

Leave of Absence Guidelines With Section 125 Plans

How does FMLA, Leave of Absence or USERRA impact a Participant's FSA Election?

Overview of FMLA:

FMLA (Family Medical Leave Act) requires covered employers to permit eligible employees to take a limited amount of unpaid, job-protected leave each year for certain family and medical reasons. To be eligible for FMLA leave, an employee must have worked for a covered employer for at least 12 months (not necessarily consecutively) and must have worked at least 1,250 hours during the 12 months preceding the start of the leave. The employer must employ at least 50 employees within a 75-mile radius of the worksite at which the employee is employed.

The employee is permitted to take up to 12 weeks of unpaid, job-protect leave each year because of the birth of a child or the placement of a child for adoption or foster care, to care for a spouse, son, daughter or parent who has a serious health condition, or because of the employee's own serious health condition. FMLA also permits an eligible employee to take up to 12 work weeks of leave during any 12-month period for a "qualifying exigency" arising because a spouse, son, daughter or parent is on covered active duty (or has been notified or an impending call or order to such duty). In addition, an eligible employee who is the spouse, son, daughter, parent or next of kin of a covered service member with a "serious injury or illness" is entitled to take up to 26 work weeks of leave during a 12-month period to care for the service member.

Group Health Coverage During FMLA:

An employer must maintain coverage under any group health plan during FMLA leave at the level and under the conditions that coverage would have been provided if the employee had continued in employment. This requirement extends to any medical, surgical, hospital, dental, eye care, mental health counseling and substance abuse treatment provided under the employer's group health plan, whether or not provided through a Health FSA or as part of a cafeteria plan.

When Does Group Health Coverage Obligation Cease?

Except as required by COBRA, an employer's obligation to maintain health benefits during a FMLA leave ceases under certain conditions (e.g., if the employee fails to return from leave or continues on leave after exhausting the FMLA leave entitlement, or if an employee's premium is more than 30 days late (or later than the grace period under an established employer policy) and the employer gives at least 15 days' written notice to the employee that the premium has not been paid and that coverage will cease, among other conditions).

Paying for Group Health Coverage:

An employee who continues group health coverage during unpaid FMLA leave may pay his or her share of contributions:

- When they would be paid by payroll deduction
- When they would be paid under COBRA
- By prepayment pursuant to a cafeteria plan at the employee's option
- According to the employer's rules for payment by employees on leave without pay
- According to another system voluntarily agreed to by the employer and the employee, which may include prepayment (e.g., through increase payroll deductions when the need for the FMLA leave is foreseeable)

The employer must provide the employee with advance written notice of the conditions under which payments must be made and may not require a payment method that is not required of employees who are on a non-FMLA leave.

Recovery of Employer's Share of Health Plan Contributions

An employer may recover its share of health plan premiums paid during a period of unpaid FMLA leave if the employee fails to return when the FMLA leave has been exhausted or expires. There are some exceptions to the employer's right to recover its share of the premiums when the employee's return is prevented for certain reasons (e.g., because of a serious health condition).

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Recovery of Employee's Share of Health Plan Contribution

If an employer pays the employee's share of the health plan contributions (as well as its own share), then the employer may recover the employee's share of the contributions from the employee (whether or not the employee returns to work after the FMLA leave).

Restoration of Benefits

An employee returning from FMLA leave must be "restored to an equivalent position with equivalent employment benefits, pay, and other terms and conditions of employment." Benefits include group life insurance, health insurance, disability insurance, sick leave, annual leave, educational benefits, and pensions. When benefits must be restored, the employee cannot be required to requalify for them. However, the benefits will be subject to any changes in benefit levels during the leave that affect the entire workforce.

How to Handle Cafeteria Plan Elections During FMLA Leave

Plan sponsors that administer their cafeteria plans in accordance with the IRS FMLA Regulations should take comfort that they will be acceptable under the DOL's general rules. Some of the key concepts in the regulations are reviewed below (these rules apply regardless of the reasons for the FMLA leave).

