.

The tax credit applies to an employer's qualifying employees who are:

- Employees as defined under [Section 3\(e\) of the Fair Labor Standards Act of 1938](#), as amended;
- Employed by the employer for one year or more; and
- Not compensated in excess of 60 percent of the amount for [highly compensated employees](#) for the preceding year (for example, in 2018, employers may only apply the credit toward employees who did not earn more than \$72,000 in 2017).

For employers who meet the above criteria and who pay 50 percent of wages, they may claim a tax credit of 12.5 percent of wages paid for up to 12 weeks of FML annually. For each percentage point increase above 50 percent of wages paid, the employer may increase the tax credit by a 0.25 percentage point (not to exceed 25 percent).

The tax credit applies to wages paid to employees on FML in taxable years beginning after December 31, 2017, and before January 1, 2021.

IRS Guidance

In May 2018, the Internal Revenue Service (IRS) released its [Tax Reform Tax Tip 2018-69: How the Employer Credit for Family and Medical Leave Benefits Employers](#) and [Section 45S Employer Credit for Paid Family and Medical Leave FAQs](#) that primarily reiterated the [Tax Cuts and Jobs Act's](#) provisions that provide a new federal credit for employers that provide paid family and medical leave to their employees.

In its Tax Tip, the IRS explained that an employer must reduce its deduction for wages or salaries paid or incurred by the amount determined as a credit. Also, any wages taken into account in determining any other general business credit may not be used in determining this credit.

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In September 2018, the IRS released Notice 2018-71 (Notice) that provides Q&A guidance on the Internal Revenue Code Section 45S employer credit for paid FML. Although much of the Notice reiterated the [Tax Cut and Job Act's](#) provisions, below are some items that the IRS clarified:

- An employer does not need to be subject to Title I of the Family and Medical Leave Act of 1993 (FMLA) to be eligible for the employer credit for paid FML
- An employer's policy may not exclude any classification of employees (for example, collectively bargained employees) if they are qualifying employees. If the employer employs any qualifying employees who are not covered by Title I of the FMLA, the employer's written policy must include "non-interference" language, such as the following sample language provided in the Notice:

[Employer] will not interfere with, restrain, or deny the exercise of, or the attempt to exercise, any right provided under this policy. [Employer] will not discharge, or in any other manner discriminate against, any individual for opposing any practice prohibited by this policy.
- An employer's written policy can be in a single document or multiple documents. Unless an employer qualifies for the transition rule described below, an employer's written policy must be in place before a qualifying employee takes paid FML for which the employer claims the employer credit. The IRS will look to the written policy's adoption date or effective date, whichever is later, to determine when the policy was in place.

There is a transition rule for written policies. For an employer's first taxable year beginning after December 31, 2017, a written leave policy or an amendment to a policy will be considered to be in place as of the effective date of the policy (or amendment), rather than a later adoption date, if:

- a) the policy (or amendment) is adopted on or before December 31, 2018, and
- b) the employer brings its leave practices into compliance with the terms of the retroactive policy (or retroactive amendment) for the entire period covered by the policy (or amendment), including making any retroactive leave payments no later than the last day of the taxable year.

The Notice provides the following examples to illustrate the transition rule:

Example 1. Facts: Employer's taxable year is the calendar year. Employee takes two weeks of unpaid family and medical leave beginning January 15, 2018. Employer adopts a written policy that satisfies the requirements of Section 45S on October 1, 2018, and chooses to make the policy effective retroactive to January 1, 2018. At the time the policy is adopted, Employer pays Employee (at a rate of payment provided by the policy) for the two weeks of unpaid leave taken in January 2018.

Conclusion: Assuming all other requirements for the credit are met, Employer may claim the credit with respect to the family and medical leave paid to Employee for the leave taken in January 2018.

Example 2. Facts: Employer's taxable year is the calendar year. Employer amends its FMLA policy in writing on April 15, 2018, effective for leave taken on or after April 15, 2018, to provide that four weeks of FMLA leave will be paid leave. Employer's FMLA policy does not provide for leave for qualifying employees who are not covered by Title I of the FMLA or include "non-interference" language. Employee, who is a qualifying employee, but who is not covered by Title I of the FMLA, takes three weeks of unpaid family and medical leave beginning June 18, 2018. On October 1, 2018, Employer amends its written policy to include "non-interference" language and to provide paid leave effective April 15, 2018, for qualifying employees who are not covered by Title I of the FMLA. On October 15, 2018, Employer pays Employee for the three weeks of family and medical leave Employee took beginning June 18, 2018.

