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KPMG report: OBBBA changes to section 45S employer credit for paid family and medical leave

Section 45S allows a general business credit to eligible employers providing paid family and medical leave to its qualifying employees. Prior to the “One Big Beautiful Bill Act” (OBBBA), section 45S had been a temporary credit enacted under the “Tax Cuts and Jobs Act” (TCJA). Due to various requirements, it was difficult for employers to satisfy eligibility for the credit and it was not widely utilized. OBBBA modified the eligibility requirements and made the credit permanent. These changes to the paid leave credit are first effective for tax years beginning in 2026 and may make the credit more attractive and allow more employers the opportunity to take the credit.

Section 45S employer eligibility requirements starting in 2026

Eligibility requirements include:

- A written policy that provides:
 - Any full-time qualifying employee (as defined in section 4980E(d)(4)(B)—the rules related to the requirement of certain employers to offer health care coverage to full-time employees) is entitled to at least two weeks of annual paid family and medical leave. Qualifying part-time employees must be entitled to a prorated amount of paid family and medical leave.
 - Paid leave means payment of not less than 50% of wages normally paid.
 - Protective language that the employer will not interfere with, restrain, or deny the exercise of or the attempt to exercise any right provided under the policy, and will not discharge or in any other manner discriminate against any individual for opposing any practice prohibited by the policy.
- Paid leave must be provided to employees who have been employees for at least one year (or not less than six months at the election of the employer). Part-time employees include those customarily employed for not less than 20 hours per week.
- A “qualifying” employee cannot have annualized compensation in the prior year in excess of 60% of the amount applicable under section 414(q)(1)(B). For example, in 2026, eligible employees could not have had wages in 2025 in excess of \$96,000.
 - This means that paid leave provided to employees above this threshold, including all highly compensated employees, will not be eligible for the credit.
- Paid family and medical leave required by state or local laws is counted towards determining whether the overall paid leave program provided by the employer qualifies for the section 45S credit. However, the leave required by state or local laws is not counted towards the amount of credit.

Types of qualifying paid leave

“Qualifying paid leave” under section 45S includes paid leave for one or more of the following reasons:

- Birth of an employee's child and to care for the child
- Placement of a child with the employee for adoption or foster care
- To care for the employee's spouse, child, or parent who has a serious health condition
- A serious health condition that makes the employee unable to perform the functions of his or her position
- Any qualifying exigency due to an employee's spouse, child, or parent being on covered active duty (or having been notified of an impending call or order to covered active duty) in the Armed Forces
- To care for a service member who is the employee's spouse, child, parent, or next of kin

Eligible leave does not include vacation, medical or sick leave, or personal leave (such as PTO), meaning leave not provided exclusively for one of the reasons described above.

Calculation of credit

The amount of the credit is either the applicable percentage of the amount of wages paid to qualifying employees on qualifying leave or, if the employer has an insurance policy for paid family and medical leave in force during the tax year, the applicable percentage of the total amount of premiums paid or incurred during the tax year of the policy. The applicable percentage is a minimum of a 12.5% credit for 50% of qualifying paid leave wages. The credit is increased by 0.25 percentage points for each percentage point the paid leave exceeds 50% for a maximum credit of 25% of qualifying paid leave wages. The maximum amount of leave per employee for which the credit is available is 12 weeks. The maximum credit cannot exceed the number of hours of paid family and medical leave provided multiplied by the normal wage rate. The wages used for this purpose are the normal hourly wage rate or, for a salaried employee, the annual salary converted to a normal hourly wage rate.

An employer must reduce its deduction for wages or salaries paid by the amount of the credit for the taxable year determined with respect to wages paid or reduce its deduction for the portion of insurance premiums paid or incurred for the tax year equal to the credit if used to determine the applicable credit. In addition, any wages taken into account in determining any other business credit cannot be used to determine credit under section 45S.

Employer aggregation rule

All employers treated as a single employer under sections 414(b) and (c) are treated as a single employer for section 45S purposes unless there is a “substantial and legitimate business reason” for failing to provide a written policy providing the paid family and medical leave to the excluded employer. What constitutes a “substantial and legitimate business reason” is not described other than that it will not include the operation of a separate line of business, the rate of wages or category of jobs for employee (or any similar basis), or the application of State and local laws on paid family and medical leave, but may include “the grouping of employees of a common law employeeection 414(b) and (c) generally aggregate employers sharing 80% or more common ownership.

Need for guidance

There remain a variety of outstanding questions for which guidance would be helpful, including:

- How to calculate the amount of credit for the insurance premiums when the premium covers a portion of ineligible employees, as well as leave required by state law?
- How to calculate the credit on wages when only a portion of wages is not required by state law?
- Does the requirement that all aggregated employers have a qualifying policy mean all the employers have to have the same policy?

KPMG observation

Due to the significant changes to section 45S credit under OBBBA, companies need to evaluate whether their leave policy could make them eligible for the credit, or to consider whether reasonable modifications to the policy could make them eligible for the credit, or even whether the credit may make it attractive for them to institute a new policy.

Contact us

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