Leave of Absence Effects on Employee Benefit Plans

Go to: Laws Relevant to Leaves of Absence | Leave of Absence Considerations for Health and Welfare Benefit Plans | Leave of Absence Considerations for Tax-Qualified Retirement Plans | Bonuses, Incentive, and Equity-Based Plans | Leave of Absence Considerations for Nonqualified Deferred Compensation | Related Content

Current as of: ***04/22/2020***

This practice note discusses how an employee benefit plan must operate to comply with federal and state laws that require or permit employee leaves of absence and other benefit plan administration issues for employees on leave. As applicable, employers must account properly for the accrual of an employee's benefits and service during a leave of absence and provide opportunities for the inactive employee to make benefit elections, make contributions, or otherwise participate in the plan. Compliance failures may result in statutory and/or contractual civil liability and plan operational failures.

As a result of the novel coronavirus (COVID-19) pandemic, many U.S. employers have engaged in extensive employee furloughs and reductions in working hours in an attempt to avoid layoffs or employment terminations during the period of business disruption. This practice note has been updated to address issues arising for these employers. See also Coronavirus (COVID-19) Resource Kit.

Specifically, this practice note addresses:

- Laws Relevant to Leaves of Absence
- Leave of Absence Considerations for Health and Welfare Benefit Plans
- Leave of Absence Considerations for Tax-Qualified Retirement Plans
- Bonuses, Incentive, and Equity-Based Plans
- Leave of Absence Considerations for Nonqualified Deferred Compensation

For general information on leave of absence policies, see Attendance, Time-Off, and Leave of Absence Policies: Best Drafting and Administration Practices. Links to more specific resources are provided throughout the practice note.

Laws Relevant to Leaves of Absence

This section provides background on federal and state laws that require employers to grant leaves of absence to eligible employees due to serious health conditions, military service, or disability.

Family and Medical Leave Act (FMLA) Considerations

The Family and Medical Leave Act (FMLA), 29 U.S.C. § 2601 et seq., was designed to help employees balance their work and family responsibilities by allowing them to take reasonable unpaid leaves for certain family and medical reasons. The FMLA applies to all public agencies, all public and private elementary and secondary schools, and companies with 50 or more employees. 29 C.F.R. § 825.104.

These employers must provide an eligible employee with up to 12 weeks (26 weeks to care for a covered service-member with a serious injury or illness due to military service) of unpaid leave each year for any of the following reasons:

- For the birth and care of the newborn child of an employee
- For placement with the employee of a child for adoption or foster care
- To care for an immediate family member (spouse, child, or parent) with a serious health condition
- To take medical leave when the employee is unable to work because of a serious health condition
- For the care of a covered service-member with a serious injury or illness –or–
- Because of a qualifying exigency arising out of the fact that the employee's spouse, son, daughter, or parent is a military member on covered active duty or call to covered active duty status

29 U.S.C. § 2612, 29 C.F.R. § 825.100, 29 C.F.R. § 826. Also see Dep't of Labor: Fact Sheet #28: The Family and Medical Leave Act; Dep't of Labor: Fact Sheet #28M: The Family and Medical Leave Act; FMLA Leave: Guidance for Employers and Employees — FMLA Leave: Employer Coverage, Employee Eligibility, and Qualifying Bases; and FMLA Leave: Guidance for Employers and Employees — FMLA Employer Rights and Obligations.

In addition to job protections required during an FMLA leave, employees of employers that provide employee group health insurance are entitled to continuation of the group health insurance coverage during an FMLA leave on the same terms as if they had continued to work. 29 U.S.C. § 2614. The health continuation requirement extends to family coverage for the duration of the FMLA leave if the employer plan provides family coverage. In all cases, the employee must continue to make any normal contributions to the cost of the health insurance premiums.

For additional analysis of the FMLA, see the Family and Medical Leave practice note page.

Americans with Disabilities Act (ADA) Considerations

The Americans with Disabilities Act (ADA), 42 U.S.C. § 12101 et seq., as amended, affirmatively requires employers to make reasonable accommodations to the known limitations of disabled employees or applicants. 42 U.S.C. § 12111(9). The accommodation provided cannot pose an undue hardship on the operation of the business of the employer. 42 U.S.C. § 12111(10).

In some circumstances, employers may have to permit an employee to take a leave of absence to reasonably accommodate the employee's qualifying disability. Under these circumstances, the ADA requires employers to analyze whether a leave of absence:

- Is a reasonable accommodation for an ADA-protected disability –and–
- Will assist the disabled individual in returning to work to perform the essential functions of their job

See 42 U.S.C. § 12111(8). See also Americans with Disabilities Act: Guidance for Employers.

Consider that the ADA may intersect with FMLA requirements regarding an employee's "serious health condition" under the FMLA and the employer's responsibility to "reasonably accommodate" that condition under the ADA. For example, the requirement to reasonably accommodate may require the employee to take an FMLA leave. For additional detail on the interaction between the ADA and FMLA, see the Equal Employment Opportunity Commission (EEOC) publication, EEOC's Fact Sheet on the Family and Medical Leave Act, the Americans with Disabilities Act, and Title VII of the Civil Rights Act of 1964. For information on the intersection between the ADA and FMLA, see ADA: Employee Rights § 6.04, paragraph [2][b].

Uniformed Service Employment and Reemployment Rights Act (USERRA) Considerations

The Uniformed Service Employment and Reemployment Rights Act (USERRA), 38 U.S.C. § 4301 et seq., protects employees while serving or training in the uniformed services. The term "uniformed services" means:

- The Armed Forces
- The Army National Guard and the Air National Guard when engaged in active duty for:
    - Training

  - Inactive duty training –or–
  - Full-time National Guard duty
- The commissioned corps of the Public Health Service –and–
- Any other category of persons designated by the president in time of war or national emergency

38 U.S.C. § 4303(13); 20 C.F.R. § 1002.6. USERRA applies to sponsors of qualified plans as well as governmental plans, church plans, Section 403(b) annuity plans, and nonqualified plans. 20 C.F.R. § 1002.34.

