

Can Employees Taking Unpaid FMLA Leave Prepay Their Medical Plan Coverage on a Pre-Tax Basis?

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QUESTION: Two of our employees will be taking unpaid FMLA leave next month. They participate in our cafeteria plan and want to prepay their share of the cost of coverage under our major medical plan on a pre-tax basis. Can we allow this?

ANSWER: Yes, if your cafeteria plan documents include that option. IRS FMLA regulations permit three payment options for employees who wish to pay their share of the premiums for group health coverage during an unpaid FMLA leave: prepay (before leave commences, the employee pays contributions that will be due during leave); pay-as-you-go (the employee pays his or her share of the cost of coverage during leave); and catch-up (the employer advances payment of the employee's share during leave, and the employee repays the employer upon return). Your cafeteria plan generally may provide one or more of these payment options, so long as the options for employees on FMLA leave are offered on terms at least as favorable as those offered to employees not on FMLA leave. Note that the prepay option cannot be the sole option offered to employees on FMLA leave, although it may be restricted to employees on FMLA leave.

Under the prepay option, your employees would be given the opportunity to pay, before starting FMLA leave, the contributions that will be due during the leave period (subject to the limitation discussed below for a leave straddling two plan years). They would voluntarily elect to reduce their final pre-leave paychecks or to otherwise make special salary reduction contributions to cover their share of the premiums for all or part of the expected duration of the leave. (Prepay contributions could also be made on an after-tax basis.) Their regular salary reduction elections for the duration of their leaves would be suspended, but their benefit elections would remain in force. During the leaves, your company would pay its share of the premium in the same manner as before. When an employee's leave ends, the employee's previous salary reduction election would resume for the rest of the plan year unless the employee makes a change in election permitted under IRS regulations (e.g., for change of status) upon return from leave.

In general, if an employee's leave straddles two plan years, only the contributions 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 that generally prohibits use of one year's contributions to fund benefits in a subsequent year. (The catch-up option could be used to pay the contributions for the second year on a pre-tax basis when the employee returns from leave.) Although there is no formal guidance on this issue, a cafeteria plan with a grace period under its premium payment component arguably could allow employees taking an FMLA leave that straddles two plan years to make pre-tax prepayments for up to 2-1/2 months of coverage during the second plan year before the leave begins.

For more information, see EBIA's Group Health Plan Mandates manual at Section XVII.D ("Paying for Coverage During FMLA Leave") and EBIA's Cafeteria Plans manual at Section XIV.O.3 ("How to Handle Cafeteria Plan Elections During FMLA Leave (Regulated by the IRS)").

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