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## Employer Tax Credit for Paid Family and Medical Leave

Employers providing paid family and medical leave to their employees may be able to claim a tax credit under Internal Revenue Code (IRC) Section 45S. This In Focus provides an overview of the employer credit for paid family and medical leave, its legislative history, and possible fiscal effects of the credit. For background on paid family and medical leave generally, see CRS Report R44835, *Paid Family and Medical Leave in the United States*, by Sarah A. Donovan.

### The Employer Credit for Paid Family and Medical Leave

The employer credit for paid family and medical leave (PFML) can be claimed by employers providing paid leave (wages) to employees under the Family and Medical Leave Act of 1993 (FMLA; P.L. 103-3, as amended).

The tax credit is calculated as a percentage of either the actual PFML wages paid or the insurance premiums paid on a policy that would provide PFML wages. The credit percentage is the same in either case; it is based on the ratio of PFML wages to the employee's normal hourly wage rate. If PFML wages are 50% of the employee's normal hourly wage, then the tax credit is for 12.5% of the qualifying amount (either actual PFML wages or insurance premiums). The tax credit rate increases proportionately up to 25% of the qualifying amount if PFML wages are 100% of the employee's normal hourly wage. No credit is available for PFML wages below 50% of normal hourly wages, nor for PFML wages above 100% of normal hourly wages. When the credit is claimed based on insurance premiums, the credit is available regardless of whether any employees took PFML during the year.

The credit can only be claimed for PFML provided to certain lower-compensated employees. 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. For 2026, that threshold is set at \$96,000. To be eligible for the credit, an employer's written policy must make PFML available to all employees who meet the income threshold and have been employed by the employer for at least one year. Employers may elect to offer PFML and claim the credit for such employees who they have employed for at least six months.

All qualifying employees who customarily work at least 20 hours per week must be provided at least two weeks of PFML for an employer to be able to claim the credit (the two-week period is proportionally adjusted for part-time employees). Further, the amount of PFML wages for which the credit is claimed cannot exceed 12 weeks per employee per year.

Tax credits cannot be claimed for leave paid by state or local governments, or for leave that is required by state or local law. Thus, this tax incentive does not reduce the cost of providing leave in jurisdictions where employers are required to do so by a state or local authority. However, the tax credit may be claimed for leave provided above any legally required amounts.

A tax credit can only be claimed for wages paid for family and medical leave. General paid leave (e.g., vacation, personal, or sick leave) that is not specifically set aside for an FMLA-qualifying purpose is not considered PFML leave for purposes of the tax credit. Family and medical leave is restricted to leave associated with (1) the birth of a child or placement of an adopted or foster child with the employee; (2) a serious health condition of the employee or the employee's spouse, child, or parent; (3) an exigency arising out of the fact that a close relative is a member of the Armed Forces and on covered active duty; or (4) to care for a seriously ill or injured covered servicemember who is a close relative of the employee. Per IRS guidance for the tax credit, an employer's PFML policy may allow leave to be used to care for a broader group of individuals than allowed under FMLA (such as adding grandparents) and still be a valid PFML policy for purposes of the tax credit. However, the credit may only be claimed for caregiving that qualifies for FMLA-protected leave, which is generally limited to caregiving for a child, spouse, or parent.

To claim the credit, an employer generally must have a written family and medical leave policy in effect. The policy cannot exclude certain classifications of employees. For employers, the amount of wages and salaries deducted as a business expense is reduced by the amount of credit claimed. Further, the credit cannot be claimed for wages that have been used for another tax credit (to avoid a double tax benefit). The credit is part of the general business credit, meaning that it is subject to limitations (generally, it can be used to offset up to 75% of tax liability). Unused credits from the current tax year can be carried back one year (offsetting the prior year's tax liability) or carried forward up to 20 years to offset future tax liability. The credit is allowed against the alternative minimum tax (AMT).

### Legislative History

The employer credit for paid family and medical leave was enacted as part of P.L. 115-97. When enacted, this credit was made available for two years, 2018 and 2019. The credit was extended through 2020 in the Further Consolidated Appropriations Act, 2020 (P.L. 116-94) and through 2025 in the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Division EE of P.L. 116-260). The credit was made permanent by P.L. 119-21.

### The Credit Before 2026

In addition to making the credit permanent, P.L. 119-21 made several changes to the credit that took effect on January 1, 2026. Before 2026, the credit was only available for actual PFML wages paid; it was not available for PFML insurance premiums. Starting in 2026, an employer can claim the credit based on PFML insurance premiums paid, regardless of whether any employees received PFML wages under the insurance plan during the year.

