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## Part III - Administrative, Procedural and Miscellaneous

### Employer credit for paid family and medical leave

Notice 2018-71

#### PURPOSE

This notice provides guidance on the employer credit for paid family and medical leave under section 45S of the Internal Revenue Code (Code). This notice also announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to publish proposed regulations under section 45S.

#### BACKGROUND

Section 45S was added to the Code by “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (the Act), Pub. L. 115-97, 131 Stat. 2504, enacted December 22, 2017. For purposes of section 38, regarding the general business credit, section 45S establishes a business credit for employers that provide paid family and medical leave (the credit). The credit is equal to a percentage of wages paid to qualifying employees while they are on family and medical leave. As explained below, the purposes for which an employee may take family and medical leave under section 45S are the same purposes for which an employee may take family and medical leave under title I of the Family and Medical Leave Act of 1993, as amended (FMLA), Pub. L. 103-3; 29 U.S.C. sec. 2601.

The questions and answers in this notice provide further details regarding the requirements of section 45S, but a brief summary follows. To be eligible to claim the credit, an employer must have a written policy that satisfies certain requirements. First, the policy must cover all qualifying employees; that is, all employees who have been

employed for a year or more and were paid not more than a specified amount during the preceding year. In general, in determining whether an employee is a qualifying employee in 2018, the employee must not have had compensation from the employer of more than \$72,000 in 2017. Second, the policy must provide at least two weeks of annual paid family and medical leave for each full-time qualifying employee and at least a proportionate amount of leave for each part-time qualifying employee. Third, the policy must provide for payment of at least 50 percent of the qualifying employee's wages while the employee is on leave. Fourth, if an employer employs qualifying employees who are not covered by title I of the FMLA, the employer's written policy must include language providing "non-interference" protections, as described in Section A of this notice. Thus, the written policy must incorporate the substantive rules that must be met in order for an employer to be eligible for the credit.

Any leave paid by a State or local government or required by State or local law is not taken into account for any purpose in determining the amount of paid family and medical leave provided by the employer. Thus, any such leave is not taken into account in determining the amount of paid family and medical leave provided by the employer, the rate of payment under the employer's written policy, or the determination of the credit.

For purposes of the credit, an employer is any person for whom an individual performs services as an employee under the usual common law rules applicable in determining the employer-employee relationship. Similarly, wages qualifying for the credit generally have the same meaning as wages subject to the Federal

Unemployment Tax Act (FUTA) pursuant to section 3306(b), determined without regard to the \$7,000 FUTA wage limitation.

## GUIDANCE

This notice includes sections on the following topics:

- A. Eligible Employer
- B. Family and Medical Leave
- C. Minimum Paid Leave Requirements
- D. Calculating and Claiming the Credit
- E. Effective Date

### A. ELIGIBLE EMPLOYER

The credit is available only to eligible employers. Under section 45S(c)(1), an eligible employer is an employer that has a written policy in place that satisfies the requirements set forth in Q&A-2 below.

**Question 1:** Must an employer be subject to title I of the FMLA to be an eligible employer under section 45S?<sup>1</sup>

**Answer 1:** No. Any employer will be an eligible employer under section 45S if it has a written policy in place that provides paid family and medical leave, as described in Section B of this notice, satisfies the minimum paid leave requirements set forth in Section C of this notice, and, if applicable, includes the “non-interference” language described in Q&A-3.

**Question 2:** What must an eligible employer’s written policy provide?

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<sup>1</sup> Section 101(4) of the FMLA defines “employer” as any person engaged in commerce or in any industry or activity affecting commerce who employs 50 or more employees for each working day during each of 20 or more calendar workweeks in the current or preceding calendar year, which includes (a) any person who acts, directly or indirectly, in the interest of an employer to any of the employees of such employer; and (b) any successor in interest of an employer; and includes any “public agency,” as defined in section 3(x) of the Fair Labor Standards Act of 1938 (29 U.S.C. 203(x)).

**Answer 2:** An eligible employer’s written policy must provide paid family and medical leave, as described in Section B of this notice (Q&A-8 through Q&A-11) and must satisfy the minimum paid leave requirements set forth in Section C of this notice (Q&A-12 through Q&A-21). In summary, an eligible employer’s written policy must provide all qualifying employees with at least two weeks of paid family and medical leave (prorated for part-time employees), at a rate of at least 50 percent of the employee’s normal wages, as these terms are defined and described in more detail in Sections B and C of this notice. In addition, if the employer employs any qualifying employees, as defined in Q&A-12, who are not covered by title I of the FMLA, the employer’s written policy must include “non-interference” language, as set forth in Q&A-3.

**Question 3:** If an employer employs any qualifying employees who are not covered by title I of the FMLA, do additional requirements apply in determining whether the employer is an eligible employer?<sup>2</sup>

**Answer 3:** Yes. If an employer employs at least one qualifying employee who is not covered by title I of the FMLA (including any employee who is not covered by title I of the FMLA because he or she works less than 1,250 hours per year), in accordance with section 45S(c)(2), the employer must include “non-interference” language in its written policy and comply with this language to be an eligible employer. This requirement applies to: (a) an employer subject to title I of the FMLA that has at least one qualifying employee who is not covered by title I of the FMLA, and (b) an employer not subject to title I of the FMLA (that, thus, has no employees covered by title I of the FMLA). The

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<sup>2</sup> An employer that employs any qualifying employees who are not covered by title I of the FMLA is an “added employer” under section 45S(c)(2)(B)(ii).

