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IN FOCUS

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Employer Tax Credit for Paid Family and Medical Leave

The employer credit for paid family and medical leave (Internal Revenue Code [IRC] §45S) was enacted as part of the 2017 tax revision (P.L. 115-97) (commonly referenced as the "Tax Cuts and Jobs Act," or TCJA, the title of the House-passed version of the bill). When enacted, this credit was made available for two years, 2018 and 2019. The credit's primary sponsor, Senator Deb Fischer, called this credit a "two-year pilot program," after which there would be an opportunity to evaluate whether the credit was achieving its intended goals. This In Focus (1) provides an overview of the employer credit for paid family and medical leave; and (2) highlights some issues to consider when evaluating the credit.

The Employer Credit for Paid Family and Medical Leave

The employer credit for paid family and medical leave (FML) can be claimed by employers providing paid leave (wages) to employees under the Family and Medical Leave Act of 1993 (FMLA; P.L. 103-3). The credit can be claimed for wages paid during tax years that begin in 2018 and 2019.

The credit rate depends on how much employers provide for paid FML, relative to wages normally paid. If paid leave is 50% of wages normally paid to an employee, the tax credit is 12.5% of wages paid. If paid leave is 100% of wages normally paid to an employee, the tax credit is 25% of wages paid. The credit rate increases from 12.5% to 25% ratably as leave wages increase from 50% to 100% of wages normally paid. No credit can be claimed for paid FML that is less than 50% of wages normally paid. Further, no credit can be claimed for wages paid on leave that exceed an employee's normal wage rate.

The credit can only be claimed for paid FML provided to certain lower-compensated employees. For wages paid to an employee to be credit eligible, compensation to the employee in the preceding year cannot exceed 60% of a "highly compensated employee" threshold. For 2018, employee compensation in 2017 cannot have exceeded $72,000. Further, for an employer to claim a credit for wages paid to an employee, the employee must have been employed by the employer for at least 12 months.

The amount of paid FML wages for which the credit is claimed cannot exceed 12 weeks per employee per year. Further, all qualifying employees must be provided at least two weeks of paid FML for an employer to be able to claim the credit (the two-week period is proportionally adjusted for part-time employees).

Tax credits cannot be claimed for leave paid by state or local governments, or for leave that is required by state or local law. Thus, this tax incentive does not reduce the cost of providing leave in jurisdictions where employers are required to do so by a state or local authority.

A tax credit can only be claimed for wages paid for family and medical leave. If an employer provides paid leave (e.g., vacation, personal, or sick leave) that is not specifically set aside for a FMLA-qualifying purpose, that leave is not considered FML leave. Family and medical leave is restricted to leave associated with (1) the birth of a child or placement of an adopted or foster child with the employee; (2) a serious health condition of the employee or the employee's spouse, child, or parent; (3) an exigency arising out of the fact that a close relative is a member of the armed forces and on covered active duty; or (4) to care for a covered service member who is a close relative of the employee.

For employers, there are other requirements associated with the credit. To claim the credit, an employer must have a written family and medical leave policy in effect. The policy cannot exclude certain classifications of employees (e.g., unionized employees). Additionally, a qualified employer is required to claim the credit, unless the employer opts out. For employers, the amount of wages and salaries deducted as a business expense is reduced by the amount of credit claimed. Further, the credit cannot be claimed if wages have been used to calculate another tax credit (to avoid a double tax benefit). The credit is part of the general business credit, meaning that unused credits from the current tax year can be carried back one year (offsetting the prior year's tax liability) or carried forward up to 20 years to offset future tax liability. The credit is allowed against the alternative minimum tax (AMT).

Legislative Background

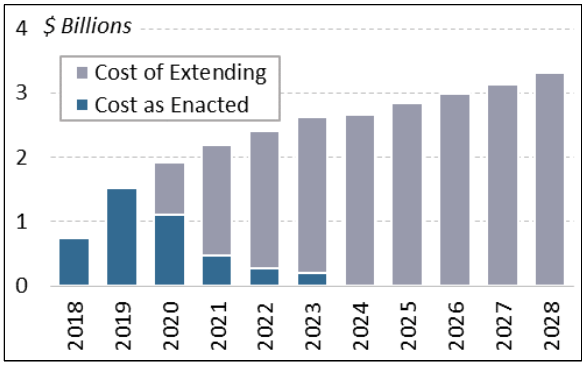
The employer credit for paid family and medical leave was added to the IRC in P.L. 115-97. In the 115th Congress, the House and Senate each passed their own versions of the Tax Cuts and Jobs Act. The House version did not contain a credit for paid family and medical leave. The credit was introduced in the Senate amendment, and the Conference Agreement followed the Senate amendment. The Strong Families Act (S. 1716) in the 115th Congress and earlier proposals of the same title proposed a similar tax credit.