Under USERRA, an employee is entitled to a leave for qualifying military service, with a right of reinstatement, if the employee properly notifies his or her employer, usually in advance of the leave. 20 C.F.R. § 1002.32. The employee does not need to obtain the employer's permission. An employee also does not need to accommodate the employer with respect to timing, duration, or frequency of his or her service. See Dep't of Labor: VETS USERRA Fact Sheet 3.

Requirements for Reinstatement

An employee who is absent from employment as a result of service or training in the uniformed services will be eligible for reemployment (reinstatement rights) with that employer. To qualify, the employee must satisfy the following:

- **Notice**. The employee must (except in exigencies) provide advance notice of the need for leave (20 C.F.R. § 1002.85).
- **Length of service**. The employee's total military service under USERRA must be five years or less (with exceptions for certain service that does not count towards the five-year limit) (20 C.F.R. § 1002.32(a)(2)).
- **Timely return to work**. The employee must timely return to work or apply for reemployment (20 C.F.R. § 1002.115).
- **No disqualifying discharges**. The employee must not have separated from military service with a disqualifying discharge (38 U.S.C. § 4304; 20 C.F.R. § 1002.32(a)(4)).

Regarding the third bullet, an employee is treated as having timely returned to work or having timely applied for reemployment under the following circumstances:

- **Less than 31 days of service**. In the case of service in the uniformed services of 30 days or less, the employee must report to the employer at the beginning of the first full work day plus eight hours after completing service.
- **31 to 180 days of service**. In the case of service in the uniformed services of between 31 and 180 days, the employee must apply for reemployment with the employer not more than 14 days after completing service.
- **More than 180 days of service**. In the case of service in the uniformed services of more than 180 days, the employee must apply for reemployment with the employer not more than 90 days after completing his or her military service.

20 C.F.R. § 1002.115.

Benefits to Which the Employee Is Entitled

Upon an employee's proper reinstatement from military leave, USERRA requires employers to provide the following:

- **Seniority-based benefits**. Reemployed service members are entitled to the seniority and all rights and benefits based on seniority that they would have attained with reasonable certainty had they remained continuously employed. A right or benefit is seniority-based if it is determined by or accrues with length of service. On the other hand, a right or benefit is not seniority-based if it is compensation for work performed or is subject to a significant contingency.

- **Non-seniority-based benefits**. Departing service members must be treated as if they are on a leave of absence. Consequently, while they are away they must be entitled to participate in any rights and benefits not based on seniority that are available to employees on non-military leaves of absence, whether paid or unpaid.
    - If there is a variation among different types of non-military leaves of absence, the service member is entitled to the most favorable treatment so long as the non-military leave is comparable. For example, a three-day bereavement leave is not comparable to a two-year period of active duty. The returning employees shall be entitled not only to non-seniority rights and benefits available at the time they left for military service, but also those that became effective during their service.

38 U.S.C. § 4316(a) and (b); 20 C.F.R. §§ 1002.149, 1002.150.

Employee Benefit Plan Protections during USERRA Leave

Among other things, USERRA:

- Prevents employers from discharging or otherwise discriminating against employees who leave their jobs for military service –and–
- Requires that they be rehired, in most cases, if they report for work within the stated period after completing their military service

USERRA requires that they be deemed by the employer to be on furlough or leave of absence and be entitled to the same rights and benefits as other employees of similar seniority, status, and pay, who are on furlough or leave of absence.

In addition to providing reinstatement rights, USERRA also protects absent uniformed service member's rights and benefits under various employee benefit plans, including their rights under:

- Pension plans
- Health plans
- Welfare plans, including life insurance coverage –and–
- Compensation programs (like awards, bonuses, severance pay)

38 U.S.C. §§ 4311 and 4316(b) and (c).

Further details are provided below under Leave of Absence Effects on Employee Benefit Plans — Leave of Absence Considerations for Health and Welfare Benefit Plans and Leave of Absence Effects on Employee Benefit Plans — Leave of Absence Considerations for Tax-Qualified Retirement Plans, as applicable. For a broader discussion regarding the USERRA, see Uniformed Services Employment and Reemployment Act (USERRA).

State and Local Leave Laws

Consider state FMLA and pregnancy leave laws in reviewing leave of absence policies. These may be more generous to employees than the corresponding federal laws. For example, some states or local jurisdictions:

- Require medical leaves of absence and include:
    - Coverage of employers with fewer than 50 employees
    - An expanded definition of family –and–
    - Leaves of longer duration than the 12 weeks (as provided under the FMLA)
- Have laws requiring paid sick leave (such as Connecticut; Washington, D.C.; San Francisco; and Seattle)
- Have anti-discrimination laws that may provide for a different reasonable accommodation than provided under the ADA, making additional required leave possible

For analysis of state and local paid sick leave laws, see Paid Sick Leave State and Local Law Survey (Private Employers).

Preemption Concerns

The FMLA does not supersede state or local law that provides greater family or medical leave rights than the FMLA does. 29 U.S.C. § 2651(b). The Department of Labor's view is that ERISA does not preempt state FMLA laws. See, e.g., Dep't of Labor, Advisory Opinion 2005-13A, 2005 ERISA LEXIS 14. For example, an employer that operates in a state that requires up to 15 weeks of unpaid family and medical leave must maintain medical coverage for an affected employee for up to 15 weeks (instead of only up to 12 weeks as would be required under the FMLA).

Families First Coronavirus Response Act

The Families First Coronavirus Response Act (FFCRA) (Pub. L. No 116-127), enacted on March 18, 2020, includes both the Emergency Paid Sick Leave Act (EPSLA) and Emergency Family and Medical Leave Expansion Act (EFMLEA). These laws generally require small- and mid-sized private employers and public employers to provide paid sick leave and paid FMLA leave for eligible absences resulting from the coronavirus outbreak. The EPSLA covers up to two weeks of paid leave for employees who are subject to a quarantine or isolation order (or doctor-advised isolation), suffering from COVID-19 symptoms, caring for others in such circumstances, or caring for children due to a coronavirus-related closure, but not able to telework. The EFMLEA provides expanded FMLA protection, ensuring paid or unpaid leave and job protection for up to 12 weeks, for employees in similar circumstances as described above. In both cases, compensation expenses are reimbursable to employers via tax credits.