“non-interference” language must ensure that the employer will not interfere with, restrain, or deny the exercise of, or the attempt to exercise, any right provided under the policy, and will not discharge, or in any other manner discriminate against, any individual for opposing any practice prohibited by the policy. The following “non-interference” language is an example of a written provision that would satisfy section 45S:

*[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.*

**Question 4:** Must an eligible employer’s written policy under section 45S be set forth in a single, separate document or meet other documentary requirements?

**Answer 4:** An eligible employer’s written policy under section 45S may be set forth in a single document or in multiple documents. For example, an employer may maintain different documents to cover different classifications of employees or different types of leave, and those documents collectively will constitute the employer’s written policy under section 45S. An eligible employer’s written policy under section 45S also may be included in the same document that governs the employer’s other leave policies. However, if an employer’s written policy provides paid leave for FMLA purposes and additional paid leave for other reasons (such as vacation or personal leave), only the leave specifically designated for FMLA purposes is considered to be family and medical leave under section 45S. See Q&A-9.

**Question 5:** What is the general rule for determining when an employer's written policy must be in place?

**Answer 5:** Except as provided in the transition rule in Q&A-6 for the first taxable year of an employer beginning after December 31, 2017, the employer's written policy must be in place before the paid family and medical leave for which the employer claims the credit is taken. The written policy is considered to be in place on the later of the policy's adoption date or the policy's effective date.

**Example.** **Facts:** Employer adopts a written policy that satisfies all of the requirements of section 45S on June 15, 2019, with an effective date of July 1, 2019.

**Conclusion:** Assuming all other requirements for the credit are met, Employer may claim the credit with respect to family and medical leave paid in accordance with that policy to qualifying employees for leave taken on or after July 1, 2019.

**Question 6:** For the first taxable year of an employer beginning after December 31, 2017, what is the transition rule for determining when the employer's written policy must be in place?

**Answer 6:** For an employer's first taxable year beginning after December 31, 2017, a written leave policy or an amendment to a policy (whether it is a new policy for the taxable year or an existing policy) will be considered to be in place as of the effective date of the policy (or amendment), rather than a later adoption date, if (a) the policy (or amendment) is adopted on or before December 31, 2018, and (b) the employer brings its leave practices into compliance with the terms of the retroactive policy (or retroactive amendment) for the entire period covered by the policy (or amendment), including making any retroactive leave payments no later than the last day of the taxable year.

**Example 1.** **Facts:** Employer's taxable year is the calendar year. Employee takes two weeks of unpaid family and medical leave beginning January 15, 2018. Employer adopts a written policy that satisfies the requirements of section 45S on

October 1, 2018, and chooses to make the policy effective retroactive to January 1, 2018. At the time the policy is adopted, Employer pays Employee (at a rate of payment provided by the policy) for the two weeks of unpaid leave taken in January 2018.

Conclusion: Assuming all other requirements for the credit are met, Employer may claim the credit with respect to the family and medical leave paid to Employee for the leave taken in January 2018.

**Example 2. Facts:** Employer's taxable year is the calendar year. Employer amends its FMLA policy in writing on April 15, 2018, effective for leave taken on or after April 15, 2018, to provide that four weeks of FMLA leave will be paid leave. Employer's FMLA policy does not provide for leave for qualifying employees who are not covered by title I of the FMLA or include "non-interference" language. Employee, who is a qualifying employee, but who is not covered by title I of the FMLA, takes three weeks of unpaid family and medical leave beginning June 18, 2018. On October 1, 2018, Employer amends its written policy to include "non-interference" language and to provide paid leave effective April 15, 2018, for qualifying employees who are not covered by title I of the FMLA. On October 15, 2018, Employer pays Employee for the three weeks of family and medical leave Employee took beginning June 18, 2018.

Conclusion: Assuming all other requirements for the credit are met, Employer may claim the credit with respect to the family and medical leave paid to Employee for the leave taken beginning in June 2018.

**Question 7:** Is an eligible employer required to provide notice to employees that it has a written policy in place providing for paid family and medical leave under section 45S?

**Answer 7:** No. Section 45S does not impose a notice requirement with respect to the written policy on employers. However, if an employer chooses to provide notice of the written policy to qualifying employees, the policy will not be considered to provide for paid leave to all qualifying employees as required under section 45S, unless the availability of paid leave is communicated to employees in a manner reasonably designed to reach each qualifying employee. This may include, for example, email communication, use of internal websites, employee handbooks, or posted displays in employee work areas.

## B. FAMILY AND MEDICAL LEAVE

An eligible employer may claim the credit under section 45S only with respect to paid family and medical leave. Under section 45S(e)(1), family and medical leave means leave for any one or more of the purposes described under subparagraph (A), (B), (C), (D), or (E) of paragraph (1), or paragraph (3), of section 102(a) of the FMLA (“FMLA purposes”), whether the leave is provided under the FMLA or by a policy of the employer. Under section 45S(e)(2), if an employer provides paid leave as vacation leave, personal leave, or medical or sick leave (other than leave specifically for one or more of the FMLA purposes), that paid leave is not considered family and medical leave under section 45S.