Revenue Loss of the Credit

The Joint Committee on Taxation (JCT) estimated that this credit will reduce federal revenue by $4.3 billion between FY2018 and FY2027. Most of the revenue loss is in FY2019 and FY2020, as the credit currently expires at the end of calendar year 2019 (see **Figure 1**). Revenue losses, however, are expected beyond FY2020 as businesses carry forward unused credits from 2018 and 2019 to offset future tax liability. Extending the provision through the 10-year budget window (FY2019-FY2028) would result in revenue losses of $22.0 billion, according to the Congressional Budget Office (CBO).

Figure 1. Annual Revenue Loss of Employer Credit for Paid Family and Medical Leave

FY2018-FY2028



Sources: JCT and CBO.

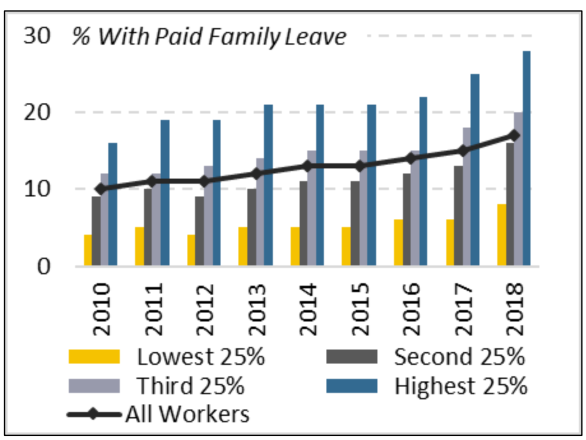
Policy Considerations

The employer credit for paid FML is targeted at a group that is less likely to have access to paid family leave: low- and moderate-income workers. In 2018, 17% of all workers had access to paid family leave. However, in 2018, 28% of workers in the top 25% of wage earners had access to paid family leave. For those in the lowest 25% of wage earners, 8% had access to paid family leave. For background, see CRS Report R44835, *Paid Family Leave in the United States*, by Sarah A. Donovan.

The share of workers with access to paid family leave has increased in recent years (see **Figure 2**). Access to paid family leave has increased across all income groups, but there remains a gap in paid family leave benefits between lower- and higher-wage workers.

Figure 2. Paid Family Leave by Wage Category

2010-2018



Source: Bureau of Labor Statistics (BLS).

Notes: Average hourly wages are $13.18, $19.87, and $31.55 at the 25th, 50th, and 75th percentiles, respectively, in 2018.

Some workers who do not have paid family and medical leave may be able to use other forms of paid leave (e.g., paid vacation, sick, or personal leave) following the birth or adoption of a child or for their own serious health condition, or that of a close relative.

Will the Credit Increase Paid Leave?

Providing a tax credit for employers that provide paid FML should, on the face of it, tend to increase access to this benefit. How effective the credit will be at achieving this goal remains an open question.

Will the credit, as currently structured, provide a large enough incentive to cause employers to change their behavior (e.g., provide a benefit they do not currently provide)? If the credit itself does not motivate employers to provide paid FML, then employers that provide paid FML for other reasons may receive a "windfall" in reduced tax liability. Currently, large employers and employers of management and professional employees are most likely to provide paid family leave. Employers of management and professional employees, however, are less likely to have large shares of employees below the wage threshold.

Employers that provide paid FML to qualified employees for other reasons, such as to attract high-quality talent, will be able to claim the credit even though their benefit policies have not changed. If most of the credit's beneficiaries are employers that would have provided paid FML without the credit, then the credit is not a particularly efficient mechanism for increasing paid FML.

There is also the possibility that employers choose to substitute credit-eligible paid FML for other forms of leave. An employer could reduce the amount of paid sick, personal, or vacation time off, knowing that employees use this time for paid family and medical leave purposes. By making this choice, when employees take leave for FMLA purposes, the employer would be allowed a tax credit. If other benefits are scaled back in favor of tax-preferred FMLA leave, employees may not be better off.

Options Related to the Current Employer Credit

There are several policy options for the employer credit for paid family and medical leave. First, the credit could be allowed to expire as scheduled. Second, the credit could be extended. Third, the credit could be made permanent. Any extension of the credit could also include a range of potential modifications.

A possible rationale for extending the credit is that the two-year window under current law provides limited opportunity for evaluation. Over time, one way to examine whether the credit has been effective could be to look at the gap in paid leave benefits between lower- and higher-wage workers. As shown in **Figure 2**, this gap has persisted, even as more workers have access to paid leave.

Any extension of the credit will reduce federal tax revenues, all things equal. A permanent extension of the credit could be expected to reduce revenues by about $22 billion. As discussed above, an issue to consider is how much of this $22 billion is claimed by taxpayers that would not have provided paid family leave without the tax incentive.

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