

What Employers Need to Know About the Enhancements to the Paid Family and Medical Leave Tax Credit

The Paid Family and Medical Leave Tax Credit under IRC Section 45S has undergone significant enhancements that employers should understand to maximize their tax benefits. Here's what you need to know about the recent changes.

Background on the Credit:

For tax years 2021 through 2025, eligible employers could claim a business credit ranging from 12.5% to 25% of wages paid to qualifying employees during family and medical leave. The credit started at 12.5% when the rate of employee pay during leave was 50% of normal wages, increasing by 0.25 percentage points for each percentage point above 50%, up to a maximum of 25% when pay reached 100% of normal wages. Major Enhancements for Tax Years After 2025: The new law permanently extends the employer credit for paid family and medical leave, making it a permanent fixture in the tax code rather than a temporary provision.

Insurance Premium Inclusion:

One of the most significant changes is that insurance policy premiums for paid family and medical leave now qualify for the credit. The rate of payment under the insurance policy is determined without regard to whether any qualifying employee is actually on family and medical leave during the tax year. Any credit claimed under this provision decreases the deduction for premiums paid.

New Work Requirements:

The new law introduces a 20-hour work-per-week requirement for qualifying employees. Additionally, employers can now elect to include employees who have worked a minimum of 6 months or more for purposes of credit, rather than the previous one-year requirement.

Qualifying Employee Requirements:

A qualifying employee must have compensation for the previous year that does not exceed 60% of the compensation threshold for highly compensated employees. For 2025, this means compensation cannot exceed \$93,000 (calculated as \$155,000 x 60%).

Eligible Leave Purposes:

Family and medical leave must be taken for purposes defined in the Family and Medical Leave Act (FMLA). Qualifying purposes include the birth or care of a child, adoption or foster care, caring for a spouse, child, or parent with a serious health condition, an employee's own serious health condition, qualifying military exigencies, and caring for a service member with a serious injury or illness.

Written Policy Requirements:

To be an eligible employer, you must have a written policy allowing all qualifying full-time employees to have at least two weeks of annual paid family and medical leave, with part-time qualifying employees receiving a pro rate. The policy cannot exclude any classification of employees and must require a rate of payment of at least 50% of normal wages.

Important Deduction Adjustment:

Remember to reduce your deduction for salaries and wages and any capitalized costs by the credit amount, even if the full credit cannot be used due to tax liability limitations

This information is provided to you by Arrowhead Tax Service. We make every effort to provide honest and accurate tax information. Please use your discretion before making any decisions based on the information provided, every tax situation is different. If you have any questions, please visit our office or call us at 937-543-5770.