Legal Update Article

Employers Who Administer PFML Programs Get Much-Needed Guidance from IRS

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Takeaways

- The Guidance clarifies the federal income and employment tax treatment of contributions and benefits under state-funded PFML Programs.
- It does not apply to privately insured or self-insured arrangements.
- Affected employers should work with their in-house finance and payroll teams to ensure that payments into the funds are treated consistent with the Guidance and that employee payments and employer pick-up payments are properly reported as taxable wages (taking into account the 2025 transition guidance).

Related links

- FAMLI Taxability Letter FINAL (2).pdf
- Revenue Ruling 2025-4

Article

In response to taxpayer and state government requests, including a2024 letter from governors of nine states imploring the Internal Revenue Service (IRS) to clarify the federal tax treatment of premiums and benefits under state paid family and medical leave programs (PFML Programs), the IRS issued Revenue Ruling 2025-4 (Guidance) which clarifies the federal income and employment tax treatment of contributions and benefits under state-funded PFML Programs.

Any employer who administers one or more PFML Programs should continue reading this article.

What Is the Relevance of the Guidance?

- Thirteen states and the District of Columbia have already adopted mandatory PFML Programs and more states are considering them. Each state PFML Program is unique, but generally PFML Programs provide income replacement for a certain number of weeks for employees who are absent from work for specified family reasons, such as the birth of a child, and/or medical reasons, such as the employee’s own serious health condition.
- Employers and states have been unsure of the federal income and employment tax treatment of the payments into the funds and the benefits being paid from the state funds. The Guidance helps fill in some of these gaps.
- As an alternative to contributions into a state fund, many states permit employers to establish and maintain private plans providing comparable benefits at comparable cost to employees. Such private plans may be insured or self-insured.
- Notably the guidance does not address the federal tax treatment of employer or employee contributions to privately insured or self-insured arrangements designed

to comply with PFML Program obligations or to benefits paid under such programs.
- Thus, while some of the analysis in the Guidance may be applicable in analyzing the tax consequences under such arrangements, the Guidance is not dispositive ragrding such arrangements.

What Does the Guidance Say?

How Are Employer Contributions Treated for Federal Tax Purposes?

State-mandated employer contributions to a state fund under a PFML Program are deductible by the employer as an excise tax.

Employees are not required to include the value of these employer payments in their compensation.

Observation: As noted above, the Guidance does not apply to privately insured or self-insured arrangements. Since the Guidance bases the exclusion of the employer payments on the fact that the payments are an excise tax, employer premium payments and coverage under privately insured and self-insured arrangements likely would not be governed by the same analysis. Until further IRS guidance is issued (which may be a while given the change in administration), employers should carefully consider whether such employer-paid premiums or coverage should be treated as taxable wages to their employees.

How Are Employee Contributions Treated for Federal Tax Purposes?

Employee contributions to a state fund are wages reportable on an employee's Form W-2. The Guidance notes that an employee is eligible for a potential income tax deduction for such contribution.

Observation: The Guidance treatment of employee contributions as taxable wages would reasonably apply to privately insured or self-insured arrangements as well. However, such employee payments likely would not be eligible for a potential tax deduction as such payments would not appear to qualify as payments of state income taxes.

How Are Employer Pick-Up Contributions Treated for Federal Tax Purposes?

An employer pick-up contribution occurs where an employer pays from its own funds all or a portion of its employees' otherwise mandatory contributions (as opposed to withholding such amounts from the employee's wages).

Employers may deduct such expenses as ordinary and necessary business expenses and must include such payments in wages on employees' Forms W-2. The Guidance provides that employees are eligible for potential tax deductions for such contributions.

How Are PFML Program Benefits Taxed for Federal Tax Purposes?

The Guidance distinguishes benefits paid for paid family leave (PFL) and paid medical leave (PML).

PFL Benefits

PFL benefit payments are fully taxable and must be included in an employee's income, but benefit payments are not wages. For benefit payments from state funds, the state must file with the IRS and furnish employees with a Form 1099 reporting the PFL payments.

Observation: For employers who pay into a state fund, generally the state has this reporting obligation rather than the employer. Notably, under the Guidance, employees do not have a "basis" equal to the employee and employer pick-up contribution payments previously treated as taxable compensation.

PML Benefits

The Guidance analogizes PML payments to disability payments and provides tax guidance that is consistent with the federal tax rules that apply to disability payments.

Accordingly, under the Guidance, generally PML benefits attributable to employer contributions are includible in employee gross income and are treated as wages.

However, PML benefits attributable to employee contributions and employer pick-up contribution payments are not includable in an employee's gross income.

Observation: The Guidance indicates that the state must follow the sick-pay reporting rules that apply to third-party payors (with insurance risk). Whether the states are able to modify their systems to comply with these requirements remains to be seen. However, employers who privately insure or self-insure these arrangements may be able to glean insights from the Guidance, particularly in the way that the Guidance applies the Internal Revenue Code's rules regarding disability pay to PML.

When Is Compliance Required?

The Guidance notes that:

"Calendar year 2025 will be regarded as a transition period for purposes of IRS enforcement and administration of the information reporting requirements and other rules described below. This transition period is intended to provide States and employers time to configure their reporting and other systems and to facilitate an orderly transition to compliance with those rules, and should be interpreted consistent with that intent."

Of note to employers who pay into state funds, for calendar year 2025, the employers are not required to treat amounts they voluntarily pay into a state fund (that would otherwise be required to be paid by employees) as wages for federal employment tax purposes.

What Are the Employer Takeaways?

Employers who administer PFML Programs (other than through privately insured and self-insured plans) now have definitive guidance concerning the treatment of payments and benefits. Such employers should work with their in-house finance and payroll teams to ensure that payments into the funds are treated consistent with the Guidance and that employee payments and employer pick-up payments are properly reported as taxable wages (taking into account the 2025 transition guidance). Generally, the states will be responsible for ensuring benefit payments are properly reported and taxed.

While the Guidance does not apply to privately insured and self-insured plans, it does provide employers participating in such arrangements with insight into the IRS's analysis of these arrangements.

Please contact a Jackson Lewis lawyer if you have questions about your organization's paid family medical leave obligations or related tax obligations.