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Alerts and Newsletters

Tax Code Revisions Will Affect Employer Policy and Litigation Strategy Decisions

The recently enacted Tax Cuts and Jobs Act ("TCJA") revises the Internal Revenue Code in many respects and includes several employment-related provisions that employers should consider as part of their strategic planning.

Paid Family and Medical Leave Tax Credit

There is no federal law requiring paid leave; however, the TCJA does address paid leave. The bill **does not** require employers to offer paid leave. Rather, the TCJA establishes a tax credit as an incentive to employers to provide paid family and medical leave. This tax credit has a sunset provision – it is only available in tax years 2018 and 2019. Furthermore, the credit is not available with respect to any amounts paid by a state or local government or required by state or local law.

Under the TCJA, eligible employers will be able to claim a general business tax credit equal to 12.5% of the wages they pay to qualifying employees for the time they take as family and medical leave. The credit is available only if the employer pays the employees on leave at least half of their hourly rate (or a prorated amount if they are not paid hourly), and only if the employer provides at least two weeks of paid family and medical leave per year. Employers that pay their employees on leave more than 50% replacement wages will be entitled to a greater tax credit. Specifically, the credit will increase by a quarter-percentage point for every percent above the 50% rate the employer pays the employee on leave, up to a maximum tax credit of 25% if the employer pays the employees 100% of their regular wages. This credit is available for up to 12 weeks of paid leave per employee per year.

Employers must offer paid leave to both full-time and part-time employees to be able to claim the tax credit. Employers must allow part-time employees to take an amount of paid leave equivalent to that provided to full-time employees, determined on a pro-rata basis. A "qualifying employee" is someone who has been employed for at least a year and paid no more than 60% of the compensation threshold for designation as a highly compensated employee under the Internal Revenue Code, or \$72,000 (60% of \$120,000 for 2017). Thus, a tax credit cannot be taken for FMLA replacement wages paid to "highly compensated" employees.

The tax credit applies for "family and medical leave," as defined under the Family and Medical Leave Act. Paid vacation leave, personal leave, or other types of medical or sick leave are not considered family and medical leave for tax credit purposes.

Note that five states – New Jersey, New York, California, Rhode Island and Washington – and the District of Columbia have enacted paid leave-related bills. Accordingly, the tax credit may not be taken by employers in these jurisdictions. New York's law went into effect Jan. 1, 2018 and those in Washington State and D.C. are effective in 2019 and 2020, respectively. All programs are funded through payroll taxes.

Nondisclosure of Sexual Harassment Settlement Agreements

The increased awareness of sexual harassment claims has focused attention on nondisclosure agreements in the settlement of harassment claims. The TCJA uses the tax code to encourage "transparency" about such settlements.

Section 162 of the Internal Revenue Code generally allows businesses to deduct certain ordinary and necessary expenses paid or incurred during the year as part of running the business. The TCJA limits such deductions by providing that no deductions are permitted for settlement amounts or attorneys' fees paid with respect to sexual harassment or sexual assault claims if they are provided pursuant to a nondisclosure or confidentiality agreement.

This limitation on deductibility of settlement amounts as business expenses will require employers to make strategic decisions about the amounts paid and whether or not to include confidentiality provisions. Settlement agreements for employment claims not involving sexual harassment are not affected by this revision.

Nondeduction of Certain Amounts Imposed by Government or Specified Non-Government Entities

The TCJA amends Section 162(f) of the Internal Revenue Code to bar employers from taking business expense deductions for amounts paid to or incurred at the direction of a government or specified nongovernmental entity (whether by lawsuit, agreement, or otherwise) because of asserted or determined violations of any law or the investigation or inquiry by such government or entity into the potential violation of any law. This section previously only denied deductions for fines and penalties paid to the government. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance.

Therefore, if the government or government entity is a complainant or investigator with respect to a violation or potential violation of law, amounts that do not represent restitution for actual damages (*i.e.*, lost wages or recovery for pain and suffering) but represent a fine or penalty (*i.e.*, treble or punitive damages) are no longer deductible even if paid directly to a plaintiff. Under prior law, these amounts were only nondeductible if paid directly to the government.

ACA Employer Mandate Still In Effect

While the TCJA repealed the penalties for the Affordable Care Act individual mandate effective in 2019, the associated employer mandate remains in effect. While the individual mandate repeal is likely to increase premiums in the individual market, it is uncertain how it will affect the employer-based market. This uncertainty creates added challenges for employers already facing enforcement of the employer mandate, extensive reporting requirements, and the impending "Cadillac Tax" on employer-sponsored health coverage above a certain threshold. The Cadillac Tax is currently scheduled to become effective in 2020 unless Congress takes action to repeal or further delay it.

If you have any questions regarding this Client Alert, please contact Harry T. Lamb at 610.205.6035, Charles C. Scheim at 610.478.2282, Zachary R. Davis at 215.751.2874 or the Stevens & Lee attorney with whom you normally consult.

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