

# LEGAL ALERT

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## HOW EMPLOYEE FURLONGHS CAN IMPACT YOUR EMPLOYEE BENEFIT PLANS

By George F. Bearup, Attorney

A recent trend in these tough economic times is to reduce hours or to provide unpaid leave for employees to address an employer's budget deficits. These decreased hours, commonly called mandatory and involuntary furloughs, are used to cut costs. **However, when an employer considers implementing a furlough, caution needs to be exercised due to the impact on employee benefit plans.**

### 401(k) Plans

Many 401(k) plans require that an employee becomes eligible to participate in the plan after a specified number of hours of work. 401(k) plans can require that the employee work for one year before becoming eligible to participate in the plan. The Tax Code permits an employer to define that one year as 1,000 hours of service. However, many 401(k) plans permit immediate participation. The 1,000 hour threshold is easy to meet for full-time workers, but it can significantly affect part-time workers or those on furlough. If an employee misses the 1,000 hour requirement, he or she may never be able to participate in the 401(k) plan or may have to wait until the next eligibility period to begin to participate. But 401(k) plans can be amended to provide that a furlough period is considered a period of active employment which can mitigate the effect of a furlough.

Along the same lines, many 401(k) plans often use employer matches to the employee's own contribution. However, if the employee does not earn compensation from work, he or she cannot

have a salary deferral election and, consequently, there will be no employer match.

Another trap for employers who implement furloughs is the non-discrimination rules with regard to 401(k) contributions. These non-discrimination rules prohibit highly compensated employees from deferring too great a percentage of their salary compared with non-highly compensated employees. In a furlough situation, highly compensated employees might be the only employees who are able to maintain or increase their contributions to the 401(k) plan. At the same time non-highly compensated employees who are furlough may have to reduce their salary contribution to the 401(k) plan in light of their loss of wages or salary. As a result, the discrimination percentages might shift, which cause the employer to fail the IRS' discrimination testing.

### Loans

Many 401(k) plans permit their participants to borrow from their own retirement account. Those loans must be repaid according to strict IRS rules. Most loans are usually repaid through salary reduction arrangements.

However, if there is no salary from which to make the repayment, the employee will have to write a check or face a default in the payment of that loan. If the employee still works and receives a salary, but works fewer hours due to the furlough, the employee will still have to repay the same loan. If the employee misses a payment for one calendar

quarter and does not make up the payment by the end of the next calendar quarter, the loan will be deemed distributed to the employee under IRS' rules. If that occurs the entire amount of the loan, plus the 10 percent penalty for early withdrawals, will be taxable to the employee.

### **COBRA Subsidies**

IRS Notice 2009-27 provides that a involuntary reduction to zero hours, through a lay-off or furlough, or other suspension of employment that results in a loss of health coverage, will be treated as an *involuntary termination* for purposes of the COBRA premium subsidy Congress recently added to the law. If reduced hours or unpaid leave result in the employee moving from being covered by the employer's health plan to not being covered, it could be considered an involuntary termination if the employee is forced to quit in response to the reduction in hours worked.

The reduction in hours without any employment termination will act as a qualifying event which triggers COBRA health insurance continuation rights, but will *not* make the individual eligible to receive the COBRA premium subsidy of 65 percent. Accordingly, a reduction in hours may cause an employee to lose plan coverage; or the employee may be eligible to pay for COBRA benefits, but not for the COBRA premium subsidy.

### **Fringe Benefits**

Many employers sponsor flexible spending accounts (FSAs) to enable their employees to pay expenses using pre-tax dollars. A furlough can affect a FSA plan for expenses such as dependent daycare or commuter benefits, both of which can be paid from a FSA.

For daycare expenses, employees may make their own election with the assumption that they will work a certain number of hours each year. When their hours are reduced by furlough they need less daycare. An employee may want to adjust the amount that he or she contributes to their FSA toward dependent care, but the ability to do so may depend on whether the employee qualifies as having a *change in status*. Taking an unpaid furlough

could constitute a change in status which triggers the right to change the election under the FSA. However, many FSA's are not designed to include unpaid leave of absence as a *change in status*. If an employee is merely on furlough with a reduction in hours worked, this might not constitute an *unpaid leave of absence* and may not enable the employee to make a change to his or her FSA election.

