Client Alert

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Ramifications of the Overturning of DOMA on Employee Benefit Plans

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On June 26, 2013, the United States Supreme Court overturned Section 3 of the Defense of Marriage Act ("DOMA"), which required the federal government to deny married same-sex couples the rights and benefits provided to married heterosexual couples. DOMA also provided states with the authority to refuse to recognize the marriages of same-sex couples from other states. In *United States v. Windsor*, the Supreme Court held that the federal government must recognize same-sex marriages performed by states (and perhaps foreign jurisdictions). Thirteen U.S. states, four Native American tribal nations, and fourteen foreign countries[1] currently allow same-sex marriages. The remaining U.S. states are divided between those with laws prohibiting the recognition of same-sex marriages, and those which may recognize same-sex marriages performed in other states.

However, the ruling does not appear to require states to recognize a valid marriage of a same-sex couple performed in another state. Nor is it clear what the effective date of the tax effects are, to what extent this ruling is retroactive, or which, if any, of the federal rights relating to marriage will be provided to same-sex married couples who live in states that do not perform or recognize same-sex marriages. It is also not clearly resolved in which cases a benefit plan is required, versus being allowed, to recognize same-sex marriages. The IRS or Department of Labor may issue regulatory guidance to clarify these issues. In addition, the *Windsor* case did not speak to domestic partnerships or civil unions, but the federal Office of Personnel Management takes the position that generally the change is applicable for same-sex married couples, but not for those in domestic partnerships or civil unions.

This article discusses some of the updates in the arena of employee benefits under the Employee Retirement Income Security Act ("ERISA"), the Internal Revenue Code ("IRC"), and state law, ensuing from overturning Section 3 of DOMA.

BACKGROUND OF FEDERAL TREATMENT OF SAME-SEX SPOUSES AND DOMESTIC PARTNERS UNDER DOMA

Most employee benefit programs maintained by non-governmental employers are governed by ERISA. ERISA broadly preempts,[2] or supersedes, state attempts to regulate the operation of employee benefit plans, but does not require employers to offer any particular benefits.

Previously, many states had passed laws providing that same-sex couples may marry or register as domestic partners, granting them the same rights and responsibilities as opposite-sex couples, including access to family

[1] Argentina, Belgium, Brazil, Canada, Denmark, France, Iceland, Netherlands, Norway, Portugal, Spain, South Africa, Sweden, and parts of Mexico.

[2] ERISA preempts state laws and regulations that "relate to" employee benefit plans, with the exception of those that regulate the business of insurance, banking, or securities. ERISA § 514. As a result, ERISA supersedes state laws and regulations whether or not they actually conflict with its provisions.

court for dissolution of relationship, inheritance rights, and child and spousal support obligations. The IRS, however, had not been permitted to recognize these relationships due to DOMA. Adopted in 1996, DOMA provided that, for purposes of interpreting and applying federal law, the term "marriage" meant a "legal union between one man and one woman as husband and wife," and the term "spouse" referred only to "a person of the opposite sex who is a husband or a wife." In addition, DOMA provided that no state is required to give effect to a marriage or marriage-equivalent between same-sex couples that is recognized under the laws of another state. However, DOMA did not generally preclude states or employers from recognizing or providing benefits and protections to same-sex spouses, as long as those benefits did not include favored federal tax status.

Complications arose because pursuant to DOMA, the IRC prohibited employers from providing tax-favored employee benefits to a non-dependent same-sex spouse and to the extent that they were offered, required employers to value those benefits and report them as additional income to the employee spouse for federal income tax purposes. Benefits provided to same-sex spouses were also subject to tax withholding and FICA and FUTA on such imputed income. However, the tax benefits associated with some employee benefits were, and continue to be, available to domestic partners and same-sex spouses who satisfy the definition of "dependent" set forth in Section 152 of the Internal Revenue Code.[3]

We recommend that employers in all states be aware of how their employee benefit plans are written and administered to ensure that their plan terms are being followed and that their plans remain qualified under the Internal Revenue Code and in compliance with ERISA and other applicable law.

