

PAID FAMILY MEDICAL LEAVE TAX CREDIT

The IRS has released Notice 2018-17 with more details on the paid family leave tax credit included in the Tax Cuts and Jobs Act of 2017. This notice includes details expected to be in future IRS regulations on the tax credit. Comments on this notice must be submitted by November 23, 2018.

The notice provides a number of tax credit details along with a number of questions and answers on how and when the tax credit applies. This *Benefit Advisor* provides:

- Background summary
- Overview of when tax credit applies
- Examples of when tax credit applies
- Examples of how to calculate tax credit

Some employers may be eligible for the tax credit even if they don't offer paid leave benefits for all Family Medical Leave Act (FMLA) qualifying reasons.

BACKGROUND SUMMARY

Section 45s of the Internal Revenue Code deals with the business tax credit for paid family leave benefits. The tax credit applies for the 2018 and 2019 tax year.

To be eligible for the tax credit, an employer has to have a written policy that satisfies the following requirements:

- The policy must cover all qualifying employees. Qualifying employees are those who have been employed for a year and not paid more than a specific threshold in the preceding year. A year of employment is 12 months of employment. For 2018, a qualifying employee can't have compensation exceeding \$72,000 in 2017. The threshold income is indexed annually.
- The policy must provide a minimum of two weeks' paid family leave for each full-time qualifying employee and a



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Continued on Page 2

proportionate amount of leave for each qualifying part-time employee.

- The policy must pay at least 50 percent of the employee's qualifying wages during the leave.
- If a qualifying employee is not eligible under the FMLA, the policy must include "non-interference" protections as described in the next section.



The written policy should cover all employer paid leave program rules.

OVERVIEW ON WHEN TAX CREDIT APPLIES

The tax credit applies to eligible employers. To be eligible, an employer must satisfy the written policy requirements and offer paid family leave benefits as stated above. An employer does not have to be subject to the FMLA to be considered eligible.

If the employer has qualifying employees that are not FMLA eligible, the written policy must state that the employer would not interfere with or discriminate against employees exercising their rights under the paid family leave policy. Sample language is included 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.

Whether the paid family leave policy is a single document or several documents, it must include all the elements in the previous section. The policy must be in place

before any paid family leave the employer plans to take credit for. However, a transition rule does exist for plans launched in the taxable year beginning after December

31, 2017. The policy will be considered "in place" as of the effective date rather than the adoption date as long as it is adopted by December 31, 2018, and the benefits are paid retroactive to the effective date.

The notice includes these examples:

- Employer adopts a written policy as of June 15, 2019, with a July 1, 2019, effective date. The policy meets all the requirements for the credit. Employer may claim the credit for any paid family medical leave that meets the credit requirements for any qualifying employees from July 1, 2019, until the end of the year.
- Employee takes two weeks of unpaid family medical leave as of January 15, 2018. Employer adopts a written policy that meets the requirements of Section 45s on October 1, 2018, with a retroactive effective date of January 1, 2018.

The employer would have to retroactively pay the two weeks unpaid leave in January and any other unpaid leaves that would qualify as eligible for paid family leave for qualifying employees. The employer can get credit for these retroactively paid leaves.

There is no official employee notice requirement. However, the rules require employers to inform employees that paid leave is available in a format reasonably designed to reach each qualifying employee. Employers may use email, employee handbooks, internal websites or notices posted in employee work areas.

Employers can take the credit for only the following qualified FMLA reasons (even if the employee is not eligible for FMLA):

- Birth of a child
- Adoption of a child or placement of a foster child
- Caring for a family member (spouse, parent, child) with a serious health condition
- Serious health condition that makes an employee unable to work
- A qualifying exigency
- Caring for a service member with a serious injury or illness

Leaves paid by a state or local government or required by a state or local law are not taken into account in determining the amount of paid family leave the employer provides. These leaves are also not taken into account in

determining the rate of payment under the employer’s policy or the determination of the credit.

Below are some useful examples to help employers understand which paid leave policies may qualify for the credit. They assume the policy meets all the Section 45s requirements:

- Employer’s written policy allows six weeks of annual paid leave for the birth of an employee’s child. The leave may not be used for any other reason and state or local government does not require paid leave. This policy would qualify under Section 45s.
- Employer’s written policy allows three weeks of annual paid leave for any FMLA purpose. The leave may not be used for any other reason and state or local government does not require paid leave. This policy would qualify under Section 45s.
- Employer’s written policy allows three weeks of annual paid leave that can be used for FMLA, minor illness, vacation or specified personal reasons and state or local government does not require paid leave. This policy would not qualify under Section 45s.

