Insight

Important Research Questions About the New Paid Leave Tax Credit

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The Tax Cuts and Jobs Act, the major tax reform legislation signed into law by President Trump at the end of 2017, included a provision that aims to increase access to paid family and medical leave.[1] For the next two years, the federal government will give businesses a tax credit to partially offset the cost of providing these kinds of leave, a structure that closely resembles Senator Deb Fischer's proposed Strong Families Act.[2] The tax credit is intended to incentivize businesses to provide paid family and medical leave benefits to more workers.

Whether the tax credit will actually do so remains an open question, however, as this is an unprecedented program. Consequently, over the next two years policymakers and researchers should closely study the tax credit, the ways employers use it, and the family and medical leave benefits that are offered to workers.

This brief report first explains the structure of the tax credit before detailing the important questions about it that researchers must address.

THE TAX CREDIT

Under a two-year pilot program that began at the start of 2018, the federal government is providing a tax credit to businesses that offer their workers paid family and medical leave. To receive the tax credit, businesses must provide at least two weeks of leave that pays at least 50 percent of a worker's regular earnings. The tax credit ranges from 12.5 percent to 25 percent of the cost of each hour of paid leave taken, depending on how much of a worker's regular earnings the benefit replaces. The government covers 12.5 percent of the benefit's costs if workers receive half of their regular earnings and up to 25 percent if workers receive their entire regular earnings. Businesses are also able to apply the credit only toward workers who earn below $72,000 per year.

RESEARCH QUESTIONS

No one knows whether the tax credit will have the intended effect, as this proposal has never been tried. Yet the existence of this pilot program gives researchers and policymakers the opportunity to study the program and draw conclusions about its approach. In general, there are five categories of important questions that researchers should address.

Access to Paid Family and Medical Leave

The most important research questions relate to how the tax credit expands access to paid family and medical leave. Specifically, how many businesses offer new paid family and medical leave benefits because of the tax credit? And, how many workers gain access to paid family and medical leave benefits?

A principle concern is that the tax credit is too small to incentivize businesses to provide more paid leave and instead will simply subsidize businesses that already provide the benefit. Federal data suggest that the kind of employee most likely to have paid family and medical leave today is a highly compensated worker in a large business.[3] This fact suggests that the tax credit could only subsidize the benefits of higher wage workers and benefit those large employers already providing paid leave, without increasing access to paid leave for those who presently lack it.

On the other hand, the credit could provide smaller businesses the assistance they need to start providing paid family and medical leave, and it could help all businesses provide the benefit to lower-wage workers. Moreover, the $72,000 earnings eligibility threshold may prevent the tax credit from subsidizing existing benefits of high wage workers. And, even if the credit does go to businesses that already provide paid family and medical leave, those businesses may use that assistance to expand the benefit within their workforces by introducing it to lower-wage employees.

Over the next few years, researchers and policymakers must identify the impact of the tax credit, looking especially at what businesses use it, whether new workers gain access to paid family and medical leave, and how much of the credit actually subsidizes new benefits.

Quality of Paid Leave Benefits Offered

The next set of questions relates to the package of paid leave benefits that employers provide.

First, how generous are the benefits that employers provide under the tax credit? For instance, how many weeks of leave do employers offer and how well are workers compensated when they go on leave? To receive the tax credit, employers must provide workers at least two weeks of leave that pays at least 50 percent of regular earnings. Do most employers provide the bare minimum of two weeks and 50 percent pay, or do most use the credit to provide more generous benefits? Moreover, how does the fact that the tax credit increases from 12.5 percent to 25 percent as pay replacement rises from 50 percent to 100 percent influence the generosity of the paid leave that employers provide? Finally, for companies that already provide paid family and medical leave, the tax credit may influence them to provide more generous benefits. Thus, does the tax credit lead companies that already have paid family and medical leave to extend the value or duration of leave available to their workers?

Second, what types of family and medical leave benefits do employers provide? Under the Family and Medical Leave Act (FMLA), certain workers are entitled up to 12 weeks of job-protected, unpaid leave to recover from a serious medical condition (“medical leave”), to care for a family member with a serious medical condition (“family care leave”), or for the birth or adoption of a child (“parental leave”). To be eligible for the tax credit, an employer must provide paid leave for only one of those reasons. With the tax credit, how often do employers provide paid leave for all three versus just one or two? If employers mostly provide paid leave for just one or two, which types of leave do they offer?

It is also unclear whether the tax credit requires that the employer benefits guarantee job protection, particularly for those who are not covered by the FMLA. Firms are unlikely to provide employees with paid family and medical leave benefits that do not protect their jobs. If that were the case, employers would effectively be paying workers to quit. However, it will be important to consider whether many workers who receive paid leave because of the tax credit are not guaranteed job protection, and whether this has any significant negative consequences.

Third, how does the tax credit impact other benefits that employers provide? Now that employers are subsidized for providing this specific benefit, they could choose to replace other types of benefits with paid family and medical leave. If this occurs, what types of other non-subsidized benefits do workers lose? Do workers simply start receiving a different mix of paid leave benefits (e.g., less vacation and more family leave) or do they lose other types of non-cash benefits as well (e.g., health insurance)? Alternatively, how often do employers simply add paid family and medical leave without taking away other benefits?

