IRS Updates 2026 tax guidance for Paid Leave benefits

On Friday, December 19th, the federal Internal Revenue Service (IRS) changed its guidance regarding federal tax treatment for state Paid Leave programs in 2026. Specifically, it delayed certain federal tax withholding and reporting requirements for paid Medical Leave until 2027. This should simplify tax compliance requirements for Minnesota employers in 2026.

The initial guidance from the IRS on the taxability of Paid Leave benefits is outlined in Revenue Ruling 2025-4. The decision to delay implementation is outlined in IRS Notice 2026-6.

As a result of this new guidance, Medical Leave benefits received in 2026 will not be treated as "third-party sick pay" for 2026 and do not need to be reported on an employee's W-2.

Are Paid Leave benefits considered wages?

Not for 2026. The IRS has delayed implementation of new requirements until 2027. Benefits do not need to be considered wages and do not need to be reported on an employee's W-2.

Are Family Leave benefits considered income?

Yes, 100% of Family Leave benefits are considered income.

Are Medical Leave benefits considered income?

Only the portion of Medical Leave benefits that is attributable to an employer is considered income.

The amount attributable to the employer is based on an employer's required premium calculation. Because most employers are required to pay at least half of the total premium, 50% of benefits paid to an employee are considered income. For small employers, only 33% of benefits paid to an employee are considered income.

Paid Leave will issue a 1099G to the employee at the end of the year on the portion of the Medical Leave benefit attributable to the employer.

The remaining portion (the amount attributable to the employee contribution) is excluded from the employee's federal gross income and is not taxable.

Can employees withhold state and federal income taxes from benefit payments?

When Minnesotans apply for Paid Leave, they will have the option to withhold state and federal taxes from their weekly benefit. If an employee chooses this option, Minnesota Paid Leave will withhold **5% for state taxes** and **10% for federal taxes.** These are reductions set in Minnesota statute, not by the IRS.

What is the employer's responsibility for Medical Leave benefits for 2026?

The employer has no tax responsibility for Medical Leave benefits for 2026.

What is the employer's responsibility for Family Leave benefits for 2026?

The employer has no tax responsibility for Family Leave benefits for 2026.

Do Paid Leave benefits need to appear on an employee's W-2?

Not for 2026.

Are premiums tax-deductible for the employer?

Employers may deduct their premium contributions as an excise tax under §164.

If an employer pays more than the required minimum share of the premium, they can deduct this additional contribution as an ordinary and necessary business expense under §162. The employer must include this additional contribution as wages on the employee's W-2.

Are premiums tax-deductible for the employee?

If an employee itemizes deductions on their federal income tax return, they may deduct the full amount they pay, or that the employer pays on their behalf (up to .44% of wages), as state income tax under §164.

If an employer pays more than the required minimum share of the premium, this is additional compensation to the employee and is included in the employee's federal gross income as wages. Employees may deduct this additional contribution by the employer as state income tax under §164, if the employee itemizes deductions on their federal income tax return. These deductions apply only to the extent that they do not exceed the state and local taxes (SALT) deduction limitation provided under §164(b)(6).

How will premiums be treated on an employee's W-2?

The employee's portion of the premium is a post-tax deduction from their pay.

The employer's required portion of the premium does not increase or decrease the employee's taxable wage as reported in W-2 boxes 1,3,5. If the employer picks up an additional portion of the premium, then that amount must be reported as wages paid.

Employers must put the amount of the employee contribution and the amount of the employer pickup contribution in box 14 of the W-2. The label should be MNPFML. If you plan to split out Medical Leave and Family Leave benefits you can add each amount and include MNPML and MNPFL respectively.

How will this guidance change in 2027?

Based on current IRS guidance, starting in 2027, the portion of Medical Leave benefits attributable to the employer will be considered wages.

The share of Medical Leave benefits that count as wages will be treated as third-party sick pay, as described by the IRS in Notice 2015-6. This portion of the benefit is subject to federal income tax withholding, Social Security, Medicare and Federal Unemployment Tax Act (FUTA) taxes.

The state will deduct Social Security and Medicare taxes from the claimant and send them to the IRS on the same frequency they send payroll tax deposits. The state will provide information about

these payments to the employer on a frequent basis so the employer can pay their portion of Social Security and Medicare taxes. The employer will need to include these payments as wages on the W-2 they issue to the employee.

For more information

You can find more information on taxes our website: Taxes and Paid Leave | Minnesota Paid Leave

Still have questions?

If you have a Paid Leave question that isn't yet answered on our website, please reach out to our Contact Center.