January 9, 2026

IRS Taxation and Reporting Guidance for State Paid Family and Medical Leave

This Alert was previously issued on February 26, 2025. We have updated this Alert to reflect an additional one-year extension to the transition relief for medical leave benefits paid during 2026, which was issued by the Internal Revenue Service (IRS) on December 19, 2025.

On January 15, 2025, the IRS published Revenue Rule 2025-4 (Rev. Rul. 2025-4), which provides direct guidance addressing the federal taxation and applicable reporting requirements for contributions and benefits paid under a state paid family and medical leave (PFML) program. This guidance is generally effective for state PFML contributions and benefits paid on or after January 1, 2025, subject to a transition period for certain requirements.

This Alert is relevant for employers operating in, or with employees working in, states with mandatory PFML programs.

Background information

The Family and Medical Leave Act of 1993 (FMLA) is a federal law that generally requires covered employers to allow eligible employees to take unpaid, job-protected leave for certain circumstances. While the FMLA provides unpaid leave for eligible employees, there is no federal law that provides private sector employees with paid family and medical leave.

As of the date of this Alert, fourteen states (California, Colorado, Connecticut, Delaware, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia have implemented state PFML programs. These programs generally require employers and employees in the applicable state to make contributions to the PFML program (or make contributions at a future, specified date in accordance with the applicable state requirements).[1] While each state's PFML programs vary, the employer and employee contributions generally provide income replacement for a certain number of weeks to eligible employees who qualify for the applicable family or medical leave.

[1] The particulars of state leave laws are outside the scope of this Alert. For an overview of the current state paid family and medical leave laws, see: https://www.dol.gov/agencies/wb/paid-leave/State-Paid-Family-Medical-Leave-Laws.

Highlights

Overview

IRS Rev. Rul. 2025-4 addresses the federal tax treatment for contributions and benefits paid under a state PFML program.

This guidance is effective for payments made on or after January 1, 2025, although certain transition relief applies for 2025 and 2026. This Alert is relevant for all employers operating in, or with employees working in, states with mandatory state PFML programs.

Key provisions

- Required employer contributions are not taxable to an employee. An employer may deduct these contributions.
- Employee contributions and discretionary employer contributions are taxable wages to an employee. Employees may be able to deduct these contributions, subject to certain limitations.
- An employer can deduct discretionary contributions as ordinary and necessary business expenses.
- Family leave benefits are taxable.
- Medical leave benefits are tax-free to the extent the contributions were treated as taxable income to the covered employee

Employer action items

Employers subject to state PFML laws should consult with the appropriate advisors to determine what steps are needed to comply with this recent IRS guidance.

Although some states have had their PFML laws in place for several years, the tax and reporting requirements for PFML contributions and benefits were unclear. Employers operating in states with mandatory PFML programs, or with employees working in these states, have had little choice but to rely on imperfect – and in some cases outdated – interpretations for how any applicable taxation and reporting requirements should apply. New Rev. Rul. 2025-4 helps clarify the applicable taxation and reporting requirements for state-run PFML programs, although it does not address these requirements for private employer plans providing paid family or medical leave (including when permitted in lieu of the employer participating in the state program).

Federal taxation of contributions to state PFML programs

In general, there are three types of contributions that can apply to a PFML program:

1. Employer contributions,
2. Employee contributions, and
3. Employer contributions on behalf of employees (referred to by the IRS as "employer pick-up" contributions).

Note: Rev. Rul. 2025-04 only addresses federal taxation and reporting. State tax issues are determined by the individual states (and D.C.) and are outside the scope of this Alert.

Employer contributions

When an employer must contribute a percentage of an employee's wages annually to a state PFML program, the contributions are considered a state tax and are not taxable income to the employees (i.e., the required employer contributions are not included in an employee's federal taxable gross income).

An employer may take a deduction for its required contributions as a state excise tax paid in carrying on a business activity.[2] Since the required employer contribution is not considered taxable wages to employees, the employer does not have a federal withholding or reporting obligation for this amount.

Employee contributions

When the state PFML program requires employees to contribute a percentage of their wages, the employee contributions must be made on an after-tax basis (i.e., they are included in an employee's federal taxable gross income as wages and are subject to federal income and employment taxes).

The employer must report these contributions on the employee's Form W-2 for the year the contributions are made. If an employee itemizes deductions on their federal personal income tax return, the employee can take a deduction for their contributions as a payment of state taxes for the year in which the amount was withheld. This deduction cannot exceed the applicable state and local tax (SALT) deduction amount.[3]

Employer pick-up contributions

An employer may choose to pay all or a portion of the employee mandatory state PFML contributions from its own funds instead of withholding the amounts from employee wages. The IRS views these employer pick-up

[2] See Internal Revenue Code (IRC) Section 164. An employer can still consider a required employer contribution to fall under IRC Section 164 if the contribution is paid into a separate state established fund, so long as the separate fund is established for public purposes and for the purpose of discharging a government function.