**Question 8:** What are the FMLA purposes for which paid family and medical leave under section 45S may be provided to a qualifying employee?

**Answer 8:** The FMLA purposes for which paid family and medical leave under section 45S may be provided are:

- (a) The birth of a son or daughter of the employee and in order to care for the son or daughter.
- (b) The placement of a son or daughter with the employee for adoption or foster care.
- (c) Caring for the spouse, or a son, daughter, or parent, of the employee, if the spouse, son, daughter, or parent has a serious health condition.
- (d) A serious health condition that makes the employee unable to perform the functions of the employee’s position.

(e) Any qualifying exigency (as the Secretary of Labor shall, by regulation, determine) arising out of the fact that the spouse, or a son, daughter, or parent of the employee is a member of the Armed Forces (including the National Guard and Reserves) who is on covered active duty (or has been notified of an impending call or order to covered active duty).

(f) 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. The FMLA purposes are the purposes for which an employee may take leave under the FMLA. The terms used in this Q&A-8 have the same meaning as defined in section 825.102 of the FMLA regulations, 29 CFR § 825.102.

**Question 9:** Under what circumstances is paid leave considered family and medical leave under section 45S?

**Answer 9:** Other than the narrow exception described in Q&A-10, paid leave made available to an employee is considered family and medical leave under section 45S only if the leave is specifically designated for one or more FMLA purposes, may not be used for any other reason, and is not paid by a State or local government or required by State or local law. See *also* Q&A-21.

**Example 1. Facts:** Employer's written policy provides six weeks of annual paid leave for the birth of an employee's child, and to care for that child (an FMLA purpose). The leave may not be used for any other reason. No paid leave is provided by a State or local government or required by State or local law.

**Conclusion:** Employer's policy provides six weeks of family and medical leave under section 45S.

**Example 2. Facts:** Employer's written policy provides three weeks of annual paid leave that is specifically designated for any FMLA purpose and may not be used for any other reason. No paid leave is provided by a State or local government or required by State or local law.

**Conclusion:** Employer's policy provides three weeks of family and medical leave under section 45S.

**Example 3. Facts:** Employer's written policy provides three weeks of annual paid leave for any of the following reasons: FMLA purposes, minor illness, vacation, or specified personal reasons. No paid leave is provided by a State or local government or required by State or local law.

**Conclusion:** Employer's policy does not provide family and medical leave under section 45S because the leave is not specifically designated for one or more FMLA purposes and can be used for reasons other than FMLA purposes. This is true even if an employee uses the leave for an FMLA purpose.

**Question 10:** What is the consequence under section 45S if an employer's written policy provides paid leave that otherwise would be specifically designated for an FMLA purpose (for example, to care for a spouse, child, or parent who has a serious medical condition), except for the fact that the leave is available to care for additional individuals not specified in the FMLA (for example, a grandchild, or grandparent who has a serious medical condition)?

**Answer 10:** In this limited circumstance, the fact that the leave could also be used to care for additional individuals for whom care under the FMLA purpose is not required does not prevent the leave from being considered specifically designated for an FMLA purpose. However, the employer may not claim the credit for any leave taken to care for an individual other than a qualifying employee's spouse, parent, or child. See also Q&A-28.

**Example. Facts:** Employer's written policy provides four weeks of annual paid leave to care for family members with a serious health condition. The policy's definition of "family members" includes the individuals specified in the FMLA (spouse, children, and parents), and also includes grandparents, grandchildren, and domestic partners. Employee uses one week of annual paid leave to care for her grandmother, and at a later time, uses one week of annual paid leave to care for her son.

**Conclusion:** Employer's policy provides paid leave specifically designated for an FMLA purpose. Although the paid leave taken by Employee to care for her grandmother is not family and medical leave under section 45S, and Employer may not claim the credit for this leave, the paid leave taken by Employee to care for her son is family and medical leave under section 45S for which Employer may claim the credit, assuming all other requirements for the credit are met.

**Question 11:** May paid leave provided pursuant to an employer's short-term disability program be characterized as family and medical leave under section 45S?

**Answer 11:** Yes. Paid leave provided under an employer's short-term disability program, whether self-insured by an employer or provided through a short-term disability insurance policy, may be characterized as family and medical leave under section 45S if it otherwise meets the requirements to be family and medical leave under section 45S. See Q&A-9 and Q&A-15.

#### C. MINIMUM PAID LEAVE REQUIREMENTS

For an employer to be eligible to claim the credit, an employer's written policy must meet certain minimum requirements with respect to paid family and medical leave, as described in section 45S(c)(1) and (c)(2). These requirements are:

(1) the policy must provide at least two weeks of annual paid family and medical leave to all qualifying employees who are not part-time employees, and at least a proportionate amount of paid family and medical leave to qualifying employees who are part-time employees,

(2) the policy must require a rate of payment that is not less than 50 percent of the wages normally paid to the qualifying employee for services performed for the employer, and

(3) if the employer employs one or more qualifying employees who are not covered by title I of the FMLA, the employer's written policy also must include the "non-interference" language described in Q&A-3.