ISSUES FOR RETIREMENT PLANS

ERISA generally requires benefit plan fiduciaries to administer their plans in strict accordance with their terms. Thus, if a benefit plan excludes same-sex spouses, but same-sex spouses are recognized in the operation of the plan as required by *Windsor*, the plan's fiduciaries could be regarded as failing to follow the terms of the plan, thereby potentially breaching their fiduciary duties. If, on the other hand, a benefit plan excludes same-sex spouses, and is administered in accordance with those terms, it would be in conflict with *Windsor*, and as a result the tax-qualified status of the plan under the IRC could be jeopardized.

Spousal Annuity Benefits and Death Benefits

Spouses have special beneficiary, distribution, consent and tax rights under qualified retirement plans that other beneficiaries do not have. Previously these rights did not apply to same-sex spouses. For example, the IRC and ERISA require defined benefit pension plans to provide a pre-retirement survivor annuity in cases where a married participant dies before his or her spouse. This requirement will now apply to same-sex spouses. Also, the default marital pension benefit (a qualified joint and survivor annuity, or "QJSA") required to be provided in defined benefit plans will now apply to a participant with a same-sex spouse. Same-sex spouses will now be treated as spouses for all purposes under qualified retirement plans. We advise reviewing plan documents for conformity to the law. The plan's definition of spouse (if defined in the plan) may need to be updated to comply with the Court's ruling. For employers with employees in multiple states, some permitting same-sex marriage and some not, one issue to consider is whether such employers wish to define "spouse" as (i) "wife or husband under applicable state law of employee's residence" or (ii) "wife or husband as defined in any jurisdiction." The first of these two definitions limits same-sex spouses to those married and residing in any of the states that do, in fact, recognize

[3] *See, e.g.*, IRS Letter Ruling 200339001.

same-sex marriage, while the second definition covers same-sex spouses married in in any state or foreign country which performs such marriages, even if residing in one of the states that precludes recognition of same-sex marriages from other jurisdictions.

Beneficiary Designations

In any retirement plan that offers the spousal annuity form of distribution, the participant's spouse must consent if the participant selects a form of distribution other than the spousal annuity form. In 401(k) and 403(b) plans not offering annuity forms of distribution, a spouse is automatically the participant's beneficiary unless the spouse consents to waiver of beneficiary status. Importantly, under DOMA, the IRC did not require that a same-sex spouse be the beneficiary or consent to the participant's election of an optional form of benefit. This consent is now required. We recommend that plan sponsors provide notice to all plan participants that spousal consent is now required from same-sex spouses in order to designate other beneficiaries and elect non-spousal forms of annuities, and that if such consent is not obtained, such designations and elections shall be invalid.

Required Minimum Distributions

Qualified retirement plans must consider a same-sex spouse to be a "spouse" under the required minimum distribution rules; the IRS requires that different mortality tables must be used for married participants versus single participants. This now applies to participants with same-sex spouses.

Rollovers

Same-sex spouses are now included in the rollover rules which permit spousal beneficiaries to roll over eligible rollover distributions to their own IRA.

Hardship Distributions and Loans

To the extent that a plan required spousal consent to obtain participant loans, spousal consent now must be obtained from same-sex spouses. Hardship distributions may be made to cover expenses for same-sex spouses even if the spouse is not a dependent.

Divisions of Retirement Assets in Connection with Divorce

Judges may now grant domestic relations orders dividing the assets of a same-sex couple pursuant to a divorce, including assets held under a retirement plan benefit held by an employee.

ISSUES FOR HEALTH AND WELFARE PLANS

Health and Welfare Benefit Coverage of Same-Sex Spouses

Health and welfare plans governed by ERISA, such as medical, dental, and vision benefit plans, may cover domestic partners and same-sex spouses. In states which recognize same-sex marriages, same-sex spouses often must be covered by benefit plans to the same extent that opposite-sex spouses are. Insured plans generally already reflect applicable state law regarding coverage of same sex spouses and domestic partners. Otherwise, it does not appear that plans must cover same-sex spouses. Employers of self-funded plans should clarify their coverage intentions and confirm that the plan definitions of eligible individuals correspond with their administrative practices.

Open Enrollment (HIPAA)

The portability provisions of HIPAA (The Health Insurance Portability and Accountability Act) provide special health plan enrollment rights to "spouses" and "dependents." These rights allow the enrollment of eligible individuals outside a health plan's annual open enrollment period. DOMA effectively limited these rights where the individual at issue is a same-sex spouse.