- An employer may:
 - Allow an employee going on unpaid FMLA leave to either revoke or continue health coverage (including Health FSA coverage); or
 - Require that health coverage continue, but allow the employee to discontinue contributions.

If the employer continues coverage during an unpaid leave, the employer may recover the employee's share of the premiums when the employee returns to work.

- Upon returning from FMLA leave, the employee has a right to be reinstated in the group health plan coverage on the same terms as before the FMLA leave (subject to any changes in benefit levels) if such coverage terminated during the leave (either by revocation or due to nonpayment of premiums). This reinstatement right includes the right to revoke or change elections under the permitted election change regulations on the same terms as employees who are working and not on FMLA leave.
- An employee who elects to continue health coverage while on unpaid FMLA leave may do so in one of three ways:
 - Prepay
 - Pay-as-you-go
 - Catch-up
- An employer must apply detailed special rules for administering Health FSA coverage during and after an employee's unpaid FMLA leave.

To Continue (or Not Continue) Coverage Elections During and After FMLA Leave

The IRS FMLA regulations confirm that employers can require reinstatement of coverage upon return from FMLA leave and can also require coverage continuation during a paid leave. While the rules discussed below literally apply only to group health coverage, similar concepts should also apply to other benefits if required for employees on non-FMLA leave.

Can an Employer Continue Coverage, but Allow Employees to Discontinue Contributions and Recoup Payments?

Employees taking FMLA leave are entitled to continuation of health coverage (and non-health coverage if continued during non-FMLA leave). The IRS FMLA regulations provide that employers must let employees on FMLA leave make the same election changes as employees who are working and not on FMLA leave. Also, employers must allow one of the following options for employees taking unpaid FMLA leave:

- *Option 1: Employees May Revoke Coverage.* Under this option, employees may choose to revoke health coverage instead of continuing coverage. If the employee elects to revoke coverage, coverage can cease (subject to the reinstatement right). For those who continue coverage, the regulations provide three payment options for someone who continues coverage: prepay, pay-as-you-go, and catch-up options.
- *Option 2: Employees Must Continue Health Coverage but May Discontinue Contributions.* If the employer requires that coverage continue, but the employee elects to discontinue contributions, the employer can continue coverage by paying the employer's and the employee's share of the contributions. The employer may recoup the employee's share of contributions when the participant returns from leave.

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For non-health benefits, similar rules presumably apply to FMLA leave if required for non-FMLA leave.

Why Would an Employer Want to Pay the Employee's Share of the Health Premium During FMLA Leave?

All employers must reinstate coverage to an employee returning from FMLA leave. Consequently, some employers keep health coverage intact during a leave, even though that may temporarily impose financial obligations on the employer. It may be easier for recordkeeping purposes to keep an employee at the same level of coverage during the plan year, especially if a Health FSA is involved. The employer may also be maintaining the employee's non-health benefits to ensure that coverage will be available when the employee gets back, without preexisting conditions, medical underwriting, etc. The employer's financial risk is limited-it's usually a small dollar amount and the employer has the ability to recoup the employee's share upon return to work.

Can Employers Require Continuation of Coverage During Paid FMLA Leave?

Employers may require employees taking a paid FMLA leave to continue benefits during the leave, but only if the employer requires continuation of benefits during a comparable non-FMLA paid leave.

Can Employers Require Reinstatement of Coverage Upon Return from FMLA Leave?

An employer may mandate reinstatement of coverage upon return from FMLA leave, but only if the employer requires reinstatement of coverage upon return from a non-FMLA leave of absence.

Review Your Plan Documents. Many plans only reinstate a participant's cafeteria plan election if the employee returns from non-FMLA leave within 30 days after the leave began and allow employees to make new elections if they return more than 30 days after the non-FMLA leave began. A plan with these rules could not require reinstatement of a participant's cafeteria plan election if the employee returned more than 30 days after the FMLA leave began. Review plan documents to ensure that they incorporate more flexible provisions in the regulations, if desired by the employer.

