AMERICAN BENEFITS
COUNCIL

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Robert Neis
Benefits Tax Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Stephen Tackney
Deputy Associate Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

William Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Guidance Request on New Employer Tax Credit for Paid Family and Medical Leave - Internal Revenue Code Section 45S

We are writing to request guidance and provide recommendations on the new employer tax credit for paid family and medical leave added by Section 13403 of H.R. 1, also known as the Tax Cuts and Jobs Act of 2017 (the "Act"). Those changes added a new section to the Internal Revenue Code – Section 45S – and make available a new tax credit for 2018 and 2019 for certain employers providing paid family and medical leave ("FML") to their employees. Our comments below are offered to highlight the areas of the new tax credit that will require the most attention from the Department of the Treasury ("Treasury") and Internal Revenue Service ("Service"). Given the limited duration of the new tax credit and its sudden effective date, we believe that the issues discussed below deserve immediate attention from Treasury and IRS, and warrant guidance that is simple and flexible for employers.

The American Benefits Council (the "Council") is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that

cover more than 100 million Americans. We regularly engage on paid leave issues, and are pleased to provide our input on this important new tax provision.

I. Definition of "Wages Normally Paid"

Under Internal Revenue Code ("Code") Section 45S(c)(1)(B), the credit is only available for employers that have a written policy providing paid FML that is "not less than 50 percent of the wages normally paid to such employee for services performed for the employer." Guidance on what is meant by "wages normally paid" will be crucial for employers in determining whether they are eligible for the credit. Given the credit's sudden effective date, and the short duration for which it applies, simplicity and flexibility are key.

It is important that Treasury and IRS provide guidance for determining an employee's "wages normally paid" in a way that requires minimal disruption for employers tracking compensation. For example, employers should be permitted to determine "wages normally paid" based on the "nominal" rate of pay and in a manner that ignores discretionary bonuses, retirement and welfare benefits, commissions, equity compensations, and overtime, if they choose to do so. Conversely, as long as the calculation is applied consistently across an employer's workforce, inclusion of one or more of these elements should also be allowed if calculated on a reasonable basis.

While calculating a percentage of "wages normally paid" for hourly and salaried employees should be a relatively straightforward proposition with flexible guidance from Treasury and IRS, calculating a percentage of "wages normally paid" for commission-based employees presents a unique challenge. Any guidance from Treasury and IRS on the calculation of "wages normally paid" must be sensitive to those difficulties and offer flexibility for employers.

II. Credit Limit Based on "Normal Hourly Wage Rate" and Hours on Leave

Code Section 45S(b)(1) establishes a limit on the credit with respect to each employee. Under that limitation, no credit is allowed to the extent that the credit exceeds "the product of the normal hourly wage rate of such employee for each hour (or fraction thereof) of actual services performed for the employer and the number of hours (or fraction thereof) for which family and medical leave is taken)." As we understand this limit, because the amount of the credit is limited to 25% of the wages paid to qualifying employees, only paid FML policies that provide benefits far in excess of an employee's regular wages would ever come close to approaching the limit imposed by Code Section 45S(b)(1) (e.g., four times an employee's regular wages if an employer receives the full 25% credit). Interestingly, the conference report provides no insight into the purpose of Code Section 45S(b)(1).

Because there are virtually no FML policies that will trigger the limitation imposed by Code Section 45S(b)(1), employers should not be required to calculate a "normal hourly wage rate . . . for each hour (or fraction thereof) of actual services performed for the employer." That calculation would trigger substantial burdens in the context of non-hourly employees, like additional "hour counting" and recordkeeping for salaried and commission-based employees. This would be expensive for employers and totally unnecessary for ensuring that employers do not receive a credit in excess of the limit imposed by Code Section 45S(b)(1). Accordingly, Treasury and IRS should permit employers to verify that they comply with the limit imposed by Code Section 45S(b)(1) by certifying that their paid FML policy does not pay benefits at a rate in excess of an employee's regular wages.

