HUNTON& WILLIAMS

Client Alert

July 2013

IMPACT ON EMPLOYEE BENEFIT PLANS OF THE SUPREME COURT'S DEFENSE OF MARRIAGE ACT RULING

In a landmark ruling, *United States v. Windsor*, the Supreme Court struck down a major provision of the Defense of Marriage Act ("DOMA"). Since its enactment in 1996, DOMA provided definitions for the terms "marriage" and "spouse[1]" that, by their terms, excluded same-sex marriages. These definitions were applicable to all federal statutes, regulations, rulings and orders, including the Internal Revenue Code (the "Code") and the Employee Retirement Income Security Act ("ERISA"), as well as all other federal statutes that regulate employee benefit plans.

Since the enactment of DOMA, several states adopted laws permitting marriage between same-sex couples. The Supreme Court ruled in *Windsor* that the exclusion of married same-sex couples in the definitions of marriage and spouse set forth in DOMA violates the equal protection rights of such couples under the U.S. Constitution. The Supreme Court's decision means that, for purposes of all federal laws, legally married same-sex couples, as determined by applicable state law, must be recognized when the terms "married" and "spouse" are used. This decision returns federal law to its prior practice of recognizing marriages based on whether a marriage is valid under applicable state law. Accordingly, employee benefit plan sponsors and administrators should review their plan documents and procedures to determine whether changes need to be made to reflect this comprehensive change in federal law.

Background

The two substantive provisions of DOMA are Section 2, which permits states to decide whether to recognize marriages of same-sex couples from other jurisdictions, and Section 3, which provides the definitions of "marriage" and "spouse" that exclude same-sex couples.

Section 3 of DOMA was held unconstitutional by several lower courts and two federal Courts of Appeal. On June 26, 2013, the Supreme Court issued its ruling on DOMA, holding that Section 3 of "DOMA is unconstitutional as a deprivation of liberty" protected by the Fifth Amendment to the U.S. Constitution.

The Supreme Court's ruling does not address Section 2 of DOMA and does not address the issue of whether states must permit same-sex couples to marry or require states to recognize the marriages of such couples legally married in another state.[2]

---

[1] "[T]he word 'marriage' means only a union between one man and one woman as a husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."

[2] On procedural grounds, the Supreme Court dismissed an appeal of a federal district court's ruling that the California constitutional amendment that limited marriage to opposite-sex couples unconstitutionally violates the equal protect and due process rights of same-sex couples. As a result of the Supreme Court's ruling, the State of California began issuing marriage licenses to same-sex couples on June 28, 2013. Because the Court did not address the merits of the constitutional challenge, the lower court's ruling only applies to the State of California.

Other questions remain unanswered pending further guidance from the federal government's regulatory agencies. For example, which state's laws are applicable when the federal government seeks to determine whether a marriage is to be recognized, *i.e.*, the state where the couple was married ("the State of Celebration") or the state where the couple resides ("the State of Residence").

Currently, same-sex couples can become legally married in 13 states and the District of Columbia ("Recognition States")[3]. Of the