Allowing employees to take paid family leave for other family members (not FMLA designated) will not disqualify the policy for the credit. However, any wages paid for a non-FMLA family member would not qualify for the credit.

The notice explains whether a short-term disability plan could be considered a paid leave plan

under Section 45s. A short-term disability plan (insured or self-funded) can be considered a paid leave policy as long as it meets the Section 45s requirements. The short-term disability benefits would have to be available for all employees. Policies that limit disability coverage to only full-time employees would not qualify under Section 45s. Plans that offer short-term benefits to all employees and meet all the Section 45s requirements will qualify for the credit. The employer could self-fund benefits for employees the short-term disability plan does not cover.

EXAMPLES ON DETERMINING WHEN TAX CREDIT APPLIES

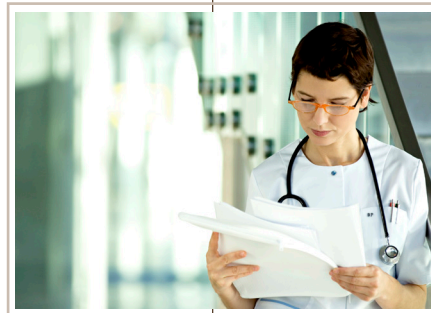
Employers must offer all employees paid family leave. They can’t require employees work a minimum number of hours to be eligible for the benefit. They can’t exclude a class of employees from the benefit. The notice offers the following examples:

- Employer has a short-term disability plan that covers all employees after six months continuous service. The plan includes a pre-existing condition limitation. A pre-existing condition is a condition for which a person consulted a physician, received treatment or took prescribed medications in the three months before the effective coverage date. The plan will not cover a pre-existing condition for the first twelve months on the plan. This plan would not

be eligible for the Section 45s credit. One problem is requiring six months of continuous employment might exclude qualifying employees from a benefit. Another problem is the pre-existing condition limitation. Some qualifying employees may not be eligible for a benefit under the plan.

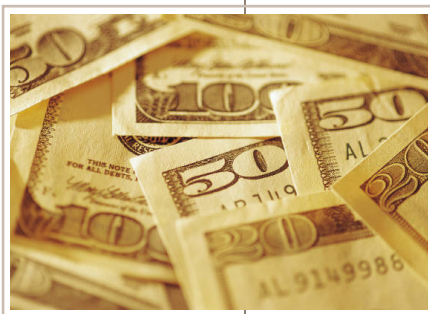
- The next example assumes the same facts as above, but the employer adopts a written policy that provides paid leave to any qualifying employee that does not receive a benefit under the short-term disability policy because of the consecutive six-month employment requirement or does not receive a benefit due to the pre-existing condition limitation. Benefits are paid from the employer’s general assets. The policy meets all the requirements under Section 45s. Since the short-term plan and the self-funded portion pieced together cover all qualifying employees, this plan would be eligible for the Section 45s credit.

- An employer’s written policy provides four weeks annual paid family and medical leave to any qualifying employee expected to work forty hours a week and two weeks to any qualifying employee expected to work twenty hours a week. All employees work either



twenty or forty hours. This policy would be eligible for the Section 45s credit. All qualifying employees are offered the benefit and the part-time benefit is proportional to the full-time benefit.

For a policy to meet the requirements, it must pay at least 50 percent of the wages of an employee on paid family and medical leave. Wages mean the wages normally paid for services performed.



Overtime and discretionary bonuses are not included. The percentage of income replacement and the period of paid family medical leave does not need to be uniform for all qualifying employees or for all FMLA purposes.

The notice offers the following examples:

- Employer’s written policy provides six weeks of paid family medical leave for the birth or adoption of a child. The rate of pay for these six weeks is 100 percent of wages. For all other FMLA purposes, the policy provides each qualifying employee with two weeks of annual paid leave at 75 percent of wages. This plan would meet all the requirements for the credit under Section 45s.
- Employer’s written policy provides two weeks of paid family medical leave for the birth or adoption of a child at 100 percent of wages. The policy also provides

all qualifying employees not covered by a collective bargaining agreement two weeks of paid leave for their own serious health condition at 100 percent of wages. The benefits paid under this plan for birth or adoption would meet all the require-

ments for the credit under Section 45s. However, the benefits paid for the employees’ serious health conditions will not qualify for the credit under Section 45s because union employees are excluded.