For initial guidance, see DOL, Families First Coronavirus Response Act: Questions and Answers. For an overview of the applicable rules, see Employers Confront Their Obligations as Coronavirus (COVID-19) Spreads and Labor Dept. Expands Guidance On COVID-19 Paid Leave Law.

Leave of Absence Considerations for Health and Welfare Benefit Plans

Review employer-sponsored welfare benefit plans for consistency with applicable leave of absence laws and coordinate their leave of absence provisions with plan administrator compliance processes. In this context, consider:

- Health plans
- Flexible spending accounts
- Health reimbursement accounts
- Health savings accounts
- Life insurance plans

Special rules for cafeteria plans under I.R.C. § 125 apply in the context of FMLA leaves, particularly as discussed further below.

Counsel should pay careful attention to plan terms and make sure that handbook or company policies do not create obligations that do not exist in the related plan/policy terms. Employers need to understand when benefits are supposed to end or continue, not only as a matter of their company practice, but as set forth in applicable plan documents and insurance policies.

Health and Cafeteria Plans

FMLA Considerations

The FMLA requires employers to maintain group health benefits for employees who take FMLA leave. 29 C.F.R. § 825.209. Employers often require employees to pay some portion of their health insurance premiums/contributions while the employee is on leave or upon return.

Health Plans

Employers must maintain the same health benefits (including dental benefits) during an employee's FMLA leave as they would if the employee was still working, and must generally restore the employee to an equivalent position (including one earning equivalent employee benefits) upon return from FMLA leave. These rules are established under FMLA. 29 U.S.C. § 2614(c); 29 C.F.R. §§ 825.100(b), 825.209, 825.211, 825.215.

On the other hand, the plan does not have to allow the employee to accrue any additional benefits or seniority during unpaid FMLA leave. Benefits accrued at the time leave began, however, must continue to be credited to the individual upon return from leave. 29 C.F.R. §§ 825.215(d)(2).

The FMLA applies to coverage provided through a group health plan. Thus, an employer is required to keep an employee (and enrolled spouse and dependents) covered in the group medical plan by continuing to pay the employer-paid portion of the employee's health premium. The employer may, however, condition continued coverage upon the employee's payment of the employee portion of the premium. The employer can accomplish this, on a non-discriminatory basis, by permitting any of the following methods of payment:

- **Payment from wage continuation benefits**. The employee can pay the employee portion of the premium by deduction from any amounts paid to him or her during the leave (e.g., from short-term disability benefits (either by payroll deduction or through an insurer)).
- **Payment by check or EFT**. The employee can pay the employee portion by check or bank electronic funds transfer (EFT).
- **Prepayment or by catch-up after the leave terminates**. The employee can pay before the leave starts or with a "catch-up" payment after the employee returns from leave.

Treas. Reg. § 1.125-3, Q&A-3(a); Employee Benefits Law § 3A.02[4][b].

An employer may also choose to satisfy the employee's portion of the health premium or contribution on behalf of employees on qualifying leaves of absence (on a nondiscriminatory basis). However, any option made available to individuals on a similar unpaid non-FMLA leave of absence should apply to individuals on an unpaid FMLA leave.

Employees and employers may prefer prepayment or catch-up payment via paycheck deduction since those amounts are excluded from income and excluded from income taxes and payroll taxation. By contrast, payment by check or EFT uses funds on an after-tax basis that may not be deductible. However, the employer is not required to provide either of those options.

Where the FMLA period is paid leave, the employee's share of premiums or other costs should continue to be paid by the method normally used, typically as a payroll deduction. 29 C.F.R. § 825.207, 825.210(b).

The employer may require the employee to repay the employer's share of the premium payment if the employee fails to return to work following the FMLA leave unless the employee does not return because of circumstances that are beyond the employee's control, including a FMLA-qualifying medical condition. 29 C.F.R. § 825.213(a).

If the employee's premium payment is more than 30 days late, the employee's coverage may be dropped (if the plan so provides; some plans or policies have a longer grace period). The employer must provide written notice to the employee that the payment has not been received and allow at least 15 days after the date of the letter before coverage stops. Dep't of Labor: Fact Sheet #28A: The Family and Medical Leave Act.

It is important to ensure the company practices regarding cessation of benefit coverage is consistent with the terms of the plan document and any applicable insurance policy. Employers should also consider whether an employee's inability to return to work results from an ADA-protected disability for which a longer leave may be considered a

required reasonable accommodation. Also consult state law to determine whether the employee is entitled to rights beyond the federal FMLA law and ensure that the leave policy is consistent with those rules.

When employees return from FMLA leave, the plan must permit them to be reinstated on the same terms as if they had been working throughout the leave period without a break in coverage. 29 C.F.R. §§ 825.214, 825.215(d); Treas. Reg. § 1.125-3, Q&A-6(b)(2).

Cafeteria Plans

Many employers establish cafeteria plans (governed by I.R.C. § 125) allowing employees to select coverage under certain health and welfare benefits and in many cases contribute to or pay for those benefits on a pre-tax basis. Employers are obligated by the FMLA to maintain the same group health benefits during the FMLA leave and restore benefits upon return from the leave of absence. This includes the employee's ability to use the cafeteria plan's pre-tax feature. Treas. Reg. § 1.125-3.

Health FSAs

For employees going on FMLA leave who participate in a health flexible spending arrangement, the employer generally must:

- Permit the employee to continue coverage under the health FSA –and–
- If the FMLA leave is unpaid, permit the employee to either:
    - Revoke the health FSA coverage –or–
    - Continue coverage but allow discontinuance of employee contributions during the unpaid FMLA leave period

The employer is not required to offer revocation if it undertakes to pay the employee contributions on his or her behalf during the FMLA leave. Treas. Reg. § 1.125-3, Q&A-2.

