



United States Guidance on the Paid Family and Medical Leave Credit



Overview

Introduction

On September 24, 2018, the Internal Revenue Service (IRS) issued Notice 2018 71 (the “Notice”), which provides important guidance on the new paid family and medical leave credit added by the 2017 Tax Reform legislation.

The credit is provided by Section 45S of the Internal Revenue Code (IRC), and it allows eligible employers to claim a general business credit for up to 25 percent of the amount of certain wages paid to qualifying employees for up to 12 weeks of

family or medical leave. The IRS guidance in the recently issued Notice answers many questions about this credit.



New guidance

The Notice provides its guidance in the form of 34 questions and answers. Three sections are devoted

to critical definitional issues, and one section is devoted to calculating and claiming the credit.

Eligible employer

In order to be eligible to claim a Section 45S credit, an employer must be an “Eligible Employer,” which means the employer must have a written policy in place to provide employees with paid family and medical leave. The policy must provide for at least two weeks of paid leave for full-time employees and a prorated amount of paid leave for part-time employees.

The Notice clarifies requirements for the policy, including when the policy must be in place. Significantly, the Notice explains that the written policy requirement can be satisfied through multiple documents viewed collectively. The Notice also provides that, in general, a written policy must be in place on the later of a policy’s adoption date or effective date.

As a result, an employer would not be eligible to take the credit on wages paid prior to the date a written policy is put into effect. However, the Notice provides a special transition rule for 2018 that allows a written policy to be put into place retroactively, thereby allowing the credit to be claimed for wages paid for leave taken earlier in 2018, even before the paid leave policy was adopted.

Under the Notice, an employer is not required to notify employees of the written policy as a condition for qualifying as an Eligible Employer. However, if an employer chooses to provide notification to employees of the written leave policy, the notification must be provided to all qualifying employees.

Family and medical leave

The Section 45S credit is based on wages paid to qualifying employees while on leave to attend to medical-related or family-related needs delineated in the 1993 Family and Medical Leave Act (FMLA), the federal legislation that mandates unpaid leave options. The Notice refers to these reasons for leave as “FMLA purposes.” The Notice provides clarification on the following issues:

- While the credit is related to the FMLA, there were questions about how they are linked. The Notice makes clear that a written policy does not have to permit leave for all FMLA purposes. For example, an employer may provide paid leave related to the birth of a child, but not for other FMLA purposes, such as to care for a sick relative, and not lose eligibility for the credit.
- To claim the credit on specific wages paid, the leave cannot be provided for a purpose not covered by the FMLA. If an employer’s

written policy provides paid leave for employees to care for sick children or parents, which are FMLA purposes, as well as paid leave to care for other relatives (e.g., grandparents), the employer’s overall written policy will not be disqualified. However, the paid leave provided to care for other relatives will not be eligible for the credit. As a result, employers who are more generous with their programs will need to find ways to properly track reasons for leave so as not to take improper credits.

Minimum paid leave

To qualify for the credit, an employer’s written policy must provide leave not only for appropriate FMLA purposes, but to all “qualifying employees.” A qualifying employee must have been an employee for one year or more and, in the previous year, must not have earned more than 60 percent of the amount that qualifies an individual as a “highly compensated employee” as defined in IRC Section 414(q). For 2017, this threshold was \$120,000; accordingly, only employees who earned \$72,000 or less in 2017 can be “qualifying employees” for 2018. (Fiscal year employers are given additional choices about the measuring year.)

The Notice gives important latitude to employers in measuring the threshold year of service, but specifically states that an employer cannot look to a minimum hours standard used in connection with the FMLA. The Notice also includes additional detail regarding the compensation threshold and provides helpful choices about how to measure compensation for fiscal year employers.

Through a series of questions and examples, the Notice reinforces the idea that while an employer cannot exclude any class of employees that otherwise meet the definition of a qualifying employee, employers can still offer differing levels of payment for different types of qualifying employees (e.g., paying leave at 50 percent of normal wages for newer employees, while paying leave at 100 percent of normal wages for employees with more than 10 years of service), as well as provide different levels of payment for different FMLA purposes (e.g., paying for medical leave at 75 percent of normal wages, while paying for leave to care for a sick child at 100 percent of normal wages).

Other important issues addressed

The Notice, through direct questions and examples, helps address additional issues that came to light following the passage of Section 45S, including, but not limited to:

Short-Term Disability and Third-Party Payers. The Notice clarifies that a credit can be taken on amounts paid pursuant to either insured or self-

insured short-term disability programs, so long as all other requirements are met. Similarly, an employer can still claim a credit for amounts provided through a third party (e.g., a professional employer organization), so long as that third party does not claim the credit.

State Programs and Paid Leave Requirements. Leave paid through state or local government programs or leave required to be provided on a paid basis by applicable state law does not qualify for the credit. However, the Notice clarifies that paid leave provided in excess of state law requirements or in excess of amounts provided by state or local government programs may qualify for the credit.

Credit or Deduction. The Notice reiterated that if an employer claims a Section 45S credit, that credit amount reduces the amount of compensation deduction dollar for dollar. Additionally, any wages paid that serve as the basis for any other IRC Section 38 credits (e.g., Work Opportunity Tax Credit or Research Tax Credit) cannot be counted for purposes of the Section 45S credit.

Aggregation. Section 45S provides that all members of a 50 percent controlled group shall be treated as a single taxpayer. However, the Notice clarifies the precise reach of this declaration, indicating that entities are considered separately for purposes of setting policies, calculating the credit, and electing whether to use the credit. As a result, a determination of Eligible Employer status can be evaluated separately by each member of a controlled group. This would allow for separate evaluations of different related businesses and potentially increase the likelihood that an entity can use the credit.

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

With these additional clarifications, employers can take a fresh look at the opportunity presented by the family and medical leave credit, and work with their advisers to evaluate any needed changes to existing policies, move forward with new policies, or put systems in place to help calculate the credit.



Deloitte's view

The Notice answers critical questions, including:

- Is it too late to put a new policy into place?
- Do state laws make it impossible to take the credit?
- Does an employer need to consider all employees in its controlled group?
- Does an employer need to have a one-size-fits-all program for all qualified employees?

The Notice generally provides some clarity and taxpayer-favorable answers, but employers should be thorough in applying these new provisions and supporting credit eligibility.



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