

Supreme Court Ruling on Same-Sex Marriage: Impact on Employee Benefits

The United States Supreme Court's landmark decision on June 26, 2013 in *United States v. Windsor* that struck down Section 3 of the Defense of Marriage Act (DOMA) as unconstitutional has far reaching implications for employee benefit plans.¹ Section 3 of DOMA provided that only persons of the opposite sex could be recognized as "spouses" for purposes of federal law and that a "marriage" could only be between opposite-sex partners. Many aspects of employee benefit plans are governed by federal laws (e.g., the Internal Revenue Code and the Employee Retirement Income Security Act of 1974, as amended (ERISA)) and there are often special rules specific to "spouses" and different rules for married and single individuals. As such, Section 3 of DOMA prevented same-sex spouses from being recognized as "spouses" for benefit plan purposes and from being afforded many of the same rights and protections as opposite-sex spouses.

However, now that Section 3 of DOMA has been deemed unconstitutional, employee benefit plan sponsors will want to revisit their benefit plans and practices, as the Supreme Court's decision has immediate implications for retirement benefits, health and welfare benefits, fringe benefits and payroll practices. We highlight for you in this Alert some of the most notable implications for employee benefit plans and discuss some of the more pressing questions that the Supreme Court's decision has left open.

Impact on Employer-Sponsored Health Plans

Employers and plan sponsors must consider a number of implications that the Supreme Court's decision will have with respect to employer-provided health care benefits. As a starting point, these include:

- *Cessation of Imputation of Tax for the Value of Employer-Paid Health Coverage for Same-Sex Spouses.* Health benefits provided through employment generally enable employers to provide such benefits to employees and their "spouses" and tax dependents on a tax-free basis. This means that generally neither the benefits nor the cost of an employer contribution toward the provision of such benefits is deemed taxable to the employee. However, if group health plan coverage is extended to an individual other than a "spouse" or tax dependent, the employee must be taxed on the value of the employer-provided coverage for that individual. With the Supreme Court's decision, federally-recognized same-sex spouses are now able to be considered "spouses" for this purpose and employers will no longer have to impute income to an employee whose federally-recognized same-sex spouse receives health care benefits under an employer group health plan (e.g., medical, dental, vision and prescription drug plans).² Employers who were providing a "gross-up" to ease the impact of this imputed income on employees will be able to stop that practice as well.

¹ The Supreme Court's decision is expected to be formally binding as of July 22, 2013 when a final judgment is expected to be entered. This follows from a technical Supreme Court rule that allows for a 25-day waiting period after an opinion is issued to allow the losing party to file for a rehearing. However, some employers may choose to begin to implement the Supreme Court's decision sooner given that the likelihood of the Court rehearing such a case is remote.

² A child of an employee's federally-recognized same-sex spouse should also now qualify as the employee's stepchild which would in many instances enable the child to be considered the employee's tax dependent, and therefore health coverage for that child could be provided on a tax-free basis.

- *Pre-Tax Payment of Premiums for Same-Sex Spouse's Coverage.* As another tax advantage to health care coverage provided through the employment relationship, employees can pay their share of the cost of health coverage for themselves and their "spouses" and tax dependents on a pre-tax basis through a Section 125 "cafeteria" plan. Now, for employers with a Section 125 plan, employees will be able to pay for their federally-recognized same-sex spouse's health care benefits under an employer group health plan on a pre-tax basis.
- *Availability of COBRA Group Health Plan Continuation Coverage.*³ Under Section 3 of DOMA, employers were not previously necessarily required to provide an independent federal COBRA continuation coverage to an employee's same-sex spouse when that spouse lost coverage under the employer's group health plan. Now, federally-recognized same-sex spouses who lose their group health plan coverage may be considered "qualified beneficiaries" individually eligible for continuation coverage in the event of a COBRA qualifying event.
- *Availability of Reimbursement from Flexible Spending Accounts.* The rules under the federal tax code that enable tax-free reimbursements for qualifying expenses from flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs) or health savings accounts (HSAs) generally limit employees to obtaining reimbursement for expenses for themselves and their "spouses" or tax dependents. Now, employees should be able to obtain tax-free reimbursement under an employer's FSA, HRA or HSA for their federally recognized same-sex spouses' qualified medical expenses in the same manner as employees with opposite-sex spouses.⁴
- *Availability of HIPAA Special Enrollment Rights.* HIPAA is a federal law that provides, among other things, for special enrollment rights in an employer's group health plan when an employee's marital status changes or when an employee's "spouse" loses eligibility for coverage under another employer's health plan (as opposed to having to wait until an annual open enrollment period to make any changes to enrollment status). Now, HIPAA special enrollment rules should apply when an employee's marital status involving a federally-recognized same-sex spouse changes and when an employee's federally-recognized same-sex spouse loses eligibility for coverage under another employer's health plan.
- *Availability of Election Changes to Cafeteria Plans.* Generally, an employee can only change his or her election to pay for certain employee benefits on a pre-tax basis mid-year when a specific "change in status" event occurs (again, as opposed to having to wait until an annual open enrollment period to make any changes to enrollment status on a prospective basis). A change in status of this sort includes, but is not limited to, a change in marital status or when an employee's "spouse" loses eligibility for coverage under another employer's health plan. Now, a change in status event should include a change in marital status involving a federally-recognized same-sex spouse and when a federally-recognized same-sex spouse loses eligibility for coverage under another employer's health plan.
- *Applicability of the Family & Medical Leave Act (FMLA).* The FMLA is a federal law that entitles eligible employees of covered employers to take unpaid, job-protected leave for up to twelve workweeks in a twelve month period for specified family and medical reasons and to maintain their group health insurance coverage during the leave. One such reason is to care for the employee's "spouse". Now, an employee should be entitled to take FMLA leave in order to care for a federally-recognized same-sex spouse (assuming all other requirements of an FMLA leave are met).

