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Employee Benefit Plan Review

Ask the Experts

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Paid Leave Tax Credit

Q My company provides paid leave. A number of our employees have used their paid leave while they have been out on Family and Medical Leave Act (FMLA)-qualifying leave. What do we need to do to claim the new federal tax credit for paid FMLA leave?

A You are referring to the new tax credit under Section 45S of the Internal Revenue Code. There are a number of requirements that your company will need to meet in order to be able to claim this credit. Initially, in order to claim this credit, the use of the paid leave that your company offers must be limited to FMLA-qualifying purposes. If the paid leave can be used for other purposes, such as vacation or ordinary sick leave, then your company will not be eligible for the credit, even if the paid leave is actually used for an FMLA-qualifying purpose. In addition, your company's paid leave policy must be in writing, it must provide at least two weeks of annual paid leave for full-time qualifying employees (and a pro rata amount of annual paid leave for part-time qualifying employees), and the benefit must be equal to at least 50 percent of the qualifying employee's regular wages. The written policy may also be required to contain certain anti-retaliation provisions if the paid leave benefit is offered to qualifying employees who are not eligible for FMLA leave (for example, because the employee does not meet FMLA eligibility requirements). Finally, paid leave that your company is required to provide by state or local law is not eligible for the tax credit.

You may have noticed that our response referred to "qualifying employees." Your company may only take the credit for paid leave used by a qualifying employee. If other employees take paid leave, your company cannot take the credit for them. A "qualifying employee" is anyone who was been employed by your company for at least one year and whose compensation for the prior year is equal to or less than 60 percent of the prior year's limit under Section 414(q)(1)(B) of the Internal Revenue Code. That limit for 2018 was $120,000, so 60 percent of that number, for purposes of qualifying for the 2019 tax credit, is $72,000. Lastly, to avoid a "double counting" situation, any wages paid for which this tax credit is claimed by your company must be subtracted from any tax deduction that your company would otherwise claim for those wages.

Tracking Employee Hours Under the Affordable Care Act

Q My company sponsors a self-insured group health plan and we offer coverage under that plan to any employee who is scheduled to work at least 20 hours per week. Because we offer coverage under the group health plan based on scheduled hours, we do not track employee hours for health plan purposes. It has recently come to our attention that this may be an issue under the health care reform law. What are the health care reform law's rules regarding tracking hours for health plan purposes?

A The final regulations under the Affordable Care Act provide rules for determining hours of service and status as a full-time employee for purposes of Section 4980H of the Internal Revenue

Code (the provision of the health care reform law that imposes penalties on applicable large employers who fail to meet the "employer mandate" requirements). These regulations technically require employers to track employees' hours. For employees paid on an hourly basis, an employer must calculate actual hours of service from records of hours worked and hours for which payment is made or due (the "Hours of Service" method). For non-hourly employees, an employer must calculate hours of service by using one of the following methods: (1) using actual hours of service from records of hours worked and hours for which payment is made or due; (2) using a days-worked equivalency whereby an employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service under the "Hours of Service" method; or (3) using a weeks-worked equivalency whereby an employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service under the "Hours of Service" method.

Note, however, that the number of hours of service calculated using a days-worked or weeks-worked equivalency must generally reflect the hours actually worked and the hours for which payment is made or due. An employer is not permitted to use the days-worked or weeks-worked equivalency if the result is to substantially understate an employee's hours of service in a manner that would cause the employee not to be treated as a full-time employee, or if the result is to understate the hours of service of a substantial number of employees (even if no particular employee's hours of service are understated substantially and even if the understatement would not cause the employee to not be treated as a full-time employee).

For example, an employer may not use a days-worked equivalency in the case of an employee who generally works three days per week for 10 hours each day, because the equivalency would substantially understate the employee's hours as 24 hours of service per week, which would result in the employee not being treated as a full-time employee. An employer is not required to use the same method of tracking hours for all non-hourly employees, and may apply different methods for different categories of non-hourly employees, as long as the categories are reasonable and consistently applied. An employer may change the method of calculating the hours of service of non-hourly employees (or one or more categories of non-hourly employees) for each calendar year.[1]

Note that there are special rules regarding tracking hours for certain categories of employees whose hours are particularly challenging to identify or track or for whom the general rules described above for determining hours of service may present special difficulties (such as adjunct faculty, commissioned sales people, and airline employees), and for certain categories of work associated with some positions of employment, including layover hours (such as for airline employees) and on-call hours. Employers with such special circumstances are required to use a reasonable method of crediting hours of service that is consistent with the Affordable Care Act's employer shared responsibility provisions. A method of crediting hours is not reasonable if it takes into account only a portion of an employee's hours of service with the effect of characterizing, as a non-full-time employee, an employee in a position that traditionally involves at least 30 hours of service per week. It is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which payment is made or due by the employer, for which the employee is required to remain on-call on the employer's premises, or for which the employee's activities while remaining on-call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee's own purposes.

Given that your company offers group health insurance coverage to all of its employees who are scheduled to work at least 20 hours per week, the risk of penalties from not tracking employees' hours may be low, if your company is actually covering all of its full-time employees under your group health plan and offering them coverage that is affordable and provides minimum value in accordance with the requirements of the health care reform law. However, it is a better practice to follow the rules described above and track hours for health plan purposes, to ensure that no full-time employees accidentally slip through the cracks and are not offered coverage, such as when an employee changes schedules or fluctuates in hours. And, as noted above, tracking hours for health plan purposes is technically required by the Affordable Care Act, in accordance with the rules described above.

Note

1. *See* 26 C.F.R. §54.4980H-3.

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