If an employee's coverage under the health FSA terminates while the employee is on FMLA leave, the employee is not entitled to receive reimbursements for claims incurred during the period when the coverage is terminated. Treas. Reg. § 1.125-3, Q&A-3

Upon reinstatement into a health FSA upon return from FMLA leave (whether reinstatement is voluntary or automatic), the employee has the right to resume coverage either:

- At the level in effect before the FMLA leave and make up the unpaid contribution payments –or–
- At a level that is reduced and resume premium payments at the level in effect before the FMLA leave

If an employee elects the reduced level, the coverage is prorated for the period during the FMLA leave for which no contributions were paid. Treas. Reg. § 1.125-3, Q&A-6, 29 C.F.R. § 825.209(b).

For more information about cafeteria plans and FSAs, see Cafeteria Plan Design and Compliance (IRC § 125).

If the employer continues coverage during an FMLA leave, the employer may recover the employee's share of the contributions/premiums when the employee returns to work or, if the employee fails to return from leave, directly from the (now former) employee. FMLA also provides the employee a right to be reinstated in the FSA if coverage terminated while the employee is on the FMLA leave (either by revocation or due to non-payment of premiums). Treas. Reg. § 1.125-3, Q&A-1; 29 C.F.R. § 825.213(a).

Dependent Care FSAs

Dependent care flexible savings arrangements allow participants to pay eligible expenses for dependent care on a pre-tax basis. Eligible expenses are generally limited to costs incurred so that the participant is able to work. Consequently, the FMLA allows but does not require dependent care FSA coverage to continue during FMLA leave

(since the participant is presumptively not working). When coverage is provided, claims for reimbursement from the dependent care FSA are only permitted for temporary absences of two weeks or less. Treas. Reg. § 1.21-1(c)(ii). When the individual returns to work, they must be allowed to resume normal participation in the plan in accordance with its terms.

Cessation of Coverage and COBRA Considerations

Make certain that company policy and operations are consistent with plan documents and insurance policies regarding the triggers for losing coverage and when exactly the period of coverage ends. An employer that treats an employee on leave as continuing their medical coverage in a manner inconsistent with the underlying insurance policy could be on the hook for substantial liabilities where the insurer refused to pay for claims incurred outside of the contractual coverage period.

An employer that desires to change the terms of a plan to provide more expansive coverage of non-active employees will need to work with the applicable service providers and, for insured plans, negotiate the coverage terms with the insurer. Coverage changes must be conveyed to participants and plan communications will need to be updated. The sponsor will also need to ensure that any contemplated changes do not disproportionately favor highly paid employees in a manner that violates applicable nondiscrimination rules (e.g., I.R.C. § 105(h) for self-funded health plans).

If an employee on leave loses coverage for an employer group health plan (or does not return to work after their period of leave and loses coverage as a result of their termination or employment), a qualifying event under COBRA is likely to have occurred. A COBRA qualifying event is either of the following events if it results in a loss of coverage:

- Voluntary or involuntary termination (other than by reason of the employee's gross misconduct) –or–
- Reduction of the employee's hours (including paid or unpaid leaves of absence)

Where a qualifying event has occurred, the employer must notify the plan administrator within 30 days so that the administrator can deliver COBRA notices to the qualifying beneficiaries (or, if the employer is also the plan administrator, it has 44 days to send the notice). The COBRA notice informs the individual(s) of their right to elect to continue coverage under the plan (typically, at their own expense). For more information on COBRA, see COBRA Compliance and Enforcement and COBRA Resource Kit.

USERRA Considerations

Employees absent from work to perform qualifying military service have the right to continue their existing health coverage for a limited period under USERRA. USERRA § 4317; 20 C.F.R. § 1002.164. USERRA requires that an employer who provides employee health coverage must continue to do so for employees on military leaves for periods of less than 31 days. For such short-period coverage, the regular employer-employee contribution rates apply. If the employee serves for 31 days or more, the employer can require the employee to pay the full cost plus a 2% administrative fee (similar to COBRA continuation coverage). The employer may establish payment terms in any reasonable manner, which may be the same or different as applies for employees on FMLA leave. 20 C.F.R. § 1002.166.

If elected, USERRA continuation coverage must be provided until the earlier of:

- 24 months from the time the qualifying military absence begins –or–
- The date the employee fails to apply for reinstatement after such service within the period allowed by USERRA

38 U.S.C. § 4317(a); 20 C.F.R. § 1002.164.

Qualifying service under USERRA covers all categories of military training and service, including duty performed on a voluntary or involuntary basis, in time of peace or war. USERRA also covers certain types of service specified by members of the National Disaster Medical System. 42 U.S.C. § 300hh-11; 20 C.F.R. § 1002.6.

Although USERRA does not specify requirements for notifying eligible employees about their rights, employers and health plan administrators must develop reasonable requirements to do so. 20 C.F.R. § 1002.165. An employer will not be penalized for failing to offer USERRA coverage or for terminating coverage if the employee does not notify the employer of his or her service commitment. However, the employer must reinstate the employee's coverage retroactively upon the employee's subsequent request (and payment of any premium costs due), without imposing any additional reinstatement charges. 20 C.F.R. § 1002.167.

An employee commencing USERRA leave may have the choice of continued coverage under USERRA or COBRA. These are alternative coverage rules that run concurrently where both are applicable. 64 Fed. Reg. 5,160 (Feb. 3, 1999). Administrators should take care to notify individuals about their rights and responsibilities under each alternative and the administrative procedures that apply to each so that they can make an informed decision about which to choose.

Most active duty uniformed service members are eligible for medical coverage under the federal government's military health program, known as Tricare (formerly Civilian Health and Medical Program of the Uniformed Services (CHAMPUS)) and will elect that coverage instead of continuation coverage under the employer plan.