Can Employers Invoke the "Catch-Up" Rule for Employee's Failure to Make Contributions?

If an employee chooses the pay-as-you-go option and then misses a required contribution, the employer may continue coverage and then recoup the missed contributions when the employee returns from leave.

What Options does an Employee Have to Make Contributions During FMLA Leave?

For employees who continue coverage during FMLA leave, there are three ways to handle employee contribution obligations:

- Prepay
- Pay-as-you-go
- Catch-up.

As a practical matter, employees on paid FMLA leave will want to use the second option, while employees without ongoing compensation (those on unpaid FMLA leave) will prefer the first or third option. These three options are explained more fully in the following paragraphs.

Prepay Option

Under the prepay option, the employee is given the opportunity to pay, before commencing FMLA leave, the contributions that will be due during the leave period (see the discussion below regarding a leave that straddles two plan years). An employee choosing this option voluntarily elects to reduce his or her final pre-leave paycheck or to otherwise make special salary reduction contributions that will cover his or her share of the contributions for all or part of the expected duration of the leave. (Prepay contributions could also be made on an after-tax basis.)

The employee's regular salary reduction election for the duration of the leave is then suspended, but his or her benefit election remains in force. During the leave, the employer pays its share of the contribution in the same manner as before. When the leave ends, the employee's previous salary reduction election resumes for the duration of the plan year, unless the employee makes a change in election as permitted under the permitted election change regulations (e.g., for change in status) upon return from the leave.

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The prepay option cannot be mandated (i.e., it cannot be the sole option offered to employees on FMLA leave). But the prepay option may be restricted to employees on FMLA leave.

The prepay option works best when the employee is able to plan for the leave well in advance. It may not work as well if the employee has to take leave on short notice; the leave is expected to be of long (or indefinite) duration, or if the employee does not have enough compensation to prepay additional amounts.

Example: Prepay Option. Penelope elects health coverage under her employer's group health plan and pays a portion of the premiums for her coverage on a pre-tax basis through her employer's cafeteria plan. Both plans are calendar-year plans. Penelope takes FMLA leave for 12 weeks beginning on June 30. If the cafeteria plan offers the prepay option and Penelope has enough advance notice of her need for the leave, she can choose to prepay her share of the premiums for health coverage during the leave on a pre-tax basis from her pre-leave compensation.

Can the Prepay Option be Used When FMLA is Over Two Plan Years?

Assume the same facts as in the above example, except that Penelope's 12-week FMLA leave begins on October 31 (i.e., the leave straddles two plan years). Can she still prepay her share of the premiums for coverage during the leave on a pre-tax basis?

The IRS FMLA regulations prohibit pre-tax prepayment of contributions for a subsequent plan year. An example in the IRS FMLA regulations indicates that when a leave straddles two plan years, only the premiums for coverage during the first plan year can be prepaid on a pre-tax basis. This is because of the cafeteria plan "no-deferred-compensation" rule, which generally prohibits one year's contributions from funding benefits in a subsequent year.

Would the result be different if the employer's cafeteria plan included a 2-1/2 month grace period under its premium payment component? Under IRS guidance issued several years after the IRS FMLA regulations, unused amounts remaining at the end of a plan year can be used to pay or reimburse qualified expenses incurred during the first 2-1/2 months of the following plan year when the cafeteria plan provides for such a grace period.

Thus, a cafeteria plan with a grace period under its premium payment component arguably could allow participants taking an FMLA leave that straddles two plan years to prepay their contributions for up to 2-1/2 months of coverage during the second plan year on a pre-tax basis before the leave begins without violating the no-deferred-compensation rule.

Pay-As-You-Go Option

Under the pay-as-you-go option, the employee pays his or her share of the cost of coverage in installments during the leave. The contributions could be paid with after-tax dollars or with pre-tax dollars to the extent that the employee receives compensation (e.g., unused sick or vacation days) during the leave. When the leave ends, the employee's previous salary reduction election resumes for the duration of the plan year unless the employee makes an election change upon returning from the leave, as permitted under the permitted election change regulations (e.g., for change in status).

