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Quid Pro Quo for PFML: General Overview and Updated IRS Guidance on Section 45S Credits

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Since 1993, the Family and Medical Leave Act (FMLA) has provided legal protection for a large number of employees taking leave to care for their and their family's health, parental, and military-related needs. For most qualifying reasons, the FMLA mandates up to twelve weeks of protected leave a year for employees meeting certain requirements. However, it does not guarantee that they be paid during that time. As a result, employees have often found themselves faced with the dilemma of returning to the workforce prematurely or incurring significant financial hardship due to the exhaustion or absence of paid leave.

Some states and local governments have tried to address this issue in the context of private employers by imposing mandatory paid leave on employers and sanctions for noncompliance. Other jurisdictions have attempted voluntary incentives for private employers to provide paid FML leave. For nearly a decade now, the federal government has chosen a particular incentive in the realm of taxation.

The Tax Cuts And Jobs Act of 2017

In late 2017, the Tax Cuts And Jobs Act was signed into law and significantly revised the Internal Revenue Code. One of the changes was the creation of Code Section 45S, which offers a tax credit for private businesses who provide their employees with paid leave for FMLA qualifying reasons.

Key requirements of the 2017 Section 45S

1. The business must have employed the employee for at least one year.
2. The employee must earn no more than 60% of the IRS highly compensated employee (HCE) threshold from the prior year to be considered.
3. The reason for taking leave has to be a qualifying one under the FMLA: (a) The birth of a child or placement of a child with the employee for adoption or foster care; (b) The care for a child, spouse, or parent who has a serious health condition; (c) A serious health condition that makes the employee unable to work; or (d) Reasons related to a family member's service in the military, including qualifying exigency leave (leave for certain reasons related to a family member's foreign deployment) or Military caregiver leave (leave when a family member is a current servicemember or recent veteran with a serious injury or illness).
4. The employer has to pay at least 50% of the wage amounts it would have customarily paid the employee.
5. The employer has to offer between a minimum of two weeks up to a maximum of twelve weeks of paid leave per year.
6. Under IRS Notice 2018-71, certain employers must also have a written policy in place explicitly providing said leave and barring discrimination against or termination of any individual for opposing any

practice prohibited by the policy.

The Wage Method

Under the 2017 version of Section 45S, there was only one method for calculating the credit and was known as the “wage method.” There, the credit amount is based upon a sliding scale percentage of the costs for paying the wages. The percentage starts at 12.5% of the costs for paying 50% of the employee’s customary wages and increases to a maximum 25% of costs for paying 100% of the customary wages.

Temporary Extensions of Section 45S

Under the Tax Cuts and Jobs Act, the credit under Section 45S was originally set to expire after tax year 2019. In 2019, the Taxpayer Certainty and Disaster Tax Relief Act extended the credit until December 31, 2020. Afterwards, the Taxpayer Certainty And Disaster Tax Relief Act of 2020 created a December 31, 2025 deadline.

The One Big Beautiful Bill Act

Signed on July 4, 2025, the One Big Beautiful Bill Act (OBBBA) not only made the Section 45S credit permanent but also expanded its parameters.

Key Changes

1. There is now an alternative way to calculate the credit called the “premium method.”
2. The business may elect to use a six-month minimum period of employment instead of one year.
3. The employee must have customarily worked at least 20 hours per week.
4. Previously, employers mandated by state or local law to provide paid leave could not take advantage of the Section 45S credit. The OBBBA now allows the credit to be taken for leave paid in excess of the portions mandated or subsidized by state or local authorities.

The Premium Method and Recent IRS Guidance

With the rise of the mandates, voluntary incentives, and programs for paid leave, insurance companies have been increasingly providing private employers with policies covering wages to employees taking paid leave, including time off for qualifying FMLA reasons. Recognizing this practice, the OBBBA allows for the same sliding scale percentages in the Section 45S credit to be applied to the amount the employer pays for premiums dedicated to those qualifying leaves. One advantage of the premium method is that the credit is not contingent upon an employee actually taking paid leave. Just the payment of the premium.

Naturally, a number of questions arose over how to interpret and implement the premium method, including selection between it and the wage method. In response on August 5, 2026, the IRS issued Notice No. 2026-28 with seven items of specific guidance concerning the premium method in a question-and-answer format.

1. If any portion of the premium provides funding for leave that would not be eligible for credit under the wage method, that portion of the premium is not eligible for credit under the premium method.
2. If any portion of the premium is paid with respect to leave that would not qualify as paid family or medical leave as defined in Section 45S, that portion cannot be credited.
3. If any portion of the premium is paid with respect to paid leave taken by nonqualifying employees under Section 45S, that portion cannot be credited.
4. If any portion of the premium is paid with respect to paid leave required by state or local law or paid for by a state or local government, that portion cannot be credited.
5. If any portion of the premium is paid with respect to benefits that do not constitute wages as defined in Section 45S, that portion cannot be credited.

6. In instances where a portion of a premium can be credited ("blended premium"), the employer must allocate the premium between creditable and noncreditable coverage. The employer may do so using any reasonable method that is consistent with the policy terms and supported by contemporaneous records. Such a method must include objective criteria and must be applied consistently for the taxable year and to all persons treated as a single employer.
7. An employer may claim the credit using both the wage method with respect to certain leave and the premium method with respect to other leave. However, the premium and wage credit cannot both be claimed as to a particular instance of leave. In other words, double-dipping using the two methods is not allowed.

Anticipated Rulemaking

In Notice 2026-28, the IRS has indicated that it and the Department of the Treasury intend to publish proposed regulations under section 45S that, among other things, incorporate the guidance above. They are also requesting written comments on all aspects of the Notice and any other issues regarding implementation of the amendments to section 45S by the OBBBA. Written comments are to be submitted on or before October 16, 2026 and may be made through the mail or electronically via the Federal eRulemaking Portal at https://www.regulations.gov.

If you have any questions about the Section 45S credit, please contact your Knox Law attorney, our Labor & Employment group, or call our office at 814-459-2800.

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