Tax Insights
from Compensation,
Benefits, and Employment
Tax Services

# IRS guidance addresses expanded employer credit for paid family and medical leave

August 17, 2026

## In brief

### What happened?

Treasury and the IRS on August 5 issued Notice 2026-28, providing guidance on the Section 45S employer credit for paid family and medical leave (PFML) as amended under the One Big Beautiful Bill Act (the Act). Originally enacted as a temporary provision under 2017 tax reform (the 2017 Tax Act), Section 45S was made permanent by the Act and—for tax years beginning after December 31, 2025—enhances and expands eligibility for the credit.

The notice primarily focuses on guidance under the new premium-based method for calculating the credit, including how that method compares to the traditional wage-based method, how employers can allocate qualifying premiums, and how employers may elect between the premium method and the wage method. Treasury and the IRS also announced their intent to issue proposed regulations under Section 45S consistent with the guidance in the notice and that will address other issues and request comments.

### Why is it relevant?

The Act significantly broadens the practical relevance of Section 45S. Notable changes include:

- Employers now may elect to claim the credit for employees having at least six months of service (rather than one year).

- Qualifying employees are now limited to those customarily employed for at least 20 hours per week.
- Employers may elect to claim the credit for a tax year based on either (1) insurance premiums paid under a policy providing qualifying PFML benefits or (2) wages paid during qualifying PFML leave.
- State or local mandated paid leave can count toward determining eligibility but still cannot be used to calculate the credit amount.
- The Act also revises the aggregated group rule treatment generally and adds a potential exception for the written policy requirement.

Until now, Notice 2018-71 had been the only substantive guidance under Section 45S. Treasury and the IRS's stated intention to issue proposed regulations—consistent with Notice 2026-28 and to address broader issues—is welcome news, particularly given the now-permanent and expanded credit. For employers that provide qualifying PFML, Section 45S may offer a mechanism to offset those costs in the form of a tax credit that could deliver a greater benefit than a tax deduction.

## Actions to consider

Employers should assess whether their current PFML, short-term disability, parental leave, sick leave, and PTO programs satisfy the Section 45S written policy requirements and are specifically designated for one or more FMLA purposes. This evaluation should include accounting for employees' state footprints when assessing eligibility. Eligible employers should model the wage method against the premium method to gauge the credit and its potential tax benefit. Currently ineligible employers should consider revising their written policy language.

# In detail

## Brief background on Section 45S

Section 45S was added to the Internal Revenue Code by the 2017 Tax Act, creating a general business credit under Section 38 intended to incentivize employers to provide paid family or medical leave. Qualifying leave is tied to FMLA-type purposes— categories include birth of a child and care for the child; placement for adoption or foster care; care for a spouse, child, or parent with a serious health condition; the employee's own serious health condition; qualifying military exigency leave; and care for a covered service member. Leave not provided exclusively for one of the listed FMLA purposes (e.g., general vacation, medical or sick leave, or personal leave) generally does not qualify.

As originally enacted, the credit was temporarily effective only for tax years beginning in 2018 and 2019. Subsequent legislation continued to extend the credit and, prior to the Act's amendments, it was scheduled to expire for tax years beginning after 2025.

The amount of the credit determined under the wage-based method generally equals an applicable percentage of wages paid to qualifying employees for up to 12 weeks of qualifying leave. The applicable percentage is 12.5% at 50% wage replacement, increasing by 0.25 percentage points for each percentage point above 50%, up to a maximum of 25%. A tax deduction is not allowed for that portion of wages paid for the tax year that is equal to the PFML credit for the tax year.

## Changes addressed by the Act and Notice 2026-28

The Act changed Section 45S in several important ways:

- It made the credit permanent.
- It added a new premium-based method under which eligible employers may now elect to quantify the credit in lieu of the wage-based method (previously the sole computation method). The enacted statutory text provides that the credit equals the applicable percentage of either wages paid to qualifying employees during the qualifying leave, or—if a PFML insurance policy is in force during the tax year—premiums paid or incurred for qualifying leave with respect to that policy, determined without regard to whether any qualifying employees were actually on family and medical leave during the tax year.
- The Act allows paid leave required by state or local law, or paid by a state or local government, to count toward the amount of PFML provided by the employer but remains excluded from the credit calculation.
- Employers may now elect to include an expanded definition of qualifying employee – i.e., employees employed for at least six months (rather than one year), but the Act now limits qualifying employees to those customarily employed for at least 20 hours per week.
- The Act also clarifies that no tax deduction is allowed for the portion of premiums equal to the credit if an employer elects to claim the credit under the premium-based method.