Regardless of whether a service member elects to continue health coverage with his or her employer (or switch health coverage to Tricare) while serving in the uniformed services, USERRA requires reinstatement of health plan coverage to the returning service member and such member's dependents upon reemployment. 20 C.F.R. § 1002.168. Where the employer sponsors a cafeteria plan, participants should be entitled to make a mid-year change election when embarking on and upon concluding a period of USERRA service. 70 Fed. Reg. 75,246, 75,265.

Coronavirus-Related Leave Considerations

Continuation Coverage while on FFCRA Leave

Both the EPSLA and EFMLEA emergency leave programs under the Families First Coronavirus Response Act require employers to the health coverage of employees taking such leave under an employer health plan at the same level of coverage as was in effect prior to the leave and on the same terms as if they had continued to work. As with FMLA leave, employees must continue to make any normal contributions to the cost of their coverage, whether or not they are being paid during the leave. This can generally be handled in a variety of ways for upaid leave, such as through prepayment, payment by check, catch-up payments upon resumption of duties, or employer subsidy. (As noted above, however, there may be a modest tax advantage to allowing prepayment or catch-up payment via paycheck deduction).

ACA Employer Shared Responsibility Considerations

The Patient Protection and Affordable Care Act (ACA) (Pub. L. No. 111-148) establishes a shared responsibility mandate that requires applicable large employers (ALEs) to offer full-time employees health coverage or pay a penalty tax. I.R.C. § 4980H.

An ALE that engages in significant hours reductions or furloughs could adversely affect its ability to satisfy the offer-of-coverage requirements. The mandate generally requires employers to pay a penalty for each month in a year in which it does not offer qualifying health coverage to at least 95% percent of its full-time employees (if at least one such person receives subsidized exchange coverage). Most employers use the lookback method to identify the employees considered full-time for this purpose. An individual meeting the threshold during the measurement period (130 hours per month, on average, of paid service, not necessarily working hours) is considered full-time for a later stability period, even if their hours are reduced or eliminated during that stability period. So long as coverage continues to be offered to such employees during the stability period, there would be no adverse effect. But if they

no longer qualify for coverage due to an hours requirement under the plan, it could increase the employer's shared responsibility payments.

That being said, a period of reduced hours or leave will likely also be applied for the then-current measurement period, so that individual may lose full-time status for a later stability period (although special averaging rules may come into play for unpaid periods of FMLA, USERRA, or jury duty leave during the measurement period). Moreover, since the shared responsibility rules only apply to ALEs, determined by reference to the number of full-time employee equivalents during the preceding year (50 or over), an employer could lose ALE status based on a significant reduction in workforce paid hours during 2020.

For more information, see ACA Employer Shared Responsibility Mandate and ACA Employer Shared Responsibility Full-Time Employee Determinations.

Flexible Spending Arrangements

FSA salary deferral contributions for furloughed employees not receiving a paycheck will cease. However, existing account balances are still available for eligible expenses (including, if permitted by the plan, expanded coverage of over-the-counter medicines; see Over-the-Counter Drug Reimbursement Rules after the CARES Act). A bigger issue concerns dependent care FSAs. Eligible expenses for this benefit only include costs incurred by the employee for dependent care that enables the employee to work. I.R.C. §§ 21(b)(2), 129(e)(1). If the furloughed employee is not working, then he or she is not incurring reimbursable expenses and the FSA balance may need to be forfeited at the end of the plan year. While health FSAs can allow employees to carry over up to $500 of unused balances from one year to the next, dependent care FSAs cannot. However they are permitted to offer a grace period in the next plan year for the employee to spend down an unused balance from the previous year (up through March 31 for a calendar year plan). For more on this topic, see Cafeteria Plan Design and Compliance (IRC § 125) — Flexible Spending Arrangements.

Health Savings Accounts (HSAs) and Health Reimbursement Accounts (HRAs)

A Health Savings Account (HSA), established under I.R.C. § 223, allows employees who elect health coverage under a high-deductible health plan to contribute additional pay by payroll deduction on a pre-tax basis to an individual account. For more information on HSAs, see Health Savings Account Design and Compliance. Amounts in the account can be used to pay for out-of-pocket medical expenses. A Health Reimbursement Account (HRA) is typically an arrangement where an employer credits dollar amounts in a notional account allocated to a participant that may be used to pay or reimburse eligible health care expenses incurred by the participant and their eligible dependents. For more information on HRAs, see Health Reimbursement Account Design and Compliance.

FMLA Considerations

An HSA is not treated as coverage under a group health plan that must continue during the FMLA period. See Field Assistance Bulletin 2006-02 (Oct. 27, 2006). Employees on leave of absence may, however, continue to contribute to the HSA, provided that their high-deductible health plan coverage (as that term is defined in I.R.C. § 223(c)(2)) continues during the leave (e.g., the employee continues to make required payments, etc.).

If the terms of the HSA permit, employees may contribute by prepaying HSA contributions before the leave starts. Employees can do this by sending a check during the leave, or by making prepayments or catch-up contributions upon return, as noted above for health plan contributions.

HRAs do not permit employee contributions. The issue is whether an employee on an FMLA leave may withdraw from an HRA if otherwise permitted to do so. Here, look to the type of HRA and terms of the plan, bearing in mind that FMLA leave is treated as a period in which the individual remains employed.

USERRA Considerations

Generally, HSAs are not subject to USERRA, but the employee should be permitted to contribute to the HSA retroactively, upon reinstatement, if the employer permits payments to be made via a cafeteria plan. The employer

will be obligated to make up any missed contributions to the employee's interest in an HRA upon reinstatement following a USERRA leave of absence.

Employee Assistance Programs (EAPs)

Employee Assistance Programs (EAPs) are programs offered by employers that provide a wide-ranging set of benefits to address circumstances that may adversely affect employees' work and health, including referral services, short-term substance use disorder or mental health counseling, financial counseling, and legal services. Employers typically provide EAPs free of charge to employees through third-party vendors.

