

## Publications

# IRS Provides Tax Guidance Related to State-Run Paid Family and Medical Leave Programs

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## SERVICES

Employers & Sponsors

- Health & Welfare Programs
- Fringe Benefits & Payroll

Health Services

- State Insurance Regulation
- Taxation of Benefits

On January 16, 2025, the Internal Revenue Service (“IRS”) issued [Revenue Ruling 2025-4](#) (the “Rev. Rul.”). The Rev. Rul. provides guidance on the federal tax treatment of contributions to and benefits paid under a state paid family and medical leave (“PFML”) program, as well as the related reporting requirements. The Rev. Rul. is effective for payments made on or after January 1, 2025, although there is valuable transition relief for 2025.

Currently, the following 15 states (including D.C.) have mandatory PFML programs:

- California
- Colorado
- Connecticut
- Delaware\* (contributions began 1/1/2025; benefits begin 1/1/2026)
- D.C.
- Hawaii (temporary disability insurance only)
- New Jersey
- New York
- Rhode Island
- Maine\* (contributions began 1/1/2025; benefits begin 5/1/2026)
- Maryland\* (contributions begin 7/1/2025; benefits begin 7/1/2026)
- Massachusetts
- Minnesota\* (notice requirements begin 11/1/2025; contributions and benefits begin 1/1/2026)
- Oregon
- Washington

*\*New for 2025 and 2026*

All but Rhode Island and D.C. allow employers to satisfy their requirements through a private plan rather than making contributions to a state-run program. Many employers, administrators, and insurers have struggled with the tax treatment of these private plans for years and have relied on a patchwork of guidance from state departments of revenue and older IRS guidance in the context of state-run programs. Unfortunately, the Rev. Rul. only addresses state-run programs and “does not address the Federal tax treatment of employers’ or employees’ contributions to private or self-insurance family or medical leave plans or the amounts received by the employees as benefits under these plans.” It is not clear if the IRS intends on issuing additional guidance addressing private plans in the future. However, the IRS’ reasoning in the Rev. Rul. may provide insights on how to tax benefits under these private plans.

## Taxation of PFML Benefits and Contributions

The Rev. Rul. describes the following fictional state-run PFML program:

- Pays qualifying employees 80% of weekly pay for up to 12 weeks for qualifying leave.
- Employees can take qualifying leave for (1) the employee’s own non-occupational injuries, illness, or medical conditions or (2) to care for a family member due to the family member’s serious health condition or other prescribed circumstance.
- Funded by both employer and employee contributions equal 1% of the employees’ wages. Employer pays 60% of the contribution, and employee pays 40% of the contribution, although the employer can voluntarily fund either part or all of the employee’s contribution (the “employer pick-up”).

The Rev. Rul. addresses six scenarios and uses those scenarios to describe the taxation of both contributions and benefits under the state PFML program:

### Scenario 1 – Contributions to State PFML Fund

- *Facts:* An employee has \$104,000 in wages for the calendar year, and the employer remits \$1,040 to the state PFML fund. The employer withholds 60% (\$624) from the employee’s paycheck and pays the remaining 40% (\$416) out of its own funds and remits those amounts to the state PFML program.
- *Taxation of Contributions:* The employee’s contribution is treated as taxable wages to the employee subject to income and employment taxes, and the employer reports the wages on the employee’s Form W-2. The employer’s contribution is an employer tax liability and is not treated as taxable wages to the employee or reported on the employee’s Form W-2.
- *Deduction of Contributions:* Both employer and employee contributions are treated as state taxes. The employer can deduct the contribution under Code section 164(a)(3). The employee can deduct the contribution on the employee’s individual tax return up to the state and local tax deduction limitation under Code section 164(b)(6).

**GROOM INSIGHT:** The IRS’ decision to treat mandated employer/employee contributions to a state PFML fund as taxes for deduction purposes is consistent with prior IRS guidance addressing mandated contributions to state-administered disability programs. This position is not likely to extend to private PFML programs since the contributions under private programs are not made to the state.

### Scenario 2 – Family Leave Benefits

- *Facts:* Same facts as Scenario 1, except the employee takes 12 weeks of family leave. The state pays the employee \$19,200 (80% of weekly pay for 12 weeks) in family leave benefits.
- *Taxation of Benefits:* The leave benefits are taxable to the employee. However, the benefits are not treated as wages subject to income and employment taxes and withholding and not reportable on Form W-2. Instead, the benefits are more closely analogous to social security benefits, and the state must report the payments on Form 1099.