³ COBRA applies to employers with at least 20 employees in the preceding calendar year determined on a controlled group basis.

⁴ As an additional note regarding HSAs, "spouses" are generally required to divide the legally set maximum contribution amount that applies if either spouse has family coverage under a high deductible health plan between them. As a result of the Supreme Court's decision, it appears that federally-recognized same-sex spouses must also adhere to the joint limit, while domestic partners, civil union partners and non-federally-recognized same-sex spouses may *each* be able to contribute the maximum limit.

Impact on Employer-Sponsored Qualified Retirement Plans

The Supreme Court's decision will also impact qualified retirement plans (e.g., 401(k) plans, profit-sharing plans, money purchase plans, defined benefit plans (including cash balance plans), ESOPs and stock bonus plans) and 403(b) plans to require equal treatment of federally-recognized same-sex spouses. As a starting point, the aspects of retirement plans that will be affected include:

- *Qualified Joint and Survivor Annuities (QJSAs)*. For married participants in defined benefit plans and some defined contributions plans, benefits paid from the plan must be paid in the form of a QJSA whereby the employee receives periodic annuity payments while alive and the surviving "spouse" receives a percentage of those payments after the employee's death, unless the spouse affirmatively waives the right to the QJSA in writing. Now, federally-recognized same-sex spouses will be protected by the requirement that a QJSA be the default form of benefit, and an employee will have to obtain his or her same-sex spouse's consent in order to be able to elect an alternate form of benefit.
- *Qualified Pre-Retirement Survivor Annuities (QPSAs)*. A defined benefit plan and some defined contribution plans are generally required to provide a survivor annuity to a participant's "spouse" if the participant dies before benefits under the plan commence to the employee. Unless that form of death benefit has been waived with spousal consent, it must be provided. Both defined benefit plans and defined contribution plans (even those not subject to the QPSA requirement) provide that spousal consent is required to name a non-spousal beneficiary (for at least 50% or more of the death benefit). Federally-recognized same-sex spouses should now be afforded the same death benefit protections as opposite-sex spouses.
- *Eligible Rollovers Distributions*. Only a "spouse" of a deceased participant can rollover the participant's benefits to the spouse's own IRA or to another qualified plan; a non-spouse beneficiary can only rollover a participant's benefits to an inherited IRA. Now, a federally-recognized same-sex spouse should be treated as any other spouse and be permitted to rollover to an IRA or to another qualified plan.
- *Hardship Distributions*. Many defined contribution plans permit hardship distributions in order to pay for a "spouse's" medical, tuition or funeral expenses. Prior to the Supreme Court's decision, where the reason for a hardship distribution was to pay for a same-sex spouse's expenses the distribution was only available if the employee, subject to plan rules, specifically designed that same-sex spouse as the employee's designated beneficiary. Now, hardship distributions should be able to be taken because of expenses related to a federally-recognized same-sex spouse in the same way that they can be taken for expenses related to an opposite-sex spouse.
- *Qualified Domestic Relations Orders (QDROs)*. QDROs enable divorcing "spouses" to require a qualified retirement plan to "split" the employee's benefits in a manner provided under a domestic relations order. Now, federally-recognized same-sex spouses should be able to make use of the QDRO process upon their divorce in the same manner as opposite-sex spouses.
- *Minimum Required Distributions*. Prior to the Supreme Court's decision, benefit payments to a same-sex spouse as a beneficiary had to start within one year following a participant's death or be paid in full within five years following the participant's death. Now, like opposite-sex spouses, a plan can permit a federally-recognized same-sex spouse of a deceased participant to take advantage of the more favorable rule that allows the spouse to wait until the date that the participant would have turned age 70½ before taking a distribution.

Fundamental Unanswered Questions

The Supreme Court's decision left many unanswered questions, answers to which will be fundamental in enabling employers and plan sponsors to effectively apply the decision. These questions include, among many others:

1. *What state law controls in determining whether a same-sex spouse can be recognized? Is it the state of the employee's residency or another standard (such as the state of marriage or a plan-defined governing state law)?* If it is to be the state of residency, then employers and plan sponsors would need to monitor employees' states of residency carefully and potentially change the treatment of an employee's same-sex spouse if residency changes. For employers and employees alike, this result could be challenging.
2. *Does the Supreme Court's decision have any retroactive application?* It remains unclear whether employees and their federally-recognized same-sex spouses could legitimately make claims for past benefits. Along the same lines, it remains to be seen whether employers and plan sponsors can or will need to revisit past imputation of income for same-sex spouse's health coverage, and whether they (and perhaps employees) will be able to receive refunds of overpaid employment taxes.