Conclusion: Assuming all other requirements for the credit are met, Employer may claim the credit with respect to the family and medical leave paid to Employee for the leave taken beginning in June 2018.

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- An employer is not required to provide notice of its written policy to employees. However, if an employer chooses to provide notice of its written policy to qualifying employees, then paid leave availability must be communicated in a way that is reasonably designed to reach each qualifying employee. The Notice provides the following examples of ways an employer can communicate its written policy to qualifying employees: by email communication, internal websites, employee handbooks, or posted displays in employee work areas.
- A qualifying employee may take FML under Section 45S for the same purposes as an employee may take family and medical leave under Title I of the FMLA:
 - a) The birth of a son or daughter of the employee and in order to care for the son or daughter.
 - b) The placement of a son or daughter with the employee for adoption or foster care.
 - c) Caring for the spouse, or a son, daughter, or parent, of the employee, if the spouse, son, daughter, or parent has a serious health condition.
 - d) A serious health condition that makes the employee unable to perform the functions of the employee's position.
 - e) Any qualifying exigency (per DOL regulation) arising out of the fact that the spouse, son, daughter, 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).
 - f) Caring for a covered service member with a serious injury or illness if the employee is the spouse, son, daughter, parent, or next of kin of the service member.
- Paid leave is considered FML under Section 45S only if: the leave is specifically designated for one or more FMLA purposes (listed above), may not be used for any other reason, and is not paid by a state or local government or required by state or local law. An employer's short-term disability program may qualify as FML under Section 45S if it meets Section 45S's other requirements.

Leave that may be used to care for additional individuals can be considered specifically designated for an FMLA purpose. However, the employer may not claim the credit for any leave taken to care for an individual other than a qualifying employee's spouse, parent, or child. To illustrate, the Notice provides the following example:

Example. Facts: Employer's written policy provides four weeks of annual paid leave to care for family members with a serious health condition. The policy's definition of "family members" includes the individuals specified in the FMLA (spouse, children, and parents), and also includes grandparents, grandchildren, and domestic partners. Employee uses one week of annual paid leave to care for her grandmother, and at a later time, uses one week of annual paid leave to care for her son.

Conclusion: Employer's policy provides paid leave specifically designated for an FMLA purpose. Although the paid leave taken by Employee to care for her grandmother is not family and medical leave under Section 45S, and Employer may not claim the credit for this leave, the paid leave taken by Employee to care for her son is family and medical leave under Section 45S for which Employer may claim the credit, assuming all other requirements for the credit are met.

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- An employee does not need to work a minimum number of hours per year to be a qualifying employee. FMLA's Title I rules, which require an employee to work a minimum of 1,250 hours of service to be an eligible employee under the FMLA, do not apply to Section 45S.
- For purposes of Section 45S, a part-time employee is an employee who is customarily employed for fewer than 30 hours per week. Until the IRS issues further guidance, an employer may use any reasonable method to determine how many hours an employee customarily works per week.
- To be eligible to claim the credit, an employer must independently satisfy the minimum paid leave requirements, including providing a payment rate of at least 50 percent of wages normally paid to an employee. Leave paid by a state or local government or required by state or local law may not be included when determining whether an employer's policy provides the required payment rate. To illustrate, the Notice provides the following examples:

Example 1. 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 percent 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 percent 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 percent 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 percent of the wages normally paid to an employee.

Example 2. Facts: Same facts as Example 1, except that Employer's written policy provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 50 percent of the wages normally paid to the employee that runs concurrently with the State leave. Consequently, in the aggregate, a qualifying employee can receive six weeks of annual paid family and medical leave at a rate of payment of 100 percent of the wages normally paid to the employee.

Conclusion: Employer's policy independently satisfies the requirement that the rate of payment be at least 50 percent of the wages normally paid to an employee. Only wages paid under Employer's written policy (50 percent of wages normally paid to the employee) may be used in calculating the credit. Wages paid pursuant to State law are not used in calculating the credit.

Example 3. Facts: Under State law, employers are required to provide employees six weeks of family and medical leave, and the State law permits this leave to be either paid or unpaid. Employer's written policy provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 50 percent of the wages normally paid to the employee.

Conclusion: Employer's policy independently satisfies the requirement that the rate of payment be at least 50 percent of the wages normally paid to an employee.

- An employer must file IRS Form 8994, Employer Credit for Paid Family and Medical Leave, and IRS [Form 3800](#), General Business Credit, with its tax return to claim the credit. Each member of a controlled group generally makes a separate election of whether to claim the credit.

The Notice was effective on September 24, 2018, and applies to wages paid in taxable years after December 31, 2017, and before January 1, 2020.

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