If the employee stops making contributions during the leave, and the employer doesn't make such payments on the employee's behalf, then the employee's benefits would cease (subject to the applicable grace period for late payments discussed in subsection O.2). If the employer continues coverage for an employee who fails to make contributions, the IRS FMLA regulations allow the employer to recoup the employee's share of those payments upon reemployment (i.e., as under the catch-up option). The pay-as-you-go option must be offered to employees on FMLA leave if it is offered to employees on non-FMLA leave.

Catch-Up Option

When an employee elects the catch-up option, the employer and employee agree in advance that the employer will advance payment of the employee's share of the cost of coverage during the leave and that the employee will pay the advanced amounts when he or she returns from the leave.

Upon returning from leave, the employee makes special catch-up salary reduction contributions to cover his or her share of the cost of coverage during the leave (i.e., the amount advanced by the employer). In addition, the employee's pre-leave salary reduction

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election resumes for the duration of the plan year unless the employee makes a change in election as permitted under the permitted election change regulations (e.g., for change in status) upon return from the leave.

A cafeteria plan may permit catch-up contributions to be made on a pre-tax basis or with after-tax dollars. And if an employee doesn't make required contributions while on leave, the employer may use the catch-up option to recoup the employee's share when the employee returns, even without the employee's prior agreement.

Under the IRS FMLA regulations, the catch-up option may be the sole option offered to employees on FMLA leave only if it is the sole option offered under other types of unpaid leave. As with the prepay option, the catch-up option may not work well when the leave is expected to be of long (or indefinite) duration.

Using the Catch-Up Option Under a Health FSA.

The catch-up option puts the employer at added risk under a Health FSA because the uniform coverage requirement continues to apply. Medical expenses incurred by the employee during the FMLA leave must be reimbursed under the Health FSA (up to the annual coverage limit, as reduced by prior reimbursements), because the employee's coverage remains in force during the leave.

Can the Catch-Up Option be Used When FMLA is Over Two Plan Years?

While there is no official guidance regarding this issue, it seems reasonable that when an employee's leave straddles two cafeteria plan years, a catch-up contribution covering both years could be made on a pre-tax basis (e.g., catch-up salary reduction contributions made in year two that pay for premiums advanced by the employer for coverage in year one).

How Does Flex Credits Provided Under a Cafeteria Plan Work With A FMLA Leave?

The FMLA statute does not directly address what is required when an employee on FMLA leave has been receiving flex credits from an employer. However, this question has been addressed in a DOL Opinion Letter involving a fairly common plan design. The employer that requested the letter provided a fixed monthly amount (called an allotment) to employees who were participating in its cafeteria plan. The employees used the allotment to pay the premiums for group health plan coverage. Any remaining balance could be used to pay the premiums for dental, disability, or life insurance coverage or the employees could elect to receive that amount in cash.

The DOL concluded that "employees taking unpaid FMLA leave must have that portion of their cafeteria plan allotment allocated to group health insurance (including dental) premiums paid by [the employer] in the same amount as paid prior to the start of the FMLA leave."

The DOL based its conclusion on the requirement that an employer must maintain the group health plan coverage of an employee taking FMLA leave on the same terms and conditions that would have applied had the employee remained continuously employed during the leave, and that this requirement applied whether or not coverage under a group health plan was being "provided through a flexible spending account or other component of a cafeteria plan."

Furthermore, because the employer paid for group health insurance coverage while employees were working, it could not recover such payments from its employees when they returned to work after FMLA leave. (While not addressed by the DOL, the same principles would likely apply when an employee allocates flex credits to a Health FSA.) On the other hand, the DOL concluded that the employer was not required to continue to provide flex credits that were being used by an employee to pay for other types of coverage, such as life or disability coverage, unless the employer had an established policy of providing flex credits to employees on other forms of leave.