[3] Section 11042(a) of Public Law 115-97, 131 Stat. 2054 (December 22, 2017), referred to as the "Tax Cuts and Jobs Act," limits an individual's aggregate state and local tax (SALT) deduction for the calendar year to $10,000 ($5,000 if married and filing a separate return) for a tax year beginning after December 31, 2017, and before January 1, 2026.

contributions as additional taxable compensation paid to the employee that should be included in the employee's federal gross income as taxable wages.

Unlike *required* employer contributions, an employer cannot treat pick-up contributions as the payment of state excise taxes for deduction purposes, since the pick-up contribution is not a mandatory employer contribution imposed by the state. However, the employer can take a deduction for pick-up contributions as ordinary and necessary business expenses, since the IRS views them as taxable wages.[4]

Just like required employee contributions, an employee may be able to deduct the employer pick-up contribution as a payment of state income tax if they itemize deductions on their federal personal income tax return. The SALT deduction limitation applies.

Transition relief: Employers are not required to report employer pick-up contributions as employee federal gross income for the 2025 calendar year. The extension of enforcement relief provided via IRS Notice 2026-6 did not apply to employer pick-up contributions, so those amounts will need to be included as income to employees in 2026.

Example 1 – Employee and employer contributions

A state PFML program requires a contribution on behalf of each covered employee equal to 1% of weekly wages, with at least half contributed by the covered employer and any remaining portion withheld from the covered employee's wages. Assume ABC Company contributes the mandatory 50% from its own funds and withholds the remaining 50% from employee wages. If a covered employee's weekly wage is $1,000, the federal tax results are (shown as weekly amounts):

- The $5 required employer contribution is not taxable federal gross income to the employee. The $5 employee contribution is paid on an after-tax basis, meaning it counts towards the employee's federal gross taxable income (i.e., included on the employee's Form W-2 as taxable income).[5]
- The employer can deduct its required $5 employer contribution as the payment of state excise taxes.

Example 2 – Employer pick-up contributions

The same facts as Example 1, except ABC Company chooses to pay the entire covered employee portion as a pick-up contribution and contributes the full amount to the state from its own funds. If a covered employee's weekly wage is $1,000, the federal tax results are (shown as weekly amounts):

- The $5 required employer contribution is not taxable federal gross income to the employee. The $5 employer pick-up contribution is included in the employee's taxable federal gross income as wages (i.e., the cumulative amount will appear in the employee's Form W-2 as taxable income).[5] However, the 2025 transition relief means this does not apply to pick-up contributions made before 2026.
- The employer can deduct the required $5 contribution as the payment of state excise taxes. The employer can deduct the $5 employer pick-up contribution as an ordinary and necessary business expense.

Taxation of benefits paid by state PFML programs

Rev. Rul. 2025-4 also provides guidance regarding the taxation and reporting requirements of benefits received under state PFML programs. The taxation and reporting requirements depend on whether a covered employee receives family leave or medical leave benefits.

[4] See IRC Section 162.

[5] If the employee itemizes his or her deductions on their federal personal income tax return, the employee may be able to deduct some or all of the $500 as state income tax up to the SALT deduction limitation.

Family leave benefits

States with PFML programs generally provide covered employees with limited wage replacement benefits for leaves of absence due to specific family-related reasons, such as to care for a family member with a serious health condition, for the birth, adoption, or foster placement of a child, or for another specified circumstance as outlined in the state's PFML law.

When the PFML program pays family leave benefits to a covered employee, the benefit is included in the employee's federal gross income. There is no permitted tax exclusion, because a covered employee may receive family leave benefits for a variety of conditions unrelated to the employee's own health condition (e.g., to care for a family member with a serious health condition). As a result, the benefits cannot qualify as payments for accident or health insurance.

Although the family leave benefits are included in an employee's federal gross income, they do not count as paid wages. Therefore, the benefits are subject to federal income tax, but they are *not* subject to federal employment taxes, such as Social Security and Medicare.[6] The state is responsible for reporting these benefits to the IRS and providing the employee with a Form 1099 to report the family leave benefit payment.[7]

Please note that the form of the contributions (i.e., employee contribution, employer contribution, or employer pick-up contribution) does not impact the taxation and reporting requirements for family leave benefits paid to an employee.

Example 3 – Family leave benefits

A state PFML program pays a covered employee $20,000 in family leave benefits during 2025. The full $20,000 is included in the employee's federal gross income for federal income tax purposes, but they are not subject to federal employment taxes. The state will file with the IRS and provide a Form 1099 to the employee for these benefits.

Medical leave benefits

States with PFML programs also usually provide covered employees with limited wage replacement benefits for leaves of absence due to the employee's own serious health condition. The tax consequences for these benefits depend upon whether and to what extent the PFML contributions were included in the employee's taxable income. Unlike family leave benefits, benefits paid for an individual's own serious health condition can be treated as benefits received through accident or health insurance. This makes the benefits tax-free to the extent the PFML contributions were treated as taxable income to the covered employee.[8]

As outlined under Employer contributions, required employer contributions are not taxable income to covered employees. By contrast, employee contributions and any amount attributable to discretionary employer pick-up contributions are taxable. Therefore, if 50% of the PFML contribution is attributable to a required employer contribution and the remaining 50% is attributable to employee and/or employer pick-up contributions, 50% of the medical leave benefit will be taxable for both federal income and employment tax purposes.

