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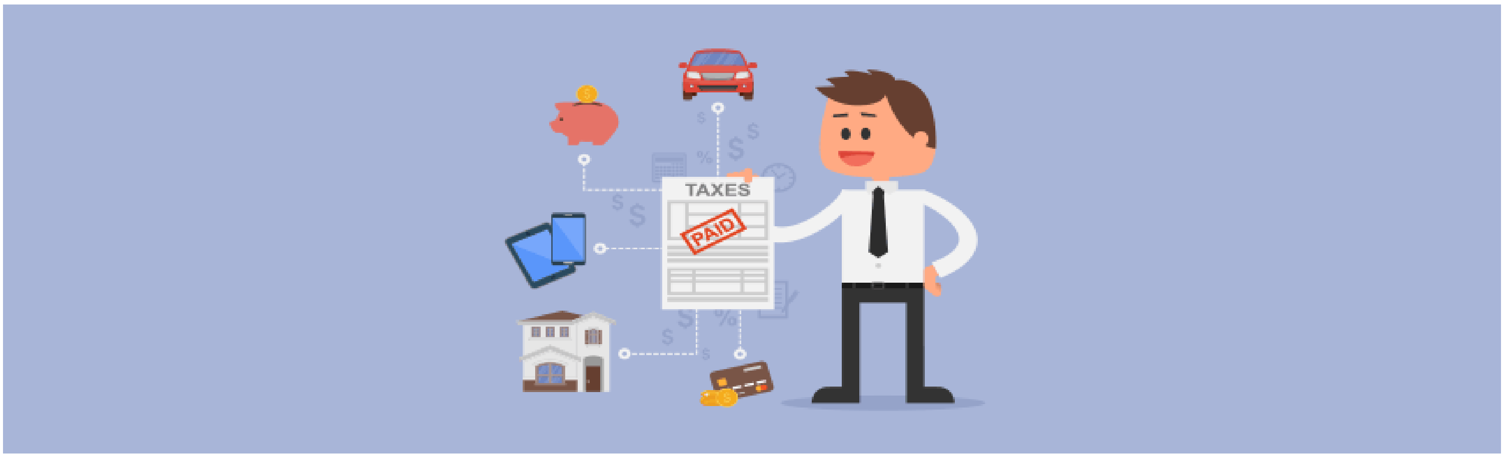
FMLA paid tax credit: IRS guidance fleshes out the details



FMLA leave is a benefit most employees find valuable. Paid FMLA leave would be better. Better still: paid FMLA leave for which you can take a tax credit on your Form 1120.

The Tax Cuts and Jobs Act provides for just such a tax credit, for paid leave provided during 2018 and 2019. The IRS has now addressed key issues related to this tax credit. The guidance is effective for tax years beginning after Dec. 31, 2018, and before Jan. 1, 2020. (Notice 2018-71, IRB 2018-41)

Paid leave particulars. Through 2019, you may take the tax credit if you voluntarily provide qualified employees with at least two weeks of FMLA leave and pay them at least half their regular salary. Employees qualify for paid FMLA leave if they've worked for you for one year and, for leave provided this year. Part-time employees must be provided with a commensurate amount of leave on a prorated basis. Contrast: Employees qualify for regular, unpaid FMLA leave if they have worked for you for at least 12 months and for least 1,250 hours over the past 12 months.

Catch: You can't take the credit for paid leave provided to highly compensated employees; it applies only to employees who earned no more than $72,000 last year. This figure is adjusted for inflation.

Paid leave must be provided under a written policy, which must be in place before employees take leave. Specificity counts: Your policy must stipulate that paid leave is FMLA-qualifying leave. Your policy won't pass muster if, say, it gives employees three weeks of paid leave for any of these reasons: FMLA purposes, minor illnesses, vacations or other personal reasons.

TRANSITION RULE: Your policy can be effective retroactive to the beginning of 2018 if it's adopted by the end of the month, your leave practices comply with the retroactive policy and employees receive back pay by the end of the month.

Covered employers and employees. FMLA-covered employers that provide paid leave to full-time employees (i.e., those who work at least 30 hours) and a proportionate amount of leave to part-time employees, qualify for

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the credit. Example: It’s proportionate if part-time employees who work 20 hours a week get two weeks of paid leave, while full-time employees who work 40 hours a week get four weeks of paid leave.

Employers not covered under the FMLA, and employers that extend paid leave to employees who would otherwise not qualify for FMLA leave, may also take the credit, if their written policies contain a noninterference clause.

Model IRS language: will not interfere with, restrain or deny the exercise of, or the attempt to exercise, any right provided under this policy. will not discharge, or in any other manner discriminate against, any individual for opposing any practice prohibited by this policy.

Impact of state and local laws. Employers that must provide paid leave under state or local laws can’t take the credit, but the IRS has developed a workaround. You remain eligible for the credit if you independently satisfy the requirements to take it. In effect, although your paid leave runs concurrently or consecutively with state-mandated leave, your federal tax credit is based only on wages paid under your policy, and not state law.

Figuring the credit. The credit is 12.5% of wages paid, and increases 0.25%, up to 25%, for each percentage point above which your rate of pay exceeds 50%. Here’s how it’s figured:

Example: ZPack’s policy provides qualifying employees with four weeks of paid FMLA leave at 75% of their salary. Result: Since ZPack’s rate of pay exceeds 50% by 25%, its tax credit is 18.75% (0.25% × 25 = 6.25% + 12.5%). During 2018, Emma took four weeks of leave. She’s normally paid $1,000 a week, so she receives $3,000 ($750/week × 4 weeks) for her leave. Result: ZPack’s credit related to Emma is $562.50 ($3,000 × 18.75%).

NO DOUBLE DIPPING: File Forms 8994 and 3800 to take the credit. This credit is part of the general business credit. If you take it, you can’t deduct the same wages as a salary expense. Unlike deductions, tax credits reduce your tax liability dollar-for-dollar. If the credit is worth more than the 21% corporate rate, taking it may pay off. But, you’ll have to run the numbers yourself to see which is more valuable.

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