Under section 45S(c)(4), any leave that is paid by a State or local government or required by State or local law is not taken into account for any purpose in determining the amount of paid family and medical leave provided by the employer.

**Question 12:** Who is a qualifying employee?

**Answer 12:** A qualifying employee is an employee (as defined in section 3(e) of the Fair Labor Standards Act of 1938, as amended (FLSA)) who has been employed by the employer for one year or more, and whose compensation for the preceding year does not exceed an amount equal to 60 percent of the amount applicable for that year under section 414(q)(1)(B)(i).<sup>3</sup> For 2017, the applicable amount of compensation under section 414(q)(1)(B)(i) is \$120,000.<sup>4</sup> Accordingly, to be a qualifying employee in 2018, an employee must have earned no more than \$72,000 (60 percent of \$120,000) in compensation in 2017 (or if applicable, in the employer's fiscal year beginning in 2017). Section 414(q)(4) provides that an employee's compensation is determined under section 415(c)(3).

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<sup>3</sup> While the "preceding year" used for this purpose is generally the preceding calendar year, an employer whose fiscal year is not the calendar year may choose to use as the "preceding year" either (a) the employer's immediately preceding fiscal year, or (b) the calendar year ending in the employer's immediately preceding fiscal year.

<sup>4</sup> See Notice 2016-62, 2016-46 IRB 725. Each year, the IRS adjusts the applicable amount under section 414(q)(1)(B)(i) (and amounts under other Code sections) and publishes the adjusted amounts in a notice. The applicable amount under section 414(q)(1)(B)(i) for 2018 is \$120,000. See Notice 2017-64, 2017-45 IRB 486.

**Question 13:** How does an employer determine whether an employee has been employed for one year or more?

**Answer 13:** Until further guidance is issued, an employer may use any reasonable method to determine whether an employee has been employed for one year or more. Treating employees as employed for one year or more if they have been employed for 12 months, as set forth in section 825.110(b) of the FMLA regulations, 29 CFR § 825.110(b), is an example of a reasonable method. However, any requirement that an employee work 12 consecutive months to be a qualifying employee would not be viewed as a reasonable method for determining whether an employee has been employed for one year.

**Question 14:** Must an employee work a minimum number of hours per year to be a qualifying employee?

**Answer 14:** No. Section 45S does not require an employee to work a minimum number of hours per year to be a qualifying employee. Until further guidance is issued, any requirement that an employee work a minimum number of hours to be a qualifying employee would not be viewed as a reasonable method for determining whether an employee has been employed for one year. The rules under section 101(2)(A)(ii) of title I of the FMLA, which require an employee to work a minimum of 1,250 hours of service to be an eligible employee under the FMLA, do not apply to section 45S.

**Question 15:** May the employer's written policy exclude any classification of employees from eligibility for paid family and medical leave?

**Answer 15:** No. An employer's written policy must provide at least two weeks of

annual paid family and medical leave to all qualifying employees who are not part-time employees, and at least a proportionate amount of annual paid family and medical leave to all qualifying employees who are part-time employees. The policy may not exclude any classification of employees (for example, collectively bargained employees) if they are qualifying employees.

**Example 1.** **Facts:** Employer has an insured short-term disability plan that provides disability benefits to any employee who becomes disabled after having completed six months of continuous service. Under the plan, a disability caused by, or resulting from, a pre-existing condition is not covered if the disability begins in the first 12 months after the effective date of coverage. For purposes of the plan, a pre-existing condition is one for which an employee consulted a physician, received medical treatment, or took prescribed drugs in the three months immediately prior to the effective date of coverage. The exclusion from coverage for pre-existing conditions applies to all employees of the employer during the applicable 12-month period.

**Conclusion:** Employees subject to the pre-existing condition exclusion are effectively not covered under the plan when they first become qualifying employees. In addition, in some cases, the requirement that an employee complete six months of continuous service might exclude some qualifying employees. Therefore, the plan will not in all cases cover all qualifying employees, and Employer may not claim the credit under section 45S for paid family and medical leave provided under the written policy with respect to any employees.

**Example 2.** **Facts:** Same facts as in Example 1, except that Employer adopts a written policy that provides for paid leave to any qualifying employee who is not covered under the short-term disability plan as a result of the six months of service requirement or the pre-existing condition exclusion. This leave is paid from Employer's general assets and the length of the paid leave is the same as the leave that would have been available under the short-term disability plan if neither the six months of service requirement nor the pre-existing condition exclusion applied to a qualifying employee.

**Conclusion:** Taking into account the leave available under Employer's insured short-term disability plan and Employer's supplemental self-insured paid leave arrangement as permitted under Q&A-4, Employer's written policy does not exclude any classification of qualifying employees and, assuming all other requirements for the credit are met, Employer may claim the credit under section 45S for paid family and medical leave provided under the written policy.

**Question 16:** How many weeks of annual paid family and medical leave must an employer provide to qualifying employees to claim the credit under section 45S?

