Maximizing Benefits: Understanding the PFML Premium Tax Credit

A guide to eligibility, calculation, and optimization

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Improvements to the Section 45S Paid Family and Medical Leave Tax Credit

The One Big Beautiful Bill Act (OBBBA),[1] signed into law on July 4, 2025, makes the paid family and medical leave tax credit in Internal Revenue Code (IRC) section 45S permanent and includes beneficial revisions that expand the credit for increased utilization by employers.

Previously, section 45S provided an employer a tax credit equal to a percentage of employee wages paid for leave under the Family Medical Leave Act (FMLA).

Beginning January 1, 2026, the updated section 45S allows an employer to claim the tax credit for a portion of the insurance premiums it pays for any plan that provides benefits for FMLA leave reasons.

The new premium-based credit can be claimed for premiums paid for group short-term disability (STD), group paid family leave or paid family and medical leave (PFL or PFML), and any group policy or provision which provides qualifying leave for disabled or non-disabling reasons.

It can be claimed regardless of whether any employees are on leave during the year.

This article provides an overview of the changes to IRC section 45S, and potential implications for employers. The discussion is for informational purposes only and is not intended in any way to provide tax advice. *For guidance on any potential business deductions or tax credits, please consult with your personal tax advisor.*

Overview of Section 45S and the One Big Beautiful Bill Act (OBBBA) changes

The change to IRC section 45S provides a tax credit for employers that pay premium for insurance coverage that pays benefits while a qualifying employee takes time off for reasons under the FMLA. These reasons include leave:

- To bond with a child born to an employee, or placed with an employee for adoption or foster care;
- To care for a spouse, parent, or child with a serious health condition;
- During an employee's own serious health condition, which leaves them unable to work; and
- To assist with an exigency due to an employee's spouse, child, or parent, being on or called to active duty in the Armed Forces, or to care for a service member who is the employee's, spouse, child, parent, or next of kin.

To be eligible for the credit an employer must have a written policy in place that provides:

1. a minimum of two weeks of PFML leave (annually) to all qualifying full-time employees (prorated for qualifying employees who work part time (i.e., less than 30 hours per week), and
2. paid leave of at least 50 percent of normal wages.

Qualifying employees

Under the statute's updated definition of qualifying employees, an employer's policy must cover all employees that have been employed for one year or more and customarily work not less than 20 hours per week. An employer now has the option to also cover employees that have worked for at least 6 months. Coverage for employees whose annual earnings (pro-rated for part-time employees) exceed 60% of the highly compensated employee threshold under IRC section 414(q) ($96,000 in 2025) in the prior year would not be eligible for the tax credit.

Treatment of paid leave benefits mandated by state or local law

Prior to OBBBA, paid leave mandated under state or local law could not be used to meet the minimum leave requirements for credit eligibility. Starting in 2026, an employer can take into account benefits required by state or local law when determining if a policy's coverage meets the thresholds for the 45S tax credit. However, an employer can only claim the tax credit for premiums paid for leave ***in excess of*** the state requirements.

Calculating the 45S Premium Tax Credit

Section 45S provides for a minimum tax credit of 12.5% of the premium paid for an insurance plan that provides at least a 50% replacement of wages. The credit increases by 0.25% for each 1% of wages replaced above 50%, with a maximum tax credit of 25% for plans that provide 100% replacement of wages. The most common wage replacement for group coverage is typically 60%, which would amount to a 15% tax credit on the premium paid. For example, if an employer paid $27,000 a year for their short-term disability coverage, replacing 60% of wages, the employer could be eligible for a tax credit of $4,050 for that tax year.

The old section 45S did not allow employers to claim any tax credit for employer-paid premiums, but employers could still take a business deduction for such premiums. If an employer takes the new premium tax credit, they cannot also receive a business deduction for the portion of premiums paid equal to the section 45S tax credit.

The revised tax credit maintains the original 45S credit for wages paid to the employee for paid family and medical leave. The amount of the wage-based tax credit depends on the wage replacement rate like the premium tax credit, except that the wage-based credit is limited to a maximum of 12 weeks of paid leave per taxable year.[2] An employer must choose a plan design and elect to either claim the 45S credit based on wages paid or premiums paid. An employer needs to decide, with the advice of a tax professional, which approach works best under their facts and circumstances.

Business Deduction vs Premium Tax Credit: Fully-Insured Group Coverage

A business deduction allows an employer to deduct the premium paid for disability coverage when determining taxable income. The current corporate tax rate is 21%. Assuming the following facts, below are very simple illustrations of how the premium tax credit can further reduce an employer's tax burden.

Income	$570,000
STD Annual Premium	$27,000
Corporate Tax Rate	21%
Wage Replacement Percentage	60%
Applicable Percentage for 45S Credit	15%

Deduction only:	
Income	**$570,000**
STD Annual Premium	$(27,000)
Taxable Income	$543,000
Tax Rate	21%
Tax Owed	**$114,030**

45S tax credit (on a percentage of premium):	
STD Annual Premium	**$27,000**
Applicable Percentage	15%
45S Tax Credit	**$4,050**

Deduction and tax credit:	
Taxable Income (after deducting STD premium)	**$543,000**
Disallowance of deduction for 45S credit	$4,050
Taxable Income	**$547,050**
Tax Rate	21%
Tax Owed	**$114,881**
45S Credit	$(4,050)
Tax Owed after 45S Credit	**$110,831**

*These illustrations are based on average numbers. The dynamics of taxable income, premium, and the allowable tax credit will vary for each employer.