A "change in status" event, that would allow mid-year election changes under a cafeteria plan, now includes a change in family status involving a same-sex spouse, or a change in a same-sex spouse's coverage and employment. We advise employers to immediately notify participants that employees may enroll same-sex spouses and their children in the employer's plan within the time frame allowed for other change in status events (typically 30 days for most plans), to the extent not previously allowed.

Cafeteria and Reimbursement Plans

Cafeteria plans (also known as Section 125 flexible benefit plans) are primarily governed by federal law. Reimbursements under healthcare flexible spending accounts for non-dependent same-sex spouses were not permitted under DOMA; nor could pre-tax payments for insurance premiums be made for non-dependent same-sex spouses. Now, however, eligible medical expenses incurred by a same-sex spouse will be reimbursable under a health flexible spending account plan, and same-sex spouses will be treated as spouses with regard to the earned income limits for the dependent care spending account limits. Similarly, same-sex spouses will be spouses for health savings account and health reimbursement arrangement purposes.

Cafeteria plan and medical expense reimbursement plan documents or summary plan descriptions should be reviewed to determine whether amendments are necessary to reflect these changes.

COBRA

COBRA requires group health plans that cover 20 or more employees to make healthcare continuation coverage available to employees, their spouses, and dependent children in various specified circumstances when it would otherwise end. Internal Revenue Code § 4980B; ERISA §§ 601-609. COBRA provides that "spouses" of covered employees are eligible to continue their health care following a qualifying event. Under DOMA, employers were able to offer COBRA-like continuation benefits to same-sex spouses, but were not required to. Now, continuation coverage required under COBRA must be extended to same-sex spouses to the same extent as opposite-sex spouses.

FICA/FUTA

It is not clear, but it may be possible for employers to file for refunds of the employer share of FICA taxes paid in the last three years on imputed federal income for health and welfare coverage of same-sex spouses. Employers may also be able to file on behalf of their employees for refunds of the employee share of FICA taxes paid in the last three years, if the employer obtains a signed statement from the employee promising not to separately pursue a FICA refund. At this point we advise employers to wait for IRS guidance on how any such refunds should be claimed.

Voluntary Employee Beneficiary Associations

Voluntary employee beneficiary associations ("VEBAs") can now provide more than a *de minimus* amount of their benefits to same-sex spouses without risking the loss of tax-exempt status.

OTHER ISSUES

FMLA

The FMLA now will provide entitlement to take leave to care for a same-sex spouse to the same extent as an opposite-sex spouse.

Medicare Secondary Payor Rules

Same-sex spouses will now be treated as spouses, such that plans covering spouses of active employees will be considered primary for Medicare purposes.

Prohibited Transaction Rules

Spouses are treated as "family members" in determining whether a person is a disqualified person for purposes of prohibited transaction rules. Same-sex spouses are now disqualified persons to the same extent that opposite-sex spouses are.

Ownership Attribution Rules

The same-sex spouse of a 5% owner of employer stock is now considered to be a 5% owner by attribution, including for purposes of identifying highly compensated employees and for top hat purposes.

ACTION ITEMS

Several action items that employers may want to address immediately include the following:

- Begin reimbursing medical care expenses for same-sex spouses of participants.
- Notify employees of the window (typically 30 days) under the cafeteria plan for family status changes and special enrollment rights for same-sex spouses and their dependents.
- Notify employees of impact on spousal income limits for dependent care reimbursement accounts.
- Stop imputing income on a federal basis for health plan benefits and premium payments for same-sex spouses (this may require differentiating spouses versus domestic partners and civil unions).
- Review definitional and choice-of-law provisions of benefit plans concerning the definition of "spouse."
- Start obtaining spousal consent from same-sex spouses for any defined benefit plan retirement distributions.
- Advise employees married to same-sex spouses to review their death beneficiary designations; if proper spousal consent has not been obtained, their designations will be void.
- Send the required general COBRA notice to same-sex spouses who have not previously received it.

- If opposite-sex spouses may self-report marital status, same-sex spouses should be allowed to self-report as well without verification.
- Dependent audits of health and welfare audits should be updated to reflect marital status under *Windsor*.

It is currently unclear whether, for purposes of the IRC, an employee who marries a same-sex partner in a state where it is allowed, but resides in a state where same-sex marriage is not recognized, is required to be treated as married under applicable benefit plans.

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