**Answer 16:** An employer's written policy must provide qualifying employees who are not part-time employees with at least two weeks of annual paid family and medical leave and must provide at least a proportionate amount of annual paid family and medical leave to qualifying employees who are part-time employees. For part-time employees, the paid leave ratio must be at least equal to the ratio of the expected weekly hours worked by a qualifying employee who is a part-time employee to the expected weekly hours worked by an equivalent qualifying employee who is not a part-time employee, as described in section 45S(c)(1)(A)(ii). In determining the amount of paid family and medical leave provided by the employer for purposes of section 45S, any leave paid by a State or local government or required by State or local law is not taken into account.

**Example. Facts:** Employer's written policy provides four weeks of annual paid family and medical leave to any qualifying employee expected to work 40 hours per week, and two weeks of paid family and medical leave to any equivalent qualifying employee who is a part-time employee and is expected to work 20 hours per week. All of Employer's employees work either 20 or 40 hours per week.

**Conclusion:** Employer's policy meets the minimum paid leave requirements because each employee who is not a part-time employee may take at least the minimum two weeks of annual paid leave and each part-time employee may take at least a proportionate number of weeks of leave. Specifically, with respect to the proportionate amount, the ratio of expected weekly hours worked by a qualifying employee who is a part-time employee (20 hours) to the expected weekly hours worked by an equivalent qualifying employee who is not a part-time employee (40 hours) is 1:2, and the policy provides two weeks of paid leave to qualifying employees who are part-time employees and four weeks of paid leave to equivalent qualifying employees who are not part-time employees, satisfying the 1:2 ratio.

**Question 17:** How does an employer determine who is a part-time employee?

**Answer 17:** A part-time employee is an employee who is customarily employed for fewer than 30 hours per week.<sup>5</sup> Until further guidance is issued, an employer may use any reasonable method to determine how many hours an employee customarily works per week for the employer. Reasonable methods include the methods set forth in 29 CFR § 2530.200b-2 for calculating hours of service in connection with certain plans, such as qualified pension plans, subject to the Employee Retirement Income Security Act of 1974, as amended.

**Question 18:** What rate of payment must an employer's written policy provide?

**Answer 18:** The employer's written policy must provide that each qualifying employee who is on paid family and medical leave will be paid at least 50 percent of the wages normally paid to the employee for services performed for the employer. In determining the rate of payment under the policy, leave paid by a State or local government or required under State or local law is not taken into account. See Q&A-21.

**Question 19:** For this purpose, how does an employer determine the wages normally paid to an employee?

**Answer 19:** Wages normally paid to an employee means the wages normally paid to the employee for services performed for the employer. Overtime (other than regularly-scheduled overtime) and discretionary bonuses are excluded from wages normally paid. Until further guidance is issued, for employees who are paid (in whole or in part) on a basis other than a salaried or hourly rate, an employer must determine wages normally

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<sup>5</sup> Section 45S(c)(1)(A)(i) uses the definition of part-time employee set forth in section 4980E(d)(4)(B), which states that a part-time time employee is any employee who is customarily employed for fewer than 30 hours per week.

paid to the employee using the rules for determining regular rate of pay set forth in regulations issued under the FLSA. See 29 CFR § 778.109.

**Question 20:** Must the rate of payment or period of paid family and medical leave provided under an employer's written policy be uniform with respect to all qualifying employees and for all FMLA purposes?

**Answer 20:** No. Section 45S does not require an employer's rate of payment or period of paid family and medical leave to be uniform with respect to all qualifying employees and for all FMLA purposes. However, to the extent an employer's policy provides different rates of payment or periods of paid family and medical leave for different FMLA purposes, the minimum paid leave requirements must be satisfied with respect to each FMLA purpose for which the employer intends to claim the credit. Conversely, if an employer's policy provides a uniform rate of payment and period of paid family and medical leave for all qualifying employees and for all FMLA purposes (or a uniform rate of payment and period for several specified FMLA purposes), the policy as a whole must satisfy the minimum paid leave requirements, and it is not necessary for the minimum paid leave requirements to be satisfied separately with respect to each FMLA purpose.

**Example 1. Facts:** Employer's written policy provides each qualifying employee with six weeks of annual paid leave for the birth or adoption of the employee's child, or to care for that child (an FMLA purpose) at a rate of payment of 100 percent of wages normally paid to the employee for services performed for Employer. For all other FMLA purposes, the policy provides each qualifying employee with two weeks of annual paid leave at a rate of payment of 75 percent of wages normally paid to the employee.

**Conclusion:** Employer's written policy satisfies the minimum paid leave requirements.

**Example 2. Facts:** Employer's written policy provides each qualifying employee with two weeks of annual paid leave for the birth or adoption of the employee's child, or

to care for that child (an FMLA purpose) at a rate of payment of 100 percent of wages normally paid to the employee, and also provides each qualifying employee who is not covered by a collective bargaining agreement with two weeks of annual paid leave for a serious health condition that makes the employee unable to perform the duties of his or her position (also an FMLA purpose) at a rate of payment of 100 percent of wages normally paid to the employee.