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Business Deduction vs Tax Credit: Self-Insured Group Coverage

For self-insured or internal employer plans, an employer can only claim a 45S tax credit based on the wages paid to qualified employees on paid family and medical leave. Assuming the following facts (similar to the examples above), below are illustrations of how the 45S tax credit for wages paid reduces taxes owed by an employer.

Income	$570,000
Paid Leave Wages	**$35,000**
Corporate Tax Rate	**21%**
Wage Replacement Percentage	**60%**
Applicable Percentage for 45S Credit	**15%**

Deduction only:

Income	**$570,000**
Employer paid leave wages	$(35,000)
Taxable Income	$535,000
Tax Rate	21%
Tax Owed	**$112,350**

45S tax credit (on a percentage of wages):

STD Annual Premium	**$35,000**
Applicable Percentage	15%
45S Tax Credit	**$5,250**

Deduction and tax credit:

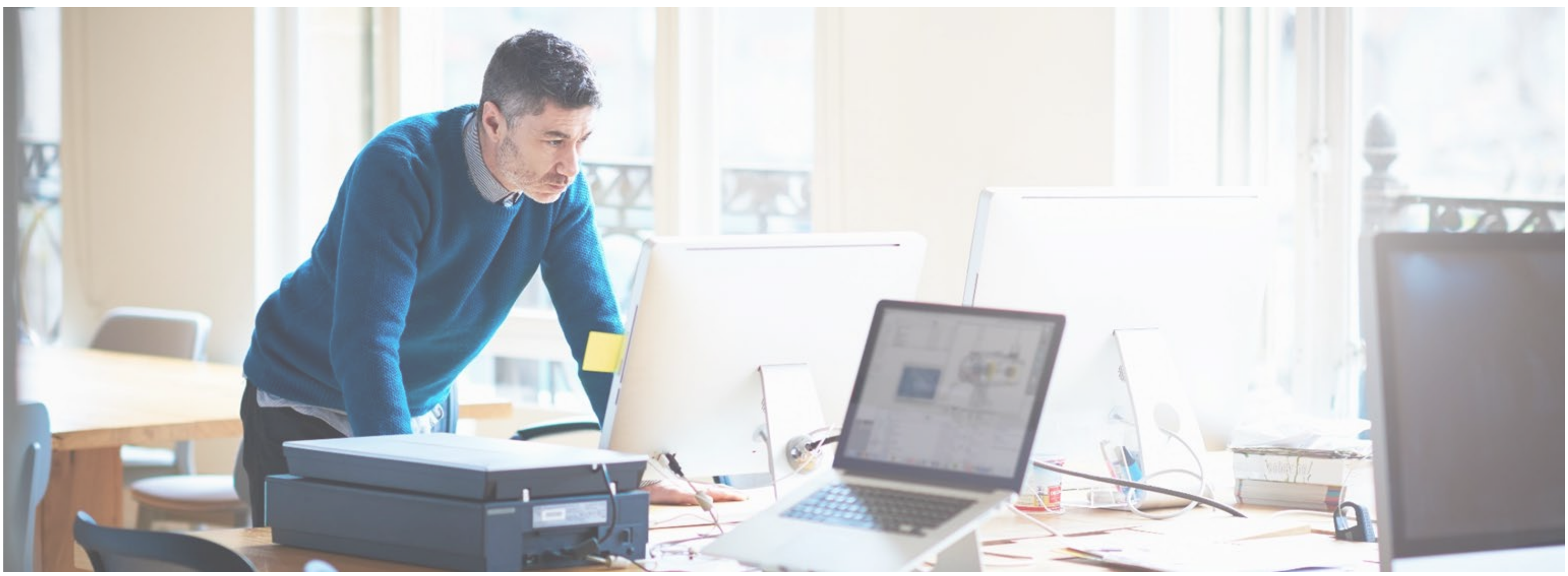
Taxable Income (after deduction of wages)	**$535,000**
Disallowance of deduction for 45S credit	$5,250
Taxable Income	**$540,250**
Tax Rate	21%
Tax Owed	**$113,453**
45S Credit	$(5,250)
Tax Owed after 45S Credit	**$108,203**

*These illustrations are based on average numbers. The dynamics of taxable income, premium, and the allowable tax credit will vary for each employer.

Fully-Insured Group Coverage that Provides PFML under Section 45S

The following is a list of group fully-insured group plans that could be eligible for the premium tax credit. This list provides only examples of such plans, and is not intended to be comprehensive:

- Non-contributory (employer paid) group STD
- Non-contributory (employer paid) group STD with a paid leave rider
- Stand-alone group paid leave policies
- Contributory (cost share) group STD (with or without a paid leave rider). Note: credit would only apply to the employer-paid premium.
- Private Plans for State PFML or State-Mandated Disability—The tax credit would only be available for the employer-paid share of premium that provides benefits ***in excess of*** the benefits required by state or local law.



1. Public Law No. 119-21: https://www.congress.gov/bill/119th-congress/house-bill/1/text.
2. A reasonable reading of the revised section 45S language is that the 12-week maximum applies only to the credit for wages paid. The application of the 12-week maximum is subject to changes in interpretation by the IRS and Treasury.

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