Answering this third set of questions is vital to understanding whether the tax credit will increase the rate at which workers are paid when they take family and medical leave. Currently, two-thirds of workers are paid when taking family and medical leave,[4] primarily through a mix of paid leave benefits like paid time off (PTO), temporary disability insurance (TDI), sick leave, vacation days, and paid parental leave.[5] If the tax credit simply replaces existing paid leave benefits, like PTO, with family and medical leave benefits, then the actual frequency at which workers receive paid leave for family and medical reasons may not change.

Family and Medical Leave Used

If the tax credit successfully expands access to paid family and medical leave in the private sector, how does greater access to paid leave impact the amount of leave workers take? The existence of more paid leave benefits could increase the likelihood that workers take family and medical leave as well as the length of time they are away from work. How does the generosity of the paid leave offered via the tax credit influence the rate at which workers take family and medical leave and the amount of time they are on leave? For instance, do workers who are offered 12 weeks of family and medical leave at 100 percent pay replacement take leave more frequently and for a longer duration than workers who are offered six weeks of leave at 50 percent pay replacement? And if the amount of family and medical leave taken rises due to the tax credit, what are the implications for labor productivity, labor force participation, and, consequently, economic growth?

The Earnings Eligibility Threshold

Employers are only able to apply the tax credit to workers who earn under $72,000 per year. The earnings threshold is included to ensure the credit subsidizes paid family and medical leave for low- and middle-wage workers, who are less likely to have access to the benefit, and to limit how much the credit goes toward high-wage workers who already have it.

There are a few potential consequences of the earnings cut-off that researchers should explore. In particular, it could prevent employers from giving raises to workers who earn just under $72,000 per year. Consider a business that applies the tax credit to provide paid family and medical leave to its entire workforce. For a worker who earns just under $72,000 per year, a raise means that the business would have to pay for both the larger salary and the entire cost of that worker’s paid family and medical leave, should he or she take it. Over the next few years, researchers should study whether the tax credit has any negative effect on wages for those earning just under $72,000 per year.

Limitations of the Pilot Program

When evaluating the tax credit's effectiveness in expanding access to paid family and medical leave, researchers will face two major limitations. It is vital they assess how much those limitations prevent them from fully understanding the merits and consequences of this approach.

First, the tax credit is only available for two years, and that short duration will likely prevent many employers from using it to introduce new paid family and medical leave benefits. For instance, a firm is unlikely to introduce a new leave benefit if it knows that it will have to take it away when the credit expires in just two years. This outcome is particularly likely among the very firms that need the credit to afford paid family and medical leave. Thus, researchers must address how much the pilot's short duration limits the effectiveness of the tax credit.

Second, analysts face major data limitations when evaluating the merits of paid leave proposals. Data on this topic are often inconsistent and lack very important pieces of information.[6] For instance, annual data on access to paid family leave from the Bureau of Labor Statistics (BLS) do not measure the duration or value of the leave.[7] The BLS data also indicate neither how often workers utilize paid family and medical leave nor for how long. Moreover, surveys of the workers who take family and medical leave are conducted infrequently.[8] Those surveys that do exist do not connect the leave that workers use to the benefits that are offered by their employers. Thus, the data available to researchers do not provide a complete picture of paid family and medical leave in the private sector. Consequently, when evaluating the tax credit, researchers should assess how these data limitations prevent them from fully understanding the effects of the policy.

CONCLUSION

The major tax reform bill signed into law at the end of 2017 contained the very first federal paid family and medical leave policy in United States history. Over the next two years, policymakers and researchers will have the opportunity to evaluate the impact of the tax credit on access to paid family and medical leave, the quality of those benefits, and how workers utilized those benefits (while determining the limitations of the pilot program as well). Understanding the merits and consequences of this approach can then guide whether or not to continue this program.

[1] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018., H.R.1, 115th Congress, 2017, https://www.congress.gov/bill/115th-congress/house-bill/1.

[2] Strong Families Act, H.R.1716, 115th Congress, 2017, https://www.congress.gov/bill/115th-congress/senate-bill/1716.

[3] Ben Gitis, "What We Know About Paid Family Leave in the Private Sector," American Action Forum, March 17, 2016, https://www.americanactionforum.org/research/know-paid-family-leave-private-sector/.

[4] Ben Gitis, "What Pew's Report on Paid Leave Preferences Means for Policy," American Action Forum, April 19, 2017, https://www.americanactionforum.org/insight/pews-report-paid-leave-preferences-mean-policy/.

[5] Jacob Alex Klerman, Kelly Daley, and Alyssa Pozniak, "Family and Medical Leave in 2012: Technical Report," US Department of Labor, revised April 2014, https://www.dol.gov/asp/evaluation/fmla/FMLA-2012-Technical-Report.pdf

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[6] Ben Gitis, “What We Know About Paid Family Leave in the Private Sector,” American Action Forum, March 17, 2016, https://www.americanactionforum.org/research/know-paid-family-leave-private-sector/.

[7] National Compensation Survey, Bureau of Labor Statistics, https://www.bls.gov/ncs/.

[8] FMLA Surveys, Wage and Hour Division, United States Department of Labor, https://www.dol.gov/agencies/whd/fmla.