Example 1: Major Medical Plan (Insufficient Flex Credits for Coverage). Oscar elects coverage under his employer's major medical plan at a cost of \$250 per month. To pay for the coverage, he uses \$200 in employer-provided flex credits and reduces his own compensation on a pre-tax basis by an additional \$50 per month, to make up the \$250 monthly total.

Oscar takes an FMLA leave and elects to maintain his coverage under the major medical plan while he is on leave. During the leave, his employer must continue to provide \$200 in flex credits each month. Oscar will be responsible for paying the remaining \$50 per

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month that is required to maintain his coverage under the major medical plan during his leave. If he fails to pay his share of the premiums on a timely basis, coverage may be dropped in accordance with the FMLA's rules

Example 2: Major Medical Plan (Sufficient Flex Credits for Coverage). Assume the same facts as in Example 1, except that Oscar receives \$250 in flex credits each month (not \$200). He uses the flex credits to pay for his coverage under his employer's major medical plan. If he elects to continue his coverage during his FMLA leave, his employer must continue to provide the \$250 in flex credits each month. No additional contributions are required for Oscar to maintain his coverage during the leave.

Example 3: Major Medical Plan and Health FSA (Insufficient Credits for Coverage). Assume the same facts as in Example 2, except that Oscar has also elected to contribute \$40 per month to a Health FSA and receives \$260 in flex credits, which he uses to pay for his coverage under the major medical plan and Health FSA. If Oscar continues his coverage under both plans while he is on FMLA leave, his employer must continue to provide \$260 in flex credits toward the cost of coverage under the two plans. But together, the plans cost \$290, leaving a \$30 deficit. Thus, Oscar must pay the remaining \$30 per month to maintain his coverage under both plans during the leave.

What if Oscar fails to make his payments on a timely basis? The employer's flex credits are enough to cover the entire cost of Oscar's coverage under the major medical plan but are not enough to also cover the entire cost of coverage under the Health FSA. In the absence of further agency guidance, it seems reasonable for an employer to adopt an ordering rule under which contributions are applied first to the cost of major medical coverage and then to the cost of coverage under the employer's other group health plans (e.g., a Health FSA or dental plan), in whatever order the employer has chosen under its rule. If such an ordering rule were applied, Oscar's coverage under the major medical plan would be continued during FMLA leave, but his coverage under the Health FSA could be terminated in accordance with the FMLA's rules (see subsection O.2) based on his failure to pay his share of the required premiums. If the employer uses an ordering rule, it should be communicated to participants and applied uniformly and consistently.

How Does a FMLA Leave Affect Health FSAs?

A Health FSA offered under a cafeteria plan must conform to the generally applicable rules concerning employees who take FMLA leave. Thus, employees taking unpaid FMLA leave must be allowed to revoke their coverage under a Health FSA during the leave. In the alternative, the employer may require that coverage continue during the leave under an existing Health FSA election but may allow the employee to discontinue contributions during the leave period.

The IRS FMLA regulations also require the plan to permit the employee to be reinstated in the Health FSA upon return from FMLA leave on the same terms as before taking leave. An employer may mandate reinstatement of coverage upon return from an FMLA leave if the employer also requires reinstatement of coverage upon return from a non-FMLA leave of absence.

How Does the Uniform Coverage Rule Apply During FMLA Leave?

The uniform coverage rule applies during FMLA leave, so long as the employee continues health coverage. Therefore, regardless of the payment option selected by the employee, so long as the employee continues coverage (or the employer continues the coverage of an employee who fails to make required contributions), the full amount of the elected coverage, less any reimbursements, must be available to the employee at all times, including during FMLA leave.

If an employee's coverage under the Health FSA ends while the employee is on FMLA leave, then the employee is not entitled to reimbursements for claims incurred during the period when the coverage is not in force. If the employee later elects to be reinstated in the Health FSA upon return from leave for the rest of the plan year, then the employee may not retroactively elect Health FSA coverage or submit claims incurred during the period when the coverage was terminated. Also, the employee is not entitled to greater Health FSA benefits relative to contributions paid than an employee who has been continuously working during the plan year.

