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EFFECT OF FMLA ON THE OPERATION OF CAFETERIA PLANS
NEW IRS REGULATIONS ISSUED

On October 17, 2001, the Internal Revenue Service (IRS) issued final regulations relating to cafeteria and health plans and the Family & Medical Leave Act of 1993 (FMLA). The IRS Regulations are in a question and answer format. The following is a summary of some of the questions and answers.

Q-1: May an employee revoke coverage or cease payment of his or her share of group health plan premiums when taking unpaid FMLA leave?

A-1: Yes. An employer must either allow an employee on unpaid FMLA leave to revoke coverage, or continue coverage but allow the employee to discontinue payment of his or her share of the premium for group health plan coverage (including a health flexible spending arrangement (FSA)) under a cafeteria plan for the period of the FMLA leave. **FMLA does not require that an employer allow an employee to revoke coverage if the employer pays the employee's share of premiums.** If the employer continues coverage during an FMLA leave, the employer may recover the employee's share of the premiums when the employee returns to work. FMLA also provides the employee a right to be reinstated in the group health plan coverage (including a health FSA) provided under a cafeteria plan upon returning from FMLA leave if the employee's group health plan coverage terminated while on FMLA leave (either by revocation or due to nonpayment of premiums).

Q-2: Who is responsible for making premium payments under a cafeteria plan when an employee on FMLA leave continues group health plan coverage?

A-2: FMLA provides that an employee is entitled to continue group health plan coverage during FMLA leave whether or not the coverage is provided under a health FSA or other component of a cafeteria plan. FMLA permits an employer to require an employee who chooses to continue group health plan coverage while on FMLA leave to be responsible for the share of group health premiums that would be allocable to the employee if the employee were working. However, FMLA requires the employer to continue to contribute the share of the cost of the employee's coverage that the employer was paying before the employee commenced FMLA leave.

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Q-3: What payment options are required or permitted to be offered under a cafeteria plan to an employee who continues group health plan coverage while on unpaid FMLA leave, and what is the tax treatment of these payments?

A-3: A cafeteria plan may offer one or more of the following payment options, or a combination of these options, to an employee who continues group health plan coverage (including a health FSA) while on unpaid FMLA leave (provided that the payment options for employees on FMLA leave are offered on terms at least as favorable as those offered to employees not on FMLA leave):

a. **Pre-pay:** Under this option, a cafeteria plan may permit an employee to pay, prior to commencement of the FMLA leave period, the amounts due for the FMLA leave period. However, FMLA provides that the employer may not mandate that an employee pre-pay the amounts due for the leave period.

b. **Pay-as-you-go:** Under this option, employees may pay their share of the premium payments on the same schedule as payments would have been made if the employee were not on leave. An employer is not required to continue the group health coverage of an employee who fails to make required premium payments while on FMLA leave, provided that the employer follows the notice procedures under the FMLA. However, if the employer chooses to continue the health coverage of an employee who fails to pay his or her share of the premium payments while on FMLA leave, FMLA permits the employer to recoup the premiums to the extent of the employee's share.

c. **Catch-up:** Under the catch-up option, the employer and the employee may agree in advance that the group coverage will continue during the period of unpaid FMLA leave, and that the employee will not pay premiums until the employee returns from the FMLA leave. **Where an employee is electing to use the catch-up option, the employer and the employee must agree in advance of the coverage period that: the employee elects to continue health coverage while on unpaid FMLA leave; the employer assumes responsibility for advancing payment of the premiums on the employee's behalf during the FMLA leave; and these advance amounts are to be paid by the employee when the employee returns from FMLA leave.** When an employee fails to make required premium payments while on FMLA leave, an employer is permitted to utilize the catch-up option to recoup the employee's share of the premium payments when the employee returns from FMLA leave. If the employer chooses to continue group coverage under these circumstances, the prior agreement of the employee is not required.

Exceptions to the payment options:

- Whatever payment options are offered to employees on non-FMLA leave must be offered to employees on FMLA leave.

- FMLA does not permit the pre-pay option to be the sole option offered to employees on FMLA leave. However, the cafeteria plan may include pre-payment as an option for employees on FMLA leave even if such option is not offered to employees on non-FMLA leave without pay.

- **FMLA allows the catch-up option to be the sole option offered to employees on FMLA leave if and only if the catch-up option is the sole option offered to employees on non-FMLA leave without pay.**

- If the pay-as-you-go option is offered to employees on non-FMLA leave without pay, the option must also be offered to employees on FMLA leave.



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Q-4: Do the special FMLA requirements concerning payment of premiums by an employee who continues group health plan coverage under a cafeteria plan apply if the employee is on paid FMLA leave?

A-4: No. The Labor Regulations provide that if an employee's FMLA leave is paid leave and the employer mandates that the employee continue group health plan coverage while on FMLA leave, the employee's share of the premium must be paid by method normally used during any paid leave (e.g., by pre-tax salary reduction if the employee's share of the premiums were paid by pre-tax salary reduction before the FMLA leave began).

Q-5: What restrictions apply to contributions made when an employee's FMLA leave spans two cafeteria plan years?

A-5: No amount will be included in an employee's gross income due to participation in a cafeteria plan during FMLA leave, provided that the plan complies with other generally applicable cafeteria plan requirements. Among other requirements, a plan may not operate in a manner that enables employees on FMLA leave to defer compensation from one cafeteria plan year to a subsequent plan year.

Q-6: Are employees entitled to non-health benefits while taking FMLA leave?

A-6: FMLA does not require an employer to maintain an employee's non-health benefits (e.g., life insurance) during FMLA leave. An employee's entitlement to benefits other than group health benefits under a cafeteria plan during a period of FMLA leave is to be determined by the employer's established policy for providing such benefits when the employee is on non-FMLA leave (paid or unpaid).

However, FMLA provides that, in certain cases, an employer may continue an employee's non-health benefits under the employer's cafeteria plan while the employee is on FMLA leave in order to ensure that the employer can meet its responsibility to provide equivalent benefits to the employee upon return from unpaid FMLA leave. If the employer continues an employee's non-health benefits during FMLA leave, the employer is entitled to recoup the costs incurred for paying the employee's share of the premiums during the FMLA leave period.

Q-7: What is the applicability date of the regulations in this section?

A-7: Cafeteria plan years beginning on or after January 1, 2002.

If you have any questions or would like further information, please contact N. DeWayne Pope or Douglas B. Kauffman at (205) 251-8100.

If you no longer wish to receive this update or have an address change, please contact Nora Yardley at nyardley@balch.com or (205) 226-3476.

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