The definition of a “qualifying employee” was also changed. Before 2026, a qualifying employee had to be employed by the employer for at least one year; PFML wages paid to employees with shorter tenures did not qualify for the credit. Starting in 2026, employers may claim the credit for employees employed for at least six months, if they opt to extend PFML leave to such employees. Additionally, all employees who met the FLSA definition of an employee were required to be covered by the employer’s written PFML policy, regardless of the number of hours worked. Starting in 2026, a qualifying employee must be customarily employed for at least 20 hours per week.

The treatment of leave required by state or local law was also changed. Before 2026, any leave required by state or local law was disregarded for purposes both of calculating the credit and of determining if the policy offered at least 50% wage replacement. Employers could have potentially claimed the credit for PFML benefits provided above legally required amounts. However, since state and local PFML programs usually provide for wage replacement rates above 50%, it would not be possible for employers in those jurisdictions to offer an additional benefit that provided at least 50% wage replacement. Starting in 2026, legally required leave can be included for purposes of meeting the minimum 50% threshold, but cannot be claimed as part of the credit.

For example, suppose an employer offered a PFML benefit with 100% wage replacement. The employer is located in a state that requires a benefit with at least 60% wage replacement. Under the pre-2026 rules, this policy would not qualify for the credit since the required 60% is disregarded and the remaining 40% does not meet the minimum 50% threshold. Now, the employer would be considered to have a qualifying plan since it meets the 50% threshold; however, it could only apply the 40% voluntary portion toward calculating the tax credit.

Before 2026, the credit used a stricter standard to determine if two employers were related and therefore treated as a single employer. For example, two businesses would be related if an owner controlled more than 50% of the voting power (for corporations) or ownership interest (for partnerships). Starting in 2026, the standard was changed to generally controlling at least 80% of the voting power or ownership interest of related businesses. If two or more employers are related, then they would generally need to have a written policy providing PFML to all qualified workers at each employer to qualify for the credit. In addition to changing the affiliation standard, employers may qualify for an exception to the written policy rule

starting in 2026 if they can demonstrate “a substantial and legitimate business reason for failing to provide” one. Both of these changes could increase the number of employers potentially eligible for the credit.

### Credit Outreach and Awareness

The explanatory statement accompanying the U.S. Small Business Administration’s (SBA’s) appropriations for FY2026 in the Consolidated Appropriations Act, 2026 (P.L. 119-75) directs the SBA to use up to \$1 million of its salaries and expenses appropriations (a total of \$323 million) for outreach and awareness of the PFML tax credit. Specifically, the statement directs “SBA to educate small businesses about the availability of the [PFML] tax credit,” and that, “[i]n partnership with [SBA’s nationwide network of] district offices, the SBA shall conduct outreach which could include targeted communications, education, training, and technical assistance to the relevant parties.”

### Estimated Take-up and Revenue Loss of the Credit

Research on employer participation in the Section 45S tax credit is limited. One of the only studies is a Department of the Treasury Office of Tax Analysis report from 2023, which found that 1,230 firms claimed credits worth about \$101 million in 2020. According to that study, more service-industry firms claimed the credit than goods-producing firms (810 vs. 420). Most firms claiming the credit had revenue under \$25 million (62% of claimants), however most of the credits were claimed by firms with revenue over \$1 billion (88% of the total).

The credit is only available for PFML wages paid to certain employees: those who meet the income, tenure, and weekly hours requirements. Therefore, the credit provides an incentive for employers to offer PFML benefits to lower-income workers, who are less likely to receive those benefits. By targeting the incentive toward employees who are less likely to receive PFML benefits, the credit might be effective at inducing employers to offer PFML benefits when they otherwise would not have. However, the credit’s targeting could reduce take-up if employers are in a situation where they need to finance PFML benefits for non-covered employees themselves, such as if the employer offers a PFML benefit to all employees.

When the credit was first enacted, the Joint Committee on Taxation (JCT) estimated the two-year tax credit would reduce federal revenue by \$4.3 billion between FY2018 and FY2027. The one-year extension through 2020 was estimated to reduce federal revenue by an additional \$2.2 billion between FY2020 and FY2029, while the subsequent extension through 2025 was estimated to reduce federal revenues by an additional \$3.8 billion between FY2021 and FY2030. JCT estimated that the 10-year cost of making the credit permanent would be about \$5.5 billion over FY2025-FY2034 under both the current-law and current-policy baselines.

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