FMLA and USERRA Considerations

If an EAP provides medical care, rather than only referral services, it generally is considered group health plan coverage that must continue during an FMLA leave period or a USERRA leave period. 29 U.S.C. § 2614(c)(1), 38 U.S.C. § 4303(7).

ADA Considerations

The ADA does not require continuation of EAP coverage under any circumstances.

Wellness Programs

An employer-sponsored wellness program may simply promote good health or may itself constitute a group health plan if it provides medical care. Examples of medical care include biometric screenings (including cholesterol screenings); physical examinations; flu shots; counseling by trained professionals; and other programs that are diagnostic or preventive, or coach individuals regarding specifically identified health risks. 29 U.S.C. § 1167. See Wellness Program Design and Compliance.

FMLA and USERRA Considerations

A wellness program that is a group health plan is subject to the requirements of FMLA and USERRA. 29 U.S.C. § 1167. For a further discussion on the intersection of wellness programs and FMLA and USERRA leaves of absence, see Medical and Genetic Information Request, Handling, and Disclosure Checklist.

Life Insurance

Review the employer's life insurance plan or policy to determine whether it covers employees on leave. Some plans require that an employee be "actively at work" (i.e., not on leave) to be eligible for benefits. For an insured plan, the insurance policy may not cover an employee who is not actively at work. For a self-insured plan, a reinsurer may refuse to pay.

FMLA Considerations

For FMLA considerations, if the employee had life insurance coverage pre-leave, the benefit must be reinstated post-leave.

USERRA Considerations

USERRA requires that an employer offer continued life insurance coverage to its employees absent from work due to military service where the employer offers continued life insurance coverage to similarly situated employees on furlough or leave of absence. If the employer has more than one kind of non-military leave and varies the level and type of benefits provided according to the type of leave used, the comparison should be made with the employer's most generous form of comparable leave. 20 C.F.R. § 1002.150.

Leave of Absence Considerations for Tax-Qualified Retirement Plans

Coordinate leave of absence considerations for tax-qualified retirement plans (like a 401(k) plan, 403(b) plan, employee stock ownership plan, or defined benefit plan) with the employer's leave of absence policy. Consider the following issues:

- How the plan will credit service during a leave of absence
- How to take into account compensation paid (e.g., short-term disability pay) or imputed during the leave for purposes of determining the amount of the employee's benefit
- How participant loans from the plan are to be repaid during leave
- Whether hardship distributions are available to individuals on leave

Service Crediting during Leave

Failure to count service during a period of leave can adversely impact the employee's eligibility service, vesting service, benefit accrual service, and/or early retirement eligibility under a retirement plan, particularly where the plan uses the hours-of-service method for accruing service. A participant's credited service with a sponsor employer is traditionally used to determine the accrued benefit under a defined benefit plan and, more generally, often for purposes of determining eligibility to participate in a plan and for fulfilling vesting requirements for certain benefits. When active service is interrupted during an unpaid furlough period, for example, it could ultimately reduce the amount of a participant's defined benefit plan benefit, delay entry into a plan, or delay the time when a plan benefit becomes nonforfeitable. An extended leave can lead to a break in service, which can magnify the adverse effects.

Because these effects are important but not necessarily well known, it is a good practice to notify affected individuals about them. If a plan sponsor desires to mitigate the negative impact on a group of employees subject to a mandatory furlough period, it could, for example, amend the plan to impute hours of service for the leave period. However, it is important consider whether the amendment will have, or be considered to have, a discriminatory effect that disproportionately favors highly compensated employees. See 26 C.F.R. § 1.401(a)(4).

For a general discussion on retirement plan service crediting, see Employee Benefits Law § 5.03. Also note the special rules discussed below that apply for USERRA and pregnancy/adoption leaves of absence.

USERRA Considerations

Each period of uniformed service is treated as an uninterrupted period of employment with the employer(s) maintaining the pension plan in determining:

- Eligibility for participation in the plan
- The nonforfeitability of accrued benefits –and–
- The accrual of service credits, contributions and elective deferrals

70 Fed. Reg. 75,245, 75,280 (Dec. 19, 2005). See 20 C.F.R. §§ 1002.259–1002.267. Specifically, an individual reemployed under USERRA is treated with respect to such plan as not having incurred a break in service due to the individual's period of qualified military service. I.R.C. § 414(u)(8)(A);38 U.S.C. § 4318(a)(2)(A). The service is credited upon reemployment. I.R.C. § 414(u)(8)(B). However, even if the employee dies or becomes disabled while performing qualified military service, the plan can (but is not required to) treat the individual as if he or she had resumed employment and provide a (death) benefit based on the imputed additional service. I.R.C. § 414(u)(8)(A). For a further discussion on the service and break in service rules, see Employee Benefits Law § 5.03.

<u>Defined Benefit Plans</u>

Hence, for purposes of determining the benefit accruals under a defined benefit plan for the period of military leave:

- Impute the employee's/service member's pay and service –and–

- Apply compensation and service rates that, to a degree of reasonable certainty and considering the individual's work history before and after going on active duty, the employee would have had if the civilian job had not been interrupted

I.R.C. § 414(u)(7) and (u)(8)(B); 20 C.F.R. § 1002.267.

Defined Contribution Plans

For defined contribution plans, employers providing a non-elective contribution (for example, an automatic 3% of compensation allocation in a 401(k) plan), must make the non-elective employer contributions to the rehired veteran's plan account that would have been made during the military service period. The same standard applies for missed matching contributions. The rehired veteran has up to three times the period of service, not to exceed five years, to make up missed employee contributions. I.R.C. § 414(u)(8)(C). If the employer contributions were contingent on the employee making elective contributions and the employee makes up the missed contributions, the employer must make up its contributions over the same period (e.g., matching contributions) that the veteran uses to pay the makeup deferrals. I.R.C. § 414(u)(8)(C).