The IRS has informally noted that if an individual does not work for over 30 consecutive days, a FSA can treat the individual as a new employee and the individual may lose any money that is left in his or her existing FSA. For shorter absences, a FSA can reinstate the individual to a prior election, who will lose only the FSA coverage for that period of absence, assuming no COBRA election is made.

### **Health Plans**

Most health plan eligibility criteria are set forth in the contract between the insurer and the employer. It is possible the insurer will not cover individuals who are not part of an eligibility group that are described in the contract. If the furloughed employees would otherwise be ineligible, and the employer wants to make them eligible to participate in the health plan, the contract between the insurer and the employer will need to be modified, if possible.

### **Conclusion**

With an economy in turmoil, employers are now willing to explore radical options to reduce their costs. While voluntary or mandatory furloughs are one option that many employers now consider, they need to be cognizant of the impact of employee furloughs on existing employee benefit plans, and amend their plans when warranted.

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## THE TIME TO UPDATE YOUR FAMILY AND MEDICAL LEAVE ACT POLICY IS NOW (IF NOT SOONER)

By Robert C. Stone, Attorney

With so much focus in the employment arena on health care reform and the proposed Employee Free Choice Act, it is not surprising that recent changes to the Family and Medical Leave Act have gone relatively unnoticed. Nevertheless, new FMLA regulations were published by the Department of Labor on November 17, 2008, and became effective on January 16, 2009.

While some of the changes in the new regulations merely reflect “fine-tuning” of the existing statute, others significantly change the process and paperwork required for handling FMLA requests. Still others address 2008 changes in the law which added new categories of FMLA leave. **The bottom line is that employers need to review their FMLA policies and procedures to bring them in line with the new FMLA requirements.**

As part of the National Defense Authorization Act of 2008 (NDAA), amendments to the FMLA added two new types of FMLA leave. Both new leave types involve military personnel and can be described generally as follows:

“Military Caregiver Leave” – The 2008 amendment permits a “spouse, son, daughter, parent or next of kin” to take up to 26 weeks in 12 months to care for a “covered service member” (current military only). The “next of kin” is the nearest blood relative. Leave is available only when the service member suffers “serious injury or illness” while on active duty. The term “serious injury or illness” is broader than current FMLA definition of “serious health condition”. New forms are required for this type of leave.

“Qualifying Exigency Leave” – The 2008 amendment also added “qualifying

exigency leave” to the FMLA. Eligible employees can take up to 12 weeks (same period as for FMLA) for a “qualifying exigency” that arises when a spouse, parent or child is on or has been called to active duty. It only applies to call up of retired, reserve, National Guard, etc. It does not apply to families of regular armed forces. Examples of a “qualifying exigency leave” are short-notice deployment, military events, childcare and school activities, financial and legal arrangements, counseling, rest and recuperation, post-deployment activities and “other events”. New forms are also required for this type of leave.

In addition to these new FMLA leave categories, there are also a number of changes to the existing FMLA leave requirements that require other changes to the policies and procedures employers use to deal with FMLA leave requests. Some of those changes are as follows:

- Time spent on military leave should be counted as work for 12 month/1250 hour requirements.
- If the employee is eligible for FMLA because of being unable to work for “over three days” with “continuing treatment”, the first treatment must be within 7 days and the second within 30 days of the condition. “Treatment” means an “in person” visit to the provider.
- Intermittent Leave – The minimum increment of leave must be no greater than the shortest time for other leave, but not greater than one hour.

- There is a new procedure with (1) an initial employer's response to the request for leave, followed by (2) an employer's determination of leave eligibility after medical information has been received. The employer's time for responses has been extended to five days.
- There is now more flexibility for employers to contact the employee's health care provider directly for "authentication and clarification". Contact can be made by HR or a health provider, but not by the employee's direct supervisor. There still are, however, restrictions on the process that must be followed.

- If a significant number of employees speak a language other than English, the employer must provide a translation of the materials.

Because of the numerous changes to coverage and procedures required by the new FMLA regulations, the Department of Labor has published new postings and forms for use by employers. In addition, new handbook language is required to address the changes created by the new regulations. The effective date of these new requirements was January 16, 2009, so attention to these requirements is imperative for all covered employers who have not already made the needed changes.

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