**Conclusion:** The portion of Employer's policy that provides paid leave to each qualifying employee for the birth or adoption of the employee's child, or to care for that child, satisfies the minimum paid leave requirements. However, the portion of the policy providing only certain qualifying employees (those who are not covered by a collective bargaining agreement) with paid leave for a serious health condition that makes the employee unable to perform the duties of his or her position does not satisfy the minimum paid leave requirements, and Employer may not claim the credit for any leave taken under that portion of the policy.

**Example 3. Facts:** Employer's written policy provides each qualifying employee with two weeks of annual paid leave for any FMLA purpose at a rate of payment of 100 percent of the wages normally paid to the employee, and each qualifying employee who has 10 years of service with an additional two weeks of annual paid leave for any FMLA purpose at a rate of payment of 100 percent of wages normally paid to the employee.

**Conclusion:** Employer's policy satisfies the minimum paid leave requirements.

**Question 21:** In determining the rate of payment under the employer's written policy, is leave paid by a State or local government or required by State or local law taken into account?

**Answer 21:** No. Leave paid by a State or local government or required by State or local law is not taken into account in determining whether an employer's written policy provides a rate of payment of at least 50 percent of the wages normally paid to an employee for services performed for the employer. To be eligible to claim the credit, an employer must independently satisfy the minimum paid leave requirements, including providing a rate of payment of at least 50 percent of wages normally paid to an employee. See *also* Q&A-9.

**Example 1. Facts:** Under State law, an employee on family and medical leave is eligible to receive six weeks of benefits paid by a State insurance fund at a rate of 50

percent of the employee's normal wages. Additionally, Employer's written policy concurrently provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 30 percent of the wages normally paid to the employee for services performed for Employer. Consequently, in the aggregate, a qualifying employee can receive six weeks of annual paid family and medical leave at a rate of payment of 80 percent of the wages normally paid to the employee.

Conclusion: Employer's policy does not independently satisfy the requirement that the rate of payment be at least 50 percent of the wages normally paid to an employee.

**Example 2.** Facts: Same facts as Example 1, except that Employer's written policy provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 50 percent of the wages normally paid to the employee that runs concurrently with the State leave. Consequently, in the aggregate, a qualifying employee can receive six weeks of annual paid family and medical leave at a rate of payment of 100 percent of the wages normally paid to the employee.

Conclusion: Employer's policy independently satisfies the requirement that the rate of payment be at least 50 percent of the wages normally paid to an employee. Only wages paid under Employer's written policy (50 percent of wages normally paid to the employee) may be used in calculating the credit. Wages paid pursuant to State law are not used in calculating the credit. See Q&A-26.

**Example 3.** Facts: Under State law, employers are required to provide employees six weeks of family and medical leave, and the State law permits this leave to be either paid or unpaid. Employer's written policy provides each qualifying employee with six weeks of annual paid family and medical leave at a rate of payment of 50 percent of the wages normally paid to the employee.

Conclusion: Employer's policy independently satisfies the requirement that the rate of payment be at least 50 percent of the wages normally paid to an employee.

#### D. CALCULATING AND CLAIMING THE CREDIT

Section 45S(a)(1) provides that, in the case of an eligible employer, the credit is an amount equal to the applicable percentage of the amount of wages paid to qualifying employees during any period in which the employees are on family and medical leave. Under section 45S(a)(2), the term "applicable percentage" means 12.5 percent increased (but not above 25 percent) by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50 percent.

Under section 45S(b)(3), the amount of family and medical leave that may be taken into account with respect to any qualifying employee for any taxable year may not exceed 12 weeks. Section 45S(b)(1) provides that the credit with respect to any qualifying employee for any taxable year cannot exceed an amount equal to the product of the employee's normal hourly wage rate 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.

**Question 22:** How is the applicable percentage calculated?

**Answer 22:** The applicable percentage is based on the rate of payment for the leave under the employer's policy. The base applicable percentage of 12.5 percent applies if the rate of payment is 50 percent. If the rate of payment under the policy is greater than 50 percent, the applicable percentage is increased by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50 percent, up to a maximum applicable percentage of 25 percent.

**Example 1. Facts:** Employer's written policy provides each qualifying employee with four weeks of annual paid family and medical leave at a rate of payment of 75 percent of the wages normally paid to the employee.

**Conclusion:** Because the rate of payment under the policy exceeds 50 percent by 25 percentage points, the base applicable percentage of 12.5 percent is increased by 6.25 percent (.25 percent multiplied by 25), for an applicable percentage of 18.75 percent.

$$\begin{aligned}\text{Applicable Percentage} &= 12.5 \text{ percent} + (0.25 \text{ percent} \times 25) \\ &= 12.5 \text{ percent} + 6.25 \text{ percent} \\ &= 18.75 \text{ percent}\end{aligned}$$

**Example 2. Facts:** Same facts as Example 1, except that Employer's written policy provides each qualifying employee who has at least 10 years of service a rate of payment of 100 percent of the wages normally paid to the employee for services performed by the employer, rather than 75 percent.