The amount of makeup contributions is subject to the limits that would have applied during the military service period (e.g., the I.R.C. § 402(g) limit on maximum elective deferrals). 70 Fed. Reg. 75,245 (Dec. 19, 2005).

Pregnancy or Adoption Leaves of Absence Considerations

Under the IRC, a tax-qualified plan is required to treat as hours of service certain periods of service during which the individual is absent from work due to:

- Individual's pregnancy –or–
- For maternity or paternity leave, due to the birth, adoption, or caring of a child after such birth or adoption

The requirement exists solely to prevent a break in service from occurring. However, the foregoing provision permits service recognition only up to 501 hours of service. I.R.C. § 411(a)(6)(E). This prevents a break in service from being recognized by the plan, which can have adverse consequences for service counting rules. For a further discussion of these rules, see Employee Benefits Law § 5.03.

Calculating Compensation during a Leave

Most retirement plans calculate an employee's benefit as a percentage of the plan definition of "compensation." For example, some plans may determine compensation with reference to an employee's base pay, or total pay with some adjustments. On a leave of absence, the employee may continue to receive compensation or continuation benefits (like short-term disability benefits or differential pay), depending on the type of leave. The plan's definition of compensation may include or exclude these types of pay in determining the employee's plan benefit.

USERRA Considerations

For USERRA purposes, assume the rehired employee earned compensation at the same rate they would have received during the military service period. If this is not reasonably certain, you must use the employee's average compensation during the 12-month period immediately preceding the qualified military service. See I.R.C. § 414(u)(7); IRS, Retirement Plans FAQs regarding USERRA and SSCRA. In 2019, the Department of Labor issued clarifying guidance on this topic for pension benefits calculated as a percentage of total earnings. See Dep't of Labor, USERRA Fact Sheet 1

Plan Loans

Most 401(k) plans permit the participant to borrow from his or her plan account. Plan loans generally must be repaid within five years (except for loans issued regarding the purchase of the participant's principal residence). I.R.C. § 72(p)(2)(B). However, a plan may provide for a suspension of loan repayments during a leave of absence in certain

circumstances, subject to IRS limitations. Without a permitted suspension, the following negative consequences could occur:

- The outstanding loan balance would otherwise be treated as a taxable distribution reportable on IRS Form 1099 (i.e., a deemed distribution).
- A 10% penalty (under I.R.C. § 72(t)) would apply if the default occurs prior to age 59½.
- For disqualified persons (e.g., officers, directors, or highly compensated employees), the defaulted loan amount will constitute a prohibited transaction subject to a 15% excise tax reported on IRS Form 5330 until the loan is repaid.

Treas. Reg. § 1.72(p)-1, Q&A-4; I.R.C. § 4975(d)(1)(A). For further discussion and related materials, see Plan Loan Rules for Qualified Retirement Plans and Plan Loan Resource Kit.

Military Leaves

For military leaves by uniformed service members (as defined under USERRA), the employer and plan can suspend loan repayments during the entire military leave whether or not the leave occurs for qualified military service. Treas. Reg. § 1.72(p)-1, Q&A-9(b). The payment period can be extended for a period equal to the duration of the military leave. However, the plan must resume loan repayments on completion of the participant's military service, and provide a level amortization of the remaining balance due. 65 Fed. Reg. 46,588 (July 31, 2000).

While loan repayments can be suspended during the military leave without a deemed distribution occurring, the remaining loan repayments can:

- Resume either:
    - At the same monthly amount as before the military leave of absence, even allowing for a balloon payment, if required –or–
    - At a re-amortized amount –and–
- Be amortized over a repayment period that is extended by the duration of the military leave of absence

Treas. Reg. § 1.72(p)-1, Q&A-9(b).

Remaining payments however, must be made over a period that does not exceed the maximum repayment period under I.R.C. § 72(p)(2)(B) (i.e., the remainder is permitted to be amortized over 60 months for a non-home loan, less the period of the loan preceding the military service). Treas. Reg. § 1.72(p)-1, Q&A-9(c). Thus, the plan is permitted to ignore the service member's military duty in determining the total repayment period.

<u>Example</u>

For example, assume, on July 1, 2003, a participant with a nonforfeitable account balance of $80,000 borrows $40,000 to be repaid in level monthly installments of $825 each over five years. The loan is not a principal-residence plan loan. The participant makes nine monthly payments and commences an unpaid USERRA leave of absence that lasts for two years. After the military service ends on April 2, 2006, the participant resumes active employment on April 19, 2006, continues the monthly installments of $825 thereafter. On June 30, 2010, the participant repays the full balance remaining due ($6,487) (i.e., a balloon payment). Treas. Reg. § 1.72(p)-1, Q&A-9(d), Example 2.

Because the loan satisfies the requirements of I.R.C. § 72(p)(2) and Treas. Reg. § 1.72(p)-1, Q&A-9(b), the participant does not have a deemed distribution. Alternatively, Section 72(p)(2) would also be satisfied if the amount of each monthly installment after April 19, 2006, is increased to $930 to repay the loan by June 30, 2010 (without any balance remaining due then). Treas. Reg. § 1.72(p)-1, Q&A-9(d), Example 2. For a discussion regarding the occurrence and consequences of a deemed distribution of a plan loan, see Plan Loan Program Checklist.

Non-military Leaves, Including FMLA Leaves

For leaves other than military leaves of absence protected under USERRA that are either unpaid or for which compensation is less than the amount of the installment payments required under the terms of the loan, the employer may suspend loan repayments for up to a year. However, the loan repayment period may not be extended following the employee's return, and the returning participant must make larger loan payments so that the loan is repaid during its original term. Treas. Reg. § 1.72(p)-1, Q&A-9(a). This requires a reamortization of the loan over the remaining loan period (i.e., 60 months from the loan origination). Instead of permitting a reamortization of remaining payments, the plan can permit a balloon payment at the end of the original permissible loan period. Treas. Reg. § 1.72(p)-1, Q&A-9(d), Example 1.