The taxable benefits from the PFML program are treated as a third-party payment (from the state), making the federal tax and reporting implications somewhat complicated.

- The state is generally responsible for the withholding and payment of federal employment taxes, unless the state shifts the responsibility for the employer portion of the employment taxes to the employer. This shift should not be a surprise, as the state should communicate this to covered employers participating in the PFML program. The state will remain responsible for the employee portion of those taxes.

[6] The Internal Revenue Code (and IRS) views family leave benefits as being similar to Social Security benefits, which are included in gross income for income tax purposes but are not considered wages from employment.

[7] Form 1099 is only required if the total family leave benefits are $600 or more for the taxable year.

[8] Rev. Rul. 2025-4 relies on IRC Sections 104(a)(3) and 105(a) to reach this conclusion.

Transition relief: States and employers are not required to follow the withholding and reporting requirements for third-party sick pay for the 2025 or 2026 calendar year and will not be held liable for any associated penalties.

The state is not automatically required to withhold federal income tax from benefit payments, but the state must withhold on behalf of covered employees who request it do so and who submit a completed IRS Form W-4S. The employee will ultimately "true-up" the income tax consequences when filing their federal personal income tax return. [9]

Example 4 – Medical leave benefits

A state PFML program pays a covered employee $20,000 in medical leave benefits during 2025. In 2025, the employer paid 50% of the PFML contribution as a required employer contribution with the remainder withheld and paid by covered employees on an after-tax basis. As a result, $10,000 of the benefits are included in the employee's gross income as taxable wages for federal income and employment tax purposes (the other $10,000 is tax-free).

Transition relief for withholding and reporting purposes applies to both the state and employer for the 2025 and 2026 calendar years.[10] Assuming one or both takes advantage of this transition relief for 2025 and/or 2026, the employee will be left to true-up the tax consequences when filing their federal personal income tax return for the applicable year.

After the transition relief expires (beginning in 2027), the reporting obligations for employment taxes will depend upon whether the state shifts the burden for the employer portion of those taxes to the employer. The reporting obligation for income taxes depends upon whether the covered employee elects to have the state withhold for federal income taxes. The employee will ultimately true-up the tax consequences when filing their corresponding federal personal income tax return.

PFML allocation of contributions to family and medical leave benefits

If a state PFML program does not specify what percentage of contributions apply to family leave versus medical leave benefits, Rev. Rul. 2025-4 indicates that taxpayers can assume the entire contribution applies equally to each. In other words, the contributions apply 100% to both, which is convenient for the purposes of calculating the tax consequences for any medical leave benefits.

If a state PFML program does allocate contributions between the benefits (e.g., 40% is for family leave and 60% is for medical leave), it will affect the tax calculations for medical leave benefits. We will leave further discussion of this issue to the employer's payroll and/or tax advisors.

Employer action items

We recommend employers subject to any state PFML laws review the recent IRS guidance and consult with the appropriate advisors, such as their tax advisors, payroll vendors, and/or legal counsel, to determine what steps are needed to ensure they are in compliance with the taxation and reporting requirements for state PFML contributions and benefits paid beginning with the 2025 calendar year (and beyond).

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[9] See IRC Section 3402(o) and IRS Notice 2015-6 for more information about withholding and reporting requirements for third-party sick pay.

[10] IRS Notice 2026-6 provides an extension of the transition period for the 2026 calendar year for state paid medical leave benefits attributable to employer contributions. This is an extension from the original Rev. Rul. 2025-4 guidance that provides a transition period for just the 2025 calendar year.

Private employer plans

As stated earlier, Rev. Rul. 2025-04 does not address the federal tax withholding and reporting requirements for private employer plans providing paid family or medical leave (including when permitted in lieu of the employer participating in the state program). We think employers and third-party vendors will use Rev. Rul. 2025-04 to work through certain taxation and reporting issues for private plans subject to certain caveats:

- Family leave versus medical leave – Private plan coverage for an employee's own medical condition is common and usually some form of disability benefit. Private plan coverage for family leave is rare.
- Employee contributions toward medical leave – Employers can allow employees to pay for disability coverage (or other private medical leave coverage) on a pre-tax basis, although this will cause the benefits to be taxable when paid.
- Family leave benefits and employment taxes – In the event an employer does provide for family leave benefits through a private plan, it is likely that any benefits will be subject to federal employment taxes. The IRS's rationale for excluding them when paid by the state – likening them to Social Security payments – should not apply.
- Delegation – Employers and third-party vendors generally have the discretion to assign the tax withholding and reporting responsibilities for paid leave benefits. In our experience, third-party vendors rarely perform this function unless they have contractually agreed to do so.

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