Conclusion: Because the rate of payment for a qualifying employee who has at least 10 years of service is 100 percent (which is 50 percentage points greater than 50) the base applicable percentage for these employees is increased by 12.5 percent (0.25 percent multiplied by the 50). The applicable percentage with respect to such an employee is therefore 25 percent (the base percentage of 12.5 percent, plus 12.5 percent). For a qualifying employee who has less than 10 years of service, the applicable percentage is the same as determined in Example 1.

Calculation for employee who has at least 10 years of service:

$$\begin{aligned}\text{Applicable Percentage} &= 12.5 \text{ percent} + (0.25 \text{ percent} \times 50) \\ &= 12.5 \text{ percent} + 12.5 \text{ percent} \\ &= 25 \text{ percent}\end{aligned}$$

**Question 23:** How is the credit calculated?

**Answer 23:** The credit is equal to the applicable percentage of the amount of wages normally paid to a qualifying employee during any period (up to 12 weeks) that the employee is on family and medical leave.

**Example 1. Facts:** Employer's written policy provides each qualifying employee with four weeks of annual paid family and medical leave at a rate of payment of 75 percent of wages normally paid to the employee. During 2018, Employee takes four weeks of leave under the policy. Employee is normally paid \$1,000 per week. Employer pays Employee a total of \$3,000 (\$750 per week for four weeks) for family and medical leave under section 45S.

Conclusion: Assuming all the requirements for the credit are met, Employer may claim a credit of \$562.50 with respect to Employee (18.75 percent of \$3,000).

**Example 2. Facts:** Same facts as Example 1, except that Employer's written policy provides each qualifying employee who has at least 10 years of service with a rate of payment of 100 percent of the wages normally paid to the employee. During 2018, Employee A, who has been employed for 12 years, takes leave under the policy for four weeks, and Employee B, who has been employed for five years, takes leave under the policy for two weeks. Both Employee A and Employee B are normally paid \$1,000 per week. Employer pays Employee A a total of \$4,000, and Employee B a total of \$1,500, for family and medical leave under section 45S.

Conclusion: Assuming all the requirements for the credit are met, Employer may claim a total credit of \$1,281.25 with respect to Employee A and Employee B. The credit for Employee A is \$1,000 (25 percent of \$4,000), and the credit for Employee B is \$281.25 (18.75 percent of \$1,500).

**Question 24:** What are wages for purposes of section 45S?

**Answer 24:** For purposes of section 45S, pursuant to section 45S(g), the term “wages” has the same meaning given to that term by section 3306(b) (regarding FUTA wages), determined without regard to the \$7,000 FUTA wage limitation. Section 3306(b) generally defines wages as all remuneration for employment, as defined by section 3306(c), subject to certain limitations. However, for purposes of section 45S, the term “wages” does not include any amount taken into account for purposes of determining any other credit allowed under section 38, which provides for several separate business-related credits.

**Example 1. Facts:** Employer pays wages to Employee that qualify as a research expense for purposes of determining the amount of Employer’s research credit under section 41(a). The research credit under section 41(a) is a general business credit allowed under section 38. Some of the wages paid to Employee for the performance of qualified services under section 41(b) were paid while Employee was on family and medical leave.

**Conclusion:** For purposes of determining the amount of Employer’s credit under section 45S, Employer must exclude from the wages paid while Employee was on family and medical leave any wages treated as a qualified research expense for purposes of determining the amount of Employer’s research credit under section 41(a).

**Example 2. Facts:** Employer is tax-exempt under section 501(a) as an educational organization described in section 501(c)(3). Employment with Employer is not employment for purposes of FUTA tax pursuant to section 3306(c)(8); thus, compensation paid by Employer is not FUTA wages within the meaning of section 3306(b). Although Employer is exempt from federal income tax under section 501(a), it earns unrelated business taxable income from a trade or business that is not substantially related to the performance of Employer’s exempt purpose. Employer maintains a written paid leave policy that provides at least two weeks of paid family and medical leave to all qualifying employees, including those performing services for the unrelated trade or business. Employer would like to claim the credit against its unrelated business income tax liability.

**Conclusion:** Because Employer does not pay FUTA wages within the meaning of section 3306(b), compensation paid by Employer does not constitute wages for purposes of section 45S(g). Consequently, amounts paid by Employer to its employees while on paid family and medical leave are not eligible for the credit.

**Question 25:** Are wages paid by a third-party payer (including an insurance company, a professional employer organization, or a Certified Professional Employer Organization) to qualifying employees for services performed for an eligible employer considered wages for purposes of section 45S?

**Answer 25:** Yes. However, only the eligible employer, and not the third-party payer, may take into account wages paid to qualifying employees for services performed for the eligible employer in determining the credit under section 45S.

**Question 26:** Is leave paid by a State or local government or required by a State or local law taken into account in determining the credit?

**Answer 26:** No. Leave paid by a State or local government or required by a State or local law is not taken into account in determining the credit.

**Question 27:** Are wages paid through an employer's short-term disability program for family and medical leave taken into account in determining the credit?

**Answer 27:** Yes. Wages paid through an employer's short-term disability program for family and medical leave are taken into account in determining the credit provided that the program (in combination with any other employer-paid leave arrangement) meets the minimum paid leave requirements. See Q&A-11.

