IRS Issues Guidance on State Paid Family and Medical Leave Tax Treatment

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Issued date: 02/04/25

The IRS recently issued Revenue Ruling 2025-04 (the "Revenue Ruling") explaining the tax treatment of contributions and benefits related to state paid family and medical leave laws ("PFML"). The welcomed guidance provides clarity related to the federal income tax treatment of contributions, including employee deductions, and benefits for state sponsored PFML plans, as well as providing transitional relief for reporting obligations. Tax treatment for state income tax purposes is not within the scope of this guidance.

Background

In recent years, many states have enacted and continue to enact paid family and/or medical leave laws that require employees to contribute to state funds to be eligible for partial wage replacement benefits in the event of leave for certain family or medical reasons. This includes California, Colorado, Connecticut, Delaware (2025), Washington D.C., Illinois, Maine (2025), Maryland (2025), Massachusetts, Minnesota (2026), Nevada, New Hampshire (voluntary), New Jersey, New York, Oregon, Rhode Island, Vermont (voluntary), and Washington.

Some states allow employers to sponsor private benefit programs to provide the benefits required by these laws. As state PFML laws have been enacted, there have been questions about the federal income tax treatment of the contributions and benefits. The IRS has not been clear as to whether employers were required to treat the employee contributions that were deducted as pre-tax or post-tax deductions on employee pay statements and W-2s.

Revenue Ruling

The guidance details the tax treatment and reporting requirements for:

- Employee contributions;
- Employer contributions;
- Medical leave benefits; and
- Family leave benefits.

The following guidance applies to contributions paid to state PFML programs and benefits paid from state PFML programs only.

Employers will need to consult with service providers, counsel, or tax professionals to determine how this guidance informs their treatment of contributions and benefits related to employer sponsored PFML programs (sometimes called “voluntary plans”).

Employee Contributions

According to the guidance, similar to mandatory state disability benefit program contributions that are considered income taxes, employee deductions for contributions for state PFML programs are tax deductible for federal income tax purposes. Accordingly, the PFML contribution paid by an employee via payroll deduction is deductible by the employee on their individual income tax return subject to the rules in the Code. However, amounts withheld from an employee’s paycheck to pay a state income tax are includible in the employee’s federal gross income. Therefore, the employee’s PFML contribution is included in the gross wages of the employee as reported on Form W-2. Employers will need to ensure that employee contributions for the state program are properly detailed on wage statements and included in gross wages.

Any amount of required PFML contribution paid on an employee’s behalf by the employer should be imputed as income to the employee.

Employer Contributions

Required employer contributions to state PFML programs for the employer’s share of PFML premiums are considered excise taxes paid or accrued in carrying on its trade or business that are deductible at the federal level and no part of the required employer contribution is reported as income for the employee.

However, any payments of employee contributions paid by an employer for an employee’s required contribution to a state PFML program would be considered income to the employee and should be imputed as income to the employee and reported as such. The employee may be able to deduct this amount as a state income tax on their federal individual income tax return subject to the SALT (state and local tax) limitation. Also, any amount of PFML contribution paid by the employer on behalf of the employee is deductible as an ordinary and necessary business expense by the employer for employee compensation. Employers will need to ensure that employer contributions paid on behalf of employees for an employee’s required contribution to the program are properly imputed as income and reported on Form W-2.

Medical Leave Benefits

Benefits payable to an employee under a state PFML program for reasons of medical leave for the employee’s own serious health condition are treated as if received from accident or health insurance and are not reported as income to the employee. However, the amount of medical leave benefits attributable to an employer’s contribution for medical leave would be considered income to the employee. Therefore, the amount of medical leave benefits attributable to the employer’s contribution would be reported as income to the employee on Form W-2. For example, if an employer pays 40% of the required contribution to the program, then 40% of the medical leave benefits received by an employee would be reportable as income to the employee.

Medical leave benefits attributable to amounts paid on behalf of an employee by the employer for the employee’s required contribution to the program would not be included in the medical leave benefits reported as income to the employee as the contribution amounts should already be included in the reported income to the employee. In other words, medical leave benefits attributable to employer pick-up payments for an employee's required contribution to the program are not included in the amount of medical leave benefits reported as income to the employee since the contributions have already been imputed as income to the employee when they were contributed.

Amounts received by employees for medical leave benefits that are reportable as income are subject to all required employment taxes and reporting.

Family Leave Benefits

Benefits payable to an employee under a state PFML program for reasons of family leave are considered income to the employee because they are unrelated to the employee's own health condition and cannot be treated as being received through accident or health insurance. However, family leave benefits are not taxed as wages and should be reported to the IRS and the employee using Form 1099.

Transition Relief

Calendar Year 2025 will be a transition period for enforcement of the requirements in the Revenue Ruling.
For Medical Leave benefits paid to an individual in 2025 attributable to employer contributions:

- neither a state nor an employer is required to follow the income tax withholding and reporting requirements applicable to third-party sick pay;
- neither a state nor an employer will be liable for penalties for failure to file or furnish a correct payee statement;
- neither a state nor an employer is required to withhold and pay associated taxes and will not be liable for any associated penalties.

For employee pick-up payments paid on behalf of an employee in 2025 for the employee's required contribution to a state program:

- employers are not required to treat any pick-up payments as wages for federal income tax purposes.

Employer Action

Employers will want to ensure that their payroll systems correctly identify taxable income for employees related to employer and employee required contributions to state PFML programs. Additionally, employers may want to discuss the deductibility of employer contributions as a business expense or excise tax with their own accounting or tax professional.

Employers that sponsor their own PFML plans (e.g., a voluntary plan) will need to discuss this guidance with any service providers or carriers and likely their own counsel to determine how to treat and report employee and employer contributions and benefits paid under their employer sponsored plans.

Lastly, nothing in the guidance explains how a state program will provide information to employers regarding the amount of benefits paid to an employee that may be subject to payroll taxes. Employers will need to look to state programs for this information. While the guidance does provide limited transitional relief related to certain medical leave benefits and employer pick-up payments, employers will still need to determine how their state programs will address the guidance prior to 2026.