III. Eligible Employer

Full-Time/Part-Time Employees: Code Section 45S(c)(1)(A)(i) provides that the credit is only available for employers that provide two weeks of annual paid FML to qualifying employees who are not part-time employees – i.e., the requisite leave policy must be provided to all full-time employees. For this purpose, the full-time/part-time designation is set by a cross-reference to a Code Section defining part-time employees as employees who customarily work less than 30 hours per week. As Treasury and IRS consider ways to delineate part-time employees from full-time employees, we encourage Treasury and IRS to use existing definitions and frameworks already familiar to employers. For example, Treasury and IRS could borrow concepts from the Affordable Care Act hours of service rules. *See e.g.*, Treas. Reg. § 54.4980H-1(a)(24).

Collectively Bargained Employees: New Code Section 45S does not address whether an employer that has collectively bargained and non-collectively bargained employees can receive the credit if paid FML is offered exclusively to non-collectively bargained employees. Treasury and IRS should provide guidance on whether collectively bargained employees can be excluded from paid FML policies when determining whether a taxpayer is an "eligible employer" for purposes of the credit.

IV. Exclusion for Leave Mandated or Paid For By State or Local Government

Code Section 45S(c)(2)(4) provides that, for purposes of determining the credit, there shall not be taken into account "any leave which is paid by a State or local government or required by State or local law." This provision raises a number of questions necessitating guidance.

Paid FML Policies that are More Generous than Required: Some employers provide longer leave than what is required by State or local law, or may provide for a rate of pay

during the leave that exceeds the amount required by State or local law. Similarly, if the employer has some employees covered by State or local law, and some that are not, the employer may choose to offer paid FML to all employees. We believe that the employer should be able to receive the credit (or a partial credit) in these circumstances.

Additionally, in places where paid leave benefits are paid by State or local governments, some employers provide differential wage payments reflecting the difference between the government-paid leave and the employee's normal wages. For example, California pays 60-70% of wages while an employee is on FML, and some employers pay the difference between that State-paid benefit and the employee's usual wages. Treasury should confirm that these types of payments should be eligible for the credit, at least to the extent that the employer's payments exceed the amount paid by State or local governments.

Effective Date: Guidance is also needed with respect to the effective date on the limitation for leave mandated or paid by a State or local government, especially when a State or local government adopts a paid leave law after an employer has already voluntarily adopted a paid FML policy of its own. For example, if an employer adopts a paid FML policy to take advantage of the credit, and a State or local jurisdiction subsequently mandates such leave, is the credit available only for the period the paid FML policy was not required? Such a result would seem to contradict the purpose of the law, which is to incentivize employer-paid FML. Accordingly, we encourage Treasury to adopt guidance indicating that the credit's exclusion for employer-paid FML when mandated or required by State or local law only applies with respect to State or local laws in effect on the date of H.R. 1's enactment, or on the effective date of the credit (January 1, 2018).

Policy Concerns: As an aside, the Council believes that the exclusion for employer-paid FML when mandated or paid for by a State or local government is fundamentally unfair to employers. We see no policy reason for why any employer should pay more in federal taxes in relation to an employer providing identical FML benefits simply because one employer happens to be in a jurisdiction that includes a paid leave mandate or fund. We encourage Treasury to interpret this exclusion as narrowly as possible to limit this unfairness.

V. Open-Ended Universal Paid Leave Programs

Many employers are responding to the variety of State and local paid leave mandates by offering open-ended universal paid leave policies that are unrelated to any particular purpose (e.g., vacation, personal, sick, or family leave). By adopting such a policy, employers who operate in many different States and local jurisdictions can preemptively ensure that they comply with the paid leave rules of any jurisdiction.

Additionally, this approach also avoids the need for employees to reveal private information about why leave is being taken.

Code Section 45S(e)(2) states that if "an employer provides paid leave as vacation leave, personal leave, or medical or sick leave (other than leave [for certain specific purposes described by the Family and Medical Leave Act of 1993 ("FMLA")], that paid leave shall not be considered to be family and medical leave [for purposes of the credit]." The purpose of this rule is, of course, to prevent vacation and personal sick leave policies from being used as paid FML for purposes of determining the employer's credit. Notwithstanding that intent, however, it is important for Treasury and IRS to not further incentivize employers to *reduce* their paid leave policies by limiting them to policies that are exclusively limited to FML.