- Employer’s written policy provides all qualifying employees two weeks’ paid family medical leave at 100 percent of wages for any FMLA qualified reason. The policy also provides an additional two weeks’ paid leave for qualifying employees with ten or more years of service at 100 percent of wages for any FMLA purpose. The benefits paid under this plan would meet all the requirements for the credit under Section 45s.

The notice also clarifies that benefits required under a state or local government law are not eligible for the credit. However, if an employer plan is in addition to the state or local law requirements and those additional benefits meet the minimum requirements to claim the credit, benefits paid under the additional plan qualify for credit. This means the plan meets all the policy requirements independently and the additional benefits are at least 50 percent of normal wages.

EXAMPLES ON HOW TO CALCULATE TAX CREDIT

All employers offering paid leave benefits that meet the Section 45s requirements can claim a credit based on the qualifying wages the plan pays. The credit is equal to the applicable percentage of the amount of wages paid to qualifying employees for any period on an FMLA leave. Applicable percentage means 12.5 percent increased by 0.25 percent for each percentage point by which the rate of pay exceeds 50 percent. The applicable percentage is capped at 25 percent. The amount of family leave taken into account for the credit cannot exceed 12 weeks.

For example, assume an employer’s policy offers each qualifying employee four weeks of paid FMLA at 75 percent of normal wages. The applicable percentage is calculated as follows:

50% of wages.....	12.5%
25% above the 50% threshold.....	6.25% (25 x 0.25%)
Applicable percentage.....	18.75%

The applicable percentage applied to the amount of normal wages paid to a qualifying employee while on a FMLA leave determines the credit. Assuming the FMLA paid leave is 75 percent of normal wages, how should an employer calculate the tax credit? Assume a qualifying employee takes four weeks of paid leave during the year. An employee’s normal wage is \$1,000 a week. Benefit under the paid leave plan is \$750 a week (75 percent of normal wages). The credit would be 18.75 percent of the wages paid while on FMLA leave. In this case, credit would

be 18.75 percent of \$3,000 (\$750 x 4 weeks) or \$562.50 for this specific leave.

If the employer replaces wages at a different rate for different types of leave or for qualifying employees with more years of service, the applicable percentage would need to be calculated at each percentage rate and applied to benefits paid at that percentage rate.

The notice also defines applicable wages:

- Benefits under a short-term disability plan can be taken into account as long as the program combined with any other employer-paid leave benefits meets the requirement of Section 45s
- Leave paid by a state or local government or required by a state or local law cannot be included in wages.
- Benefits paid under a leave policy to an employee who is not a qualifying employee when the leave is taken cannot be included in the wages paid for the credit. However, any leave taken once the employee is qualified can be included in the wages paid for the credit.
- Only the employer may take the credit for wages paid on a qualifying paid family leave.

Claiming this paid family leave tax credit can impact the employer's deduction for wages and salaries paid for the taxable year. An employer's deduction for wages paid is reduced by an amount equal to the amount of the credit.

To claim the credit, employers must file IRS Form 8994 (Employer Credit for Paid Family and Medical Leave) and IRS Form 3800 (General Business Credit) with the organization's tax return. These Forms are not available or not updated for the 2018 paid family leave tax credit yet.

CONCLUDING THOUGHTS

The paid family and medical leave tax credit is available at this point only for the 2018 and 2019 tax years. This notice applies to wages in those two tax years.

This notice is the precursor to regulations that the Department of Treasury intends to publish. The IRS is asking for suggestions to incorporate into regulations on the paid family medical leave tax credit.

To be eligible for the tax credit, employers must offer all employees paid family leave. They can't exclude classes of employees or require employees work a minimum number of hours to be eligible. Many employers do not currently have programs that meet the minimum requirements under Section 45s to receive a tax credit. Employers need to decide whether expanding these programs to meet tax credit eligibility makes sense.

Please contact your Marsh & McLennan Agency | Michigan team member with any questions. MMA



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