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IRC Section 45S Paid Family and Medical Leave Tax Credit

Employers who aren't eligible for the payroll tax credits enacted into law on March 18 in the *Families First Coronavirus Response Act* (FFCRA) still might be eligible for an income tax credit related to paid family and medical leave. The FFCRA provides a payroll tax credit for paid leave that is mandated under the new law, but the new law generally applies only to employers with fewer than 500 employees, as determined under *Family and Medical Leave Act* (FMLA) and *Fair Labor Standards Act* rules. In contrast, IRC Section 45S, enacted as part of 2017 tax reform known as the *Tax Cuts and Jobs Act* or TCJA, provides employers of any size with an income tax credit for paid family and medical leave, provided its requirements are satisfied. The TCJA added Section 45S to the IRC effective only for 2018 and 2019, but the 2020 appropriations bill enacted earlier this year extends the tax credit to the 2020 tax year.

Eligible employers

An employer may be eligible for the IRC Section 45S tax credit if the employer has implemented a written policy that provides all qualifying employees with at least two weeks of paid family and medical leave at a rate of at least 50% of the employee's normal wages. These various terms have specific definitions under the law and related guidance.

Under the policy, qualifying employees who are part-time employees must receive a pro rata amount of leave. If the employer employs any qualifying employees not covered by the FMLA, the written policy must include certain "noninterference language" as well.

Qualifying employees

Unlike the March 18 legislation, which applies to generally all employees of an affected employer under that law, the IRC Section 45S tax credit for the 2020 tax year applies with respect to an employee who has been employed with the employer for at least one year and who earned no more than $75,000 of compensation (as defined) in 2019.

Eligible types of paid leave

The types of leave eligible for the credit are based on traditional FMLA family and medical unpaid leave, including leave for any of the following reasons:

- The birth of a son or daughter of the employee and to care for the son or daughter
- The placement of a son or daughter with the employee for adoption or foster care

- Caring for the 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 renders the employee unable to perform the functions of his or her position
- Any qualifying exigency arising out of the fact that the spouse, son, daughter, or parent of the employee is a member of the armed forces (including the U.S. National Guard and military reserves) who is on covered active duty (or has been notified of an impending call or order to covered active duty)
- 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

If an employer provides paid leave (vacation leave, personal leave, or medical or sick leave) for other reasons than listed above, such paid leave is not eligible for the tax credit. If an employer simply pays current or former employees, that isn't eligible paid leave. The eligible leave must be for a specifically designated FMLA purpose, cannot be used for any other reason, and cannot be paid by a state or local government or required by state or local law.

The tax credit

The income tax credit is equal to at least 12.5% (and up to 25%) of the amount of normal wages paid to qualifying employees during any period in which the employees are on qualifying paid leave. The tax credit percentage equals 12.5% if the rate of paid leave is 50% of employees' normal wage rate; it increases by 0.25 percentage points for each percentage point by which the rate of paid leave exceeds 50%.

Note that if an employer takes wages into account for the newly mandated paid leave payroll tax credits under the March 18 legislation, those same wages cannot be taken into account for the IRC Section 45S income tax credit. Both tax credits are elective. The IRC Section 45S tax credit is nonrefundable and may be carried forward as part of the IRC Section 38 general business credit.

What to do now

If an employer has implemented the required terms in a written policy, the tax credit may be available for the 2020 tax year. The IRC Section 45S income tax credit is not as generous as the recently enacted payroll tax credits for mandated paid leave, but it is applicable to any size business and takes on a new significance in light of current events. It is not limited to employers or employees subject to the FMLA. Employers should take steps now to ensure eligibility for the tax credit, as it is not automatic and requires implementation before the paid leave occurs.