

Summary

In January 2025, the Internal Revenue Service (IRS) issued [Revenue Ruling 2025-4](#) to clarify how paid leave programs should treat contributions and benefits for federal tax purposes. The ruling becomes effective Jan. 1, 2026.¹ While the ruling is consistent with how the Oregon Employment Department (OED) administers family leave benefits, it changes the treatment of medical leave benefits so they could be considered wages.

This means:

- The portion of medical leave benefits funded by employer contributions would be subject to both federal income and payroll taxes.²
- Paid Leave Oregon or employers would have to report this taxable amount on Form W-2, instead of Form 1099-MISC.
- The program would also have to pay the employer portion of payroll taxes out of the Paid Leave Trust Fund or transfer that liability to employers.

Challenges

Paying payroll taxes on medical leave benefits and issuing Form W-2 would require several major program changes, increase costs for employers and the state, and create confusion for claimants and employers:

- **Complex IT and process changes:** large-scale system changes (up to 6,400 hours of Frances programming) and new business processes would delay other modernization work
- **High costs:** more than \$5.6 million in one-time costs for staffing and vendor payments and roughly \$20 million per year in ongoing payroll tax liability
- **Claimant confusion:** claimants would face unexpected Social Security and Medicare withholdings from a state benefit, unlike unemployment or other public programs
- **Employer impact:** employers could face new payroll reporting requirements and additional federal tax liability on benefits they did not issue
- **Trust Fund effects:** Payroll tax payments would reduce Trust Fund reserves

¹ OED has requested a one-year implementation extension (until Jan.1, 2027) from the IRS, jointly with WA and CO, and is awaiting a response.

² FICA, FUTA, SUTA, and other state of Oregon payroll taxes.

Implementation Options

Non-compliance could result in potential federal and state penalties of up to \$85 million per year. Accordingly, OED has identified two options for implementing the IRS ruling:

- 1) **Payroll-Tax Method:** Continue using employer contributions to fund medical leave and make the required corresponding changes as described above.
- 2) **Accounting Method:** Establish an internal accounting method that ensures employer contributions are not used to fund medical leave benefits. To accomplish this, ORS 657B.430 would have to be amended to clarify that OED may allocate employer and employee contributions to specific leave types.

The table below shows the impact of each option on employers, employees, and OED:

	Payroll-Tax Method	Accounting Method
Employers	<ul style="list-style-type: none"> • Significant tax burden (if tax liability is assigned to employers) • Requires system reprogramming for many employers 	<ul style="list-style-type: none"> • No impact or costs to employers
Claimants	<ul style="list-style-type: none"> • Lower medical benefit payments • More complex tax filing 	<ul style="list-style-type: none"> • No costs to claimants • No tax liability on medical benefits
OED	<ul style="list-style-type: none"> • Major administrative effort • Costs to Trust Fund • Major statutory changes required to implement 	<ul style="list-style-type: none"> • No meaningful Trust Fund impact • Minimal administrative effort • Statutory Change required to clarify rulemaking authority

Recommended Option

Paid Leave Oregon recommends adopting the **Accounting Method**.

This option meets the intent of the ruling while maintaining stability for claimants, employers, and the Trust Fund. It avoids unnecessary administrative and financial burdens and ensures compliance through simple accounting and rulemaking changes once authorized by the Legislature.

Next Steps

OED will work with the Legislature in the 2026 session to amend existing laws. OED will also continue coordinating with the IRS, the Oregon Department of Revenue, and other states with paid leave programs. Paid Leave Oregon will also update accounting systems and amend administrative rules as needed to ensure full transparency and compliance.

Questions? Please contact [OED Legislative Affairs@employ.oregon.gov](mailto:OED_Legislative_Affairs@employ.oregon.gov)