Coronavirus-Related Leaves

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (Pub. L. No. 116-136) provides special relief for plan loan repayments that are scheduled between March 27 and December 31, 2020, for qualifying individuals having an outstanding loan (regardless of whether the loan is related to the outbreak). Under the law, such repayments are delayed for one year, with the loan repayment schedule adjusted accordingly. (It is unclear pending further guidance whether plans must comply with this relief.) To qualify, the individual must either (1) test positive or have a spouse or dependent who tests positive for the disease or (2) suffer adverse financial effects due to a quarantine, furlough, layoff, or hours reduction; being unable to work due to lack of child care; a period of closure or reduced hours of a business owned or operated by the individual; or due to other factors determined by the Secretary of the Treasury. Pub. L. No. 116-136, § 2202(b).

If an individual does have a deemed distribution under a plan loan that occurs during calendar year 2020 and they qualify under the same criteria for plan loan relief described in the preceding paragraph, then that deemed distribution would likely be eligible for special treatment as a coronavirus-related distribution under Section 2202(a) of the Cares Act. Coronavirus-related distributions up to $100,000 are exempt from the early-withdrawal penalty of I.R.C. § 72(t), may be included in income ratably over a three-year period or may be rolled over to an IRA or eligible retirement plan within three years after the distribution.

Terminations of PBGC-Insured Defined Benefit Plans

Most private-employer defined benefit plans are subject to the termination rules of ERISA Title IV, and pay insurance premiums to the Pension Benefit Guaranty Corporation (PBGC). That insurance provides participants in a terminated defined benefit plan with minimum guaranteed annuity payments upon the plan's termination with insufficient assets to pay plan liabilities. ERISA § 4022 (29 U.S.C. § 1322); 29 C.F.R. § 4022.3.

To qualify for the guarantee, the plan participant must satisfy the conditions for entitlement to the benefit on or before the plan's termination date. Consistent with USERRA's statutory mandate to treat such persons, upon reemployment, as if they had never left the employ of their former employer, PBGC regulations provide that, so long as a service member is reemployed within USERRA time limits (i.e., within 60 months or earlier after termination of military service), PBGC will treat the participant as having satisfied the reemployment condition as of the termination date. 74 Fed. Reg. 59,093 (De. 17, 2009). The guarantee exists even if the individual's reemployment occurs after the plan's termination date. This ensures that the pension benefits of reemployed service members, like those of other employees, will generally be guaranteed for periods up to the plan's termination date. 29 C.F.R. § 4022.11.

Bonuses, Incentive, and Equity-Based Plans

Leave of absence issues arise for plans not subject to the IRC as well, such as bonus, incentive, or equity-based plans. Examples of such plans include an annual bonus or a bonus paid over a period based on the company's and/or employee's performance, or a bonus based on meeting production goals, as well as stock options, restricted stock unit, or performance unit plans. Generally, the effect of a leave of absence on these types of plans may be determined contractually, and applicable law should be considered.

FMLA Considerations

The employer may deny or reduce a bonus where payment is based on the achievement of a specified goal such as hours worked, products sold or perfect attendance, and the employee has not met the goal due to FMLA leave. This modification is impermissible if payment is otherwise made to employees on an equivalent leave status for a reason that does not qualify as FMLA leave. For example, if an employee who used paid vacation leave for a non-FMLA purpose would receive the payment, then the employee who used paid vacation leave for an FMLA-protected purpose must also receive the payment. 29 C.F.R. § 825.215(c)(2).

USERRA Considerations

Whether an employee is entitled to a bonus during USERRA leave depends upon whether the bonus is considered a seniority- or non-seniority-based benefit. USERRA does not require employers to provide pay or any specific benefits to employees out on leave. Rather, an employee who is absent from work is entitled to the same non-seniority rights and benefits provided to other employees on leave who have similar seniority, status, and pay. For a discussion on seniority and non-seniority rights, see “Uniformed Services Rights and Reemployment Rights Act (USERRA)” in Laws Relevant to Leaves of Absence, above.

Leave of Absence Considerations for Nonqualified Deferred Compensation

Leaves Constituting Separation from Service

Section 409A permits distributions when an employee separates from service (e.g., terminates employment). I.R.C. § 409A(a)(2)(A)(i). A specific standard applies for determining when a leave of absence constitutes a separation from service under Section 409A. So long as the individual retains a right to reemployment with the employer under an applicable statute or by contract, an employee does not incur a separation from service because of:

- Military leave
- Sick leave –or–
- Other bona fide leave of absence

However, the period of such leave generally must not exceed six months unless there exists a statutory or contractual right to reemployment (i.e., under USERRA). Treas. Reg. § 1.409A-1(h)(1). If there is no statutory or contractual right to reemployment, the separation from service occurs on the day after the six-month period lapses. An exception applies for medically determinable physical or mental impairments that can be expected to result in death or to last for at least six months where the employee is unable to perform the duties of his or her position of employment or any substantially similar position, in which case 29 months is substituted for the six-month limit. Treas. Reg. § 1.409A-1(h)(1)(i).

For a general discussion on I.R.C. § 409A rules, see Section 409A Fundamentals.

Related Content

Practice Notes

- Attendance and Time-Off Management: Impact of a Complex Matrix of Laws and Benefits
- Americans with Disabilities Act: Guidance for Employers
- ACA Employer Shared Responsibility Mandate
- ACA Employer Shared Responsibility Full-Time Employee Determinations
- Health Reimbursement Account Design and Compliance
- Wellness Program Design and Compliance
- FMLA Leave: Guidance for Employers and Employees — FMLA Employer Rights and Obligations

- Uniformed Services Employment and Reemployment Act (USERRA)
- Paid Sick Leave State and Local Law Survey (Private Employers)
- COBRA Compliance and Enforcement
- FMLA Leave: Guidance for Employers and Employees — FMLA Leave: Employer Coverage, Employee Eligibility, and Qualifying Bases
- Cafeteria Plan Design and Compliance (IRC § 125)
- Section 409A Fundamentals

End of Document