**GROOM INSIGHT:** The IRS' reasoning is notable for a few reasons. First, the IRS ruled that the benefits were in the nature of social security benefits rather than unemployment compensation, indicating a shift from the IRS' previous position in CCA 200630017. Second, although the Rev. Rul. does not apply to private PFML programs, the IRS' reasoning could inform the tax reporting of private PFML program benefit payments. For example, the Rev. Rul. directs states to report family leave payments on Form 1099 as non-wage income. Private plans might be able to take a similar position and report similar benefit payments as non-wage income on Form 1099-MISC.

## Scenario 3 – Medical Leave Benefits

- *Facts:* Same facts as Scenario 1, except the employee takes 12 weeks of medical leave. The state pays the employee \$19,200 (80% of weekly pay for 12 weeks) in family leave benefits.
- *Taxation of Benefits:* The employee can exclude the portion of the leave benefit attributable to employee after-tax contributions from gross income under Code section 104(a)(3) as an amount received for accident or health insurance for personal injuries or sickness. However, the employee must include the portion of the leave benefit attributable to the employer contribution in gross income (as wages) under Code section 105. To determine which portion is attributable to employee vs. employer contributions, the rules in Treas. Reg. § 1.105-1(d)(1) apply. The taxable portion is treated as a third-party payment (by a party that is not an agent of the employer) of sick pay under Code section 3402(o). Under the sick pay rules, taxable medical leave paid by a party that is not an agent of the employer (here, the state) is not subject to mandatory income tax withholding. However employees can request voluntary withholding. The third-party payor (here, the state) is liable for the employee portion of FICA and is also liable for the employer portion of FICA and FUTA, unless the liability for the employer portion of FICA and FUTA is transferred to the employer.

**GROOM INSIGHT:** This Scenario is particularly notable. In the context of private programs, many employers, third party administrators, and insurers have struggled with how to tax these payments. The Rev. Rul. provides welcome guidance and states that, if a state PFML program does not specify the proportion of contributions that are allocable to family vs. medical leave benefits, then taxpayers can assume the mandatory contributions are equally allocated to each benefit. While this does not directly apply to private programs, many private programs look at taxation under the state program for guidance. Consistent with industry practice, many taxpayers have applied the sick pay rules to medical leave benefits under combined PFML programs.

## Scenario 4 – Employer Pick-Up Contributions

- *Facts:* Same facts as Scenario 1, except the employer withholds and remits \$350 from the employee's wages (instead of \$624) and voluntarily pays the remaining \$274 as an employer pick-up.
- *Taxation/Deduction of Employer Pick-Up Contribution:* The employer's pick-up is treated as taxable wages to the employee reported on Form W-2 subject to income and employment taxes and withholding. The employer can deduct the pick-up contribution as an ordinary and necessary business expense under Code section 162 (rather than as a tax under Code section 164). Notably, the employee can deduct the pick-up amount of \$274 along with the \$350 amount withheld from wages to the PFML fund on the employee's individual tax return, up to the SALT limit.

## Scenario 5 – Family Leave Benefits (Employer Pick-Up Contributions)

- *Facts:* Same facts as Scenario 2, except the employer withholds and remits \$350 from the employee's wages and voluntarily pays the remaining \$274 as an employer pick-up.
- *Taxation of Benefits:* The leave benefits are taxed the same as in Scenario 2 and are treated as taxable non-wage income to the employee and reported by the state on Form 1099.

## Scenario 6 – Medical Leave Benefits (Employer Pick-Up Contributions)

- *Facts:* Same facts as Scenario 3, except the employer withholds and remits \$350 from the employee's wages and voluntarily pays the remaining \$274 as an employer pick-up.

- *Taxation of Benefits:* The leave benefits are taxed the same as in Scenario 3. Because the employer pick-up results in income inclusion for the employee, the amount of benefits excludible under Code section 104(a)(3) remains the same.

## Next Steps

The Rev. Rul. provides transition relief for calendar year 2025 for states and employers. The IRS asked for comments on additional situations and aspects of state PFML programs that the Rev. Rul. does not address. Comments are due by April 15, 2025.

Despite the welcome guidance from the IRS, open questions regarding the taxation of contributions and benefits under private PFML programs remain.