In order to avoid such a result, we recommend guidance explaining that an employee leave policy covering a number of different types of leave can qualify for the credit to the extent that the policy covers leave for purposes that qualify as FML under the Act. In other words, if an employer's leave policy provides paid leave for the types of leave described by the relevant Sections of FMLA, but also provides paid leave for types of leave not described by the relevant Sections of FMLA, the employer should still receive a credit to the extent that the employer's policy provides for paid FML as defined by the Act.

For example, although leave designated as "medial or sick leave" cannot qualify, Section 103(a)(1)(D) of FMLA does cover "a serious health condition that makes the employee unable to perform the functions of the position of such employee." To the extent that an employee can demonstrate that he or she qualifies for the type of leave described under Section 103(a)(1)(D) of FMLA, the employer should be able to account for such paid leave for purposes of the credit. In developing such a framework, employees should be permitted to certify under an open-ended universal paid leave program that they in fact meet the requirements of subparagraph (A), (B), (C), (D), or (E) of paragraph (1), or paragraph (3), of Section 102(a) of FMLA, and allow the employer to rely on that certification.

VI. Interaction with Short Term Disability Benefits

Similar to our comments regarding open-ended universal paid leave programs, we are also seeking clarification on the extent to which employer-paid short term disability benefits can be taken into account for purposes of determining the credit. For example, if an employer offers short term disability benefits that provide income replacement of 50% or higher, can those benefits be taken into account if paid for a purpose described by FMLA? Or, would an employer need to provide an additional two weeks of paid FML for a reason unrelated to the employee's short term disability claim. We believe that the Act permits employers to claim the credit for employer-provided benefits,

including short term disability benefits, that specifically cover one of the types of leave described by FMLA. However, confirmation from Treasury and IRS on this matter would be very helpful.

VII. Qualifying Employees

One-Year Requirement: Code Section 45S(d)(1) provides that a qualifying employee is an employee that has been employed by the employer for 1 year or more. It is not clear if this requires *continuous* employment (which would unnecessarily eliminate seasonal workers). Again, we recommend flexibility, and suggest a rule permitting an employer to use any reasonable method to determine whether an employee has been employed for 1 year or more. Guidance is also needed with respect to an individual who has not been employed for an entire year, but then takes FML and reaches the one-year anniversary date during leave. Are the payments made before reaching the one-year anniversary date eligible for the credit?

Compensation Limits: Code Section 45S(d)(2) provides that a qualifying employee cannot have compensation "for the preceding year . . . in excess of an amount equal to 60 percent of the compensation threshold for highly compensated employees under Code Section 414(q)(1)(B)" – i.e. annual compensation in excess of $72,000 for 2018. Treasury and IRS should clarify that this limitation does not require a qualifying employer to calculate an individual's compensation on a daily basis for the preceding one-year period. For example, employers should be able to rely on measurements like an employee's W-2 compensation for the last full calendar year for purposes of determining whether an employee satisfies the compensation threshold (or, if an employee did not work throughout the last full calendar year, an amount that prorates an employee's W-2 wages over a full 12-month period).

VIII. Sudden Changes Required for Payroll Systems

The sudden need to account for paid FML is not necessarily reflected in the existing capabilities of payroll systems. For example, many current payroll systems are not designed to isolate a particular date within a pay period under which FML begins. (Eligibility for leave is generally determined using a separate system within Human Resources.) Because the credit affects leave paid after December 31, 2017, this reality creates immediate programming and recordkeeping challenges for payroll systems. Accordingly, we recommend Treasury and IRS provide guidance indicating that employers can claim the credit if they can demonstrate good faith and reasonable procedures for designating the beginning and end days of paid FML.

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We applaud Treasury and IRS for placing Code Section 45S guidance on the recent Priority Guidance Plan. We hope our comments are helpful as you develop this guidance and are happy to answer any questions.

Sincerely,

Lynn D. Dudley
Senior Vice President, Global Retirement and
Compensation Policy