On these and many other open questions, guidance from the IRS and other governmental offices is necessary and expected.

Next Steps for Employers and Plan Sponsors

The full impact of the Supreme Court's landmark decision is vast and beyond the scope of this Alert. We hope that in the coming weeks and months helpful guidance from the government will emerge that addresses many of the unanswered questions and practicalities so as to enable employers and plan sponsors to implement the Supreme Court's decision in an administratively feasible and fair manner. In light of the available alternatives, in the meantime, we suggest that employers and plan sponsors take the following actions as soon as practicable:

- Determine which, if any, employees are impacted by the Supreme Court's decision. This will involve distinguishing which employees in same-sex relationships are in fact married (e.g., the Supreme Court's decision would seem to only impact same-sex *marriages*, not domestic partnerships or civil unions⁵). *Note: Employers who make it a practice to require proof of marriage from those with same-sex spouses for employee benefits and other human resources purposes should also require proof of marriage from all employees in the same fashion.*
- For employees who live and work in any of the 13 states⁶ or the District of Columbia where same-sex marriages can occur, employers should cease imputing income to those employees with same-sex spouses for the value of employer-provided health coverage. If an employer has been providing gross-up payments to help employees with the tax-burden caused by the prior necessity to impute income for same-sex spouses' benefits, those gross-up payments could be stopped for affected employees in these jurisdictions as well. If retirement plan contributions have been calculated based on total taxable income, including imputed income, these also should be revisited.

⁵ While it is anticipated that civil unions and domestic partnerships would not be treated as marriages for these purposes, under the *Windsor* decision it is possible that the IRS could take a broad interpretive view and provide that if a governing state law treats civil unions and/or certain domestic partnerships, as applicable, like marriages for state law purposes, then such formalized relationships could also be treated as marriages for purposes of federal tax law.

⁶ The states that currently permit same-sex marriage are: California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota (eff. August 1, 2013), New Hampshire, New York, Rhode Island (eff. August 1, 2013), Vermont and Washington.

- For employees who live and work in any of the 13 states or the District of Columbia where same-sex marriages can occur, employers who allow employees to pay for their share of the cost of group health coverage for opposite-sex spouses on a pre-tax basis should also allow employees to pay for their share of the cost of group health coverage for same-sex spouses on a pre-tax basis, subject to the terms and conditions of the prior election form that the employees completed to enroll their same-sex spouse in the group health plan. Notably, we are hoping that the IRS will provide guidance that formally recognizes the Supreme Court's decision as a "change in status event" to enable employees to change their cafeteria plan elections in order to begin to pay for their same-sex spouse's coverage on a pre-tax basis (or newly enroll their same sex spouses). Some employee election forms could, however, enable employers to process the change from after-tax contributions to pre-tax contributions without the need to address whether a formal change in status event has occurred.
- Examine employee benefit plan documents, payroll systems and practices to determine whether amendments are needed to address the meaning of a "spouse" or "marriage". Given the many unanswered questions regarding what state law applies to determine these definitions, employers and plan sponsors may want to wait to make any formal plan changes.
- Remember that domestic partnerships and civil unions are likely not able to be treated the same as marriages for purposes of federal law, and so same-sex partners of employees in these relationships will still not be able to be treated as "spouses" for purposes of most of the employee benefit topics listed above.⁷

Please contact any of the attorneys listed below if you would like assistance with interpreting and applying the Supreme Court's decision.

⁷ Again, it is possible (but unlikely) that the IRS could take a broad interpretive view of the Supreme Court's decision and provide that if a governing state law treats civil unions and/or certain domestic partnerships, as applicable, like marriages for state law purposes, then such formalized relationships could also be treated as marriages for purposes of federal tax law.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

<u>David M. Glaser</u>	212.336.2624	<u>dmglaser@pbwt.com</u>
<u>Bernard F. O'Hare</u>	212.336.2613	<u>bfohare@pbwt.com</u>
<u>Bruce L. Wolff</u>	212.336.2959	<u>blwolff@pbwt.com</u>
<u>Jessica S. Carter</u>	212.336.2885	<u>jcarter@pbwt.com</u>
<u>Meridith Bogart Krell</u>	212.336.2361	<u>mkrell@pbwt.com</u>

IRS Circular 230 disclosure: Any tax advice contained in this communication (including any attachments or enclosures) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed in this communication. (The foregoing disclaimer has been affixed pursuant to U.S. Treasury regulations governing tax practitioners.)

To subscribe to any of our publications, call us at 212.336.2186, email info@pbwt.com, or sign up on our website, www.pbwt.com/resources/publications.

This publication may constitute attorney advertising in some jurisdictions.

© 2013 Patterson Belknap Webb & Tyler LLP