Example: Health FSA Expenses Incurred During FMLA Leave. Bob takes FMLA leave beginning March 1 and chooses to revoke his coverage under his employer's calendar-year Health FSA. When Bob returns to work on May 1, he elects to resume his coverage and submits a Health FSA reimbursement request for expenses incurred both before and during his FMLA leave. The expenses incurred

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before Bob's FMLA leave may be reimbursed, assuming that the conditions for reimbursement are otherwise satisfied. But Bob may not be reimbursed for expenses incurred during the leave (i.e., while coverage under the Health FSA was not in effect).*

If a Health FSA participant revokes coverage (or chooses the pay-as-you-go option and then fails to pay a required contribution), what is the coverage level upon return from FMLA leave?

Under the IRS FMLA regulations, the participant has two coverage options:

- Prorated coverage based on the missed contributions or
- Reinstatement of the original coverage level

Prorated Coverage.

The employee may elect to reinstate a level of coverage that is reduced by the amount of contributions missed during the leave, at the original contribution amount. For example, assume that Maria elected \$1,200 in Health FSA coverage for the plan year and paid \$100 per month for the coverage. On April 1, after submitting no claims for reimbursement, Maria begins a three-month FMLA leave. She does not elect to continue coverage and the employer does not continue it on her behalf. When Maria returns on July 1, she may elect to have \$900 reinstated (\$1,200 minus \$300 in missed contributions) at a cost of \$100 per month for the remainder of the year.

Reinstatement of Original Coverage Level.

Under this option, the employee may elect to reinstate the level of coverage that was in effect when the leave began, provided that he or she pays the missed contributions.

Example: Assume the same facts previously described, except that Maria elects reinstatement of her original coverage level. Then she would have \$1,200 in annual reimbursement at a cost of \$150 per month for the remainder of the year (the \$100 original monthly premium plus an additional \$50 per month to make up the \$300 in missed contributions (\$300 divided by the six remaining months = \$50)).

Under either option, it appears that there is a single period of coverage (with an aggregate coverage limit before and after the leave). However, in both cases, expenses incurred during the period that the Health FSA was not in force are not eligible for reimbursement.

An employee on FMLA leave can revoke or change elections (e.g., because of changes in status) under the same conditions that apply to employees in the cafeteria plan who are not on FMLA leave. Thus, an employee who returns from unpaid FMLA leave may make a new Health FSA election for the remainder of the plan year if return from unpaid leave constitutes a change in status under the employer's cafeteria plan.

Can a Plan Limit Health FSA Risk by Restricting Election Changes?

Yes, under the IRS FMLA regulations, an employee on FMLA leave has no greater rights than an employee who is working and not on FMLA leave. * So if an employer's plan prohibits Health FSA election changes (or prohibits reductions in Health FSA elections) for all employees, the FMLA would not change the result.

What Administrative Issues are Raised by FMLA Leaves?

An employee going on FMLA leave should complete a midyear election change form to reflect any change in salary reductions or benefits on account of the unpaid leave. When the employee returns to work after the leave, the FMLA requires that he or she be allowed to re-enter the plan, presumably with the same salary reduction and benefit elections that were in place before the leave began, whether or not the end of an unpaid leave is considered to be another change in status event.

Note that going on an unpaid leave is a change in status event, regardless of the reason for the leave. Consequently, in addition to rights under the FMLA for group health coverage, an employee may be entitled to change elections for non-health coverage benefits (such as DCAP benefits) when going on unpaid leave.

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Do Employees on FMLA Leave Have Open Enrollment Rights During the Leave?

Yes. The IRS FMLA regulations provide that employees on FMLA leave have open enrollment rights.* Consequently, plan administrators should provide employees on FMLA leave with enrollment materials and permit them to enroll if they would otherwise be eligible.