**Question 28:** May an employer claim the credit with respect to an employee who is not a qualifying employee when the paid family and medical leave is taken, but who becomes a qualifying employee at a later time during the taxable year?

**Answer 28:** No. An eligible employer may claim the credit only with respect to wages paid to an employee who is a qualifying employee at the time family and medical leave is taken. Wages paid to an employee for family and medical leave taken before an

employee becomes a qualifying employee are excluded in determining the employer's credit. However, if an employer's written policy provides that employees may take paid family and medical leave before they become qualifying employees and does not provide a dedicated amount of leave meeting the minimum paid leave requirements that may only be taken after an employee becomes a qualifying employee, the leave will not fail to (a) be specifically designated for an FMLA purpose, or (b) meet the minimum paid leave requirements, solely because an employee may take paid leave before becoming a qualifying employee.

**Example. Facts:** Employer's written policy provides all employees who have completed at least six months of employment with four weeks of annual paid family and medical leave at a rate of payment of 100 percent of wages normally paid to the employee for services performed by the employer. Employee completes six months of employment with employer as of January 1, 2019, and one year of employment (becoming a qualifying employee) as of July 1, 2019. On June 15, 2019, Employee begins a four week period of paid family and medical leave under the policy.

**Conclusion:** Assuming all the requirements to claim the credit are met, Employer may use wages paid to Employee for family and medical leave on or after July 1, 2019, the date that Employee becomes a qualifying employee, in the calculation of the credit. Wages paid for family and medical leave taken before Employee becomes a qualifying employee are not eligible for the credit.

**Question 29:** Who may claim the credit?

**Answer 29:** Only an eligible employer for whom qualifying employees perform services may claim the credit with respect to wages paid. *See also* Q&A-25.

**Question 30:** Does claiming the credit affect an employer's deduction for wages or salaries paid for the taxable year?

**Answer 30:** Yes. Section 280C denies a deduction for wages or salaries paid for the taxable year equal to the amount of the credit. Under section 280C(a), an employer's deduction for wages paid is reduced by an amount equal to the amount of the credit.

**Question 31:** How does an eligible employer claim the credit?

**Answer 31:** An eligible employer must file IRS Form 8994, Employer Credit for Paid Family and Medical Leave, and IRS Form 3800, General Business Credit, with its tax return to claim the credit.

**Question 32:** For purposes of the limitation described in section 45S(b)(1), how does an employer determine the normal hourly wage rate of an employee who is not paid an hourly wage rate?

**Answer 32:** Until further guidance is issued, an employer may use any reasonable method to convert the normal wages paid to an employee who is not paid an hourly wage rate to an hourly rate.

**Question 33:** Are employers aggregated under section 45S for purposes of calculating the credit?

**Answer 33:** No. Section 45S(c)(3) provides that all persons who are treated as a single employer under section 52(a) and (b) are treated as a single taxpayer. In accordance with this aggregation rule, employers are aggregated for purposes of section 45S(h)(1), which provides that a taxpayer may elect to have section 45S not apply for any taxable year. This is the only purpose for which employers are aggregated under section 45S. Consequently, employers are not aggregated for any other purpose under section 45S, including calculating the credit as set forth in this Section D.

**Question 34:** Does each member of a controlled group of corporations (as defined in section 52(a)) and each member of a group of businesses under common control (as defined in section 52(b)) generally make a separate election to claim or not to claim the credit under section 45S(h)?

**Answer 34:** Yes. Each member of a controlled group of corporations and each member of a group of businesses under common control generally makes a separate election to claim or not to claim the credit in accordance with rules set forth under section 51(j)(2) and (3). However, in the case of a consolidated group (as defined in § 1.1502-1(h)), the election is made by the agent (as defined in § 1.1502-77) of the group. An election to claim or not to claim the credit is made for the taxable year in which the credit is available by claiming or not claiming the credit on either an original return or an amended return filed for that taxable year. See Q&A 31.

#### E. EFFECTIVE DATE

This notice is effective as of September 24, 2018, and applies to wages paid in taxable years beginning after December 31, 2017, and before January 1, 2020.

#### PUBLIC COMMENTS

This notice generally provides guidance that the Treasury Department and the IRS intend to incorporate into proposed regulations. The proposed regulations will provide interested parties an opportunity to comment on the issues addressed in the proposed regulations. However, to assist in development of the proposed regulations, the Treasury Department and the IRS request comments on the guidance provided in this notice. Public comments should be submitted no later than November 23, 2018. Comments should include a reference to Notice 2018-71. Send submissions to CC:PA:LPD:PR (Notice 2018-71), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2018-71), Courier's Desk, Internal Revenue Service, 1111

Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the following e-mail address: *Notice.comments@irsounsel.treas.gov*. Please include "Notice 2018-71" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

#### PAPERWORK REDUCTION ACT

The collection of information contained in this notice will be submitted through IRS Form 8944 to the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number. The collection of information is required to obtain a general business credit for employers that provide paid family and medical leave. The likely respondents are individuals, households, businesses, and other for-profit or not-for-profit institutions. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

#### DRAFTING INFORMATION

The principal author of this notice is Dara Alderman of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Dara Alderman at (202) 317-5500 (not a toll-free call).