***Observation**:* The credit can only be claimed for PFML provided to employees having wages not exceeding an indexed threshold. For wages paid to an employee to be credit eligible, compensation to the employee in the preceding year cannot exceed 60% of a “highly compensated employee” threshold under Section 414(q). For 2026, that threshold is set at $160,000, resulting in a $96,000 cap for credit purposes.

## Written policy requirements remain central

A compliant written PFML policy is still required. It generally must provide at least two weeks of annual PFML for full-time qualifying employees (prorated for part-time employees) at a payment rate of at least 50% of normal wages (as determined under specific rules). For employees not covered by Title I of the FMLA, Section 45S also requires protective language under which the employer will not interfere with, restrain, or deny rights under the policy and will not discharge or discriminate against individuals for opposing prohibited practices under the policy.

***Observation:*** Employers should not assume that an existing paid leave or short-term disability policy automatically qualifies. Written policies should be reviewed for specific FMLA-purpose designation, qualifying employee coverage, minimum duration, minimum wage replacement, non-interference language, and coordination with state or local mandates.

## Premium-based method: key issue is allocation

One of the main challenges under the premium-based method is the allocation of premiums between creditable and non-creditable coverage when insurance policies cover benefits beyond creditable coverage in a blended premium. This may include policies that include coverage beyond qualifying PFML purposes, beyond the maximum 12-week period, employees who are both qualifying and non-qualifying employees, state-mandated leave, etc. For now, the IRS allows a “reasonable” approach to premium allocation, provided certain consistent, objective approaches within a tax year and the single employer aggregation rule are followed, supported by contemporaneous records. The notice requests comments from the public on allocation factors and how employers may substantiate those determinations.

***Observation:*** Employers considering the premium-based method should engage with carriers and brokers now, as actuarial support may be needed to appropriately substantiate a reasonable apportionment of blended premiums.

## Aggregation and controlled groups

The Act amended the original provision to generally treat entities falling within a controlled group under Sections 414(b) and 414(c) as a single employer, with an exception if any member that fails to provide the required written policy establishes “to the satisfaction of the Secretary” a “substantial and legitimate business reason” for the failure. Such a reason does not include operating a separate line of business, rate of wages or job category, or application of state or local family and medical leave laws but may include grouping employees of a common law employer. The notice requests comments on what qualifies.

***Observation:*** Controlled group employers should review whether written PFML policies vary across entities, business units, geographic workforces, collective bargaining units, or state footprints. If policies differ, employers should document business reasons for differences and be prepared to address whether the statutory exception could apply. Until further guidance, a good faith reasonable interpretation applies.

## Administrative guidance and open questions

Treasury and the IRS intend to issue proposed regulations consistent with Notice 2026-28, and comments are requested on all aspects of the notice and other issues regarding implementation of the Section 45S amendments.

Key open questions include:

- **Premium allocation support:** What facts, actuarial data, carrier reporting, or employer records will substantiate a reasonable allocation?
- **Aggregation exceptions:** What documentation will establish a “substantial and legitimate business reason” for different policies within a controlled group?
- **Transition relief:** Will the IRS and Treasury grant transition relief similar to that provided in Notice 2018-71 for the specific written policy that must be in place for the 2026 tax year?

## Next steps

Before claiming the expanded Section 45S credit, employers should evaluate credit eligibility and readiness:

- Identify all PFML-related benefit arrangements—including insured PFML, short-term disability, parental leave, sick leave, PTO, state-comparable private plans, and collective bargaining arrangements—and inventory policies to confirm which benefits are specifically designated for FMLA purposes.

- Model both the wage and premium methods, factoring in qualifying employee determinations, payroll data, leave reason codes, employee service and compensation data, premium invoices, carrier eligibility files, state PFML contributions, and policy documents.
- Update written policies and retain contemporaneous support, as the expanded credit could increase IRS focus on whether leave is specifically designated for FMLA purposes, whether all qualifying employees are covered, whether state-mandated benefits are excluded from the credit amount, and whether premium allocations are reasonable.

Employers may also want to consider submitting comments ahead of the anticipated proposed regulations.

# Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

**Compensation, Benefits, and Employment Taxes**

Megan Marlin, *Washington DC*
(202) 669-9422
megan.marlin@pwc.com

Veena Murthy, *Washington DC*
(202) 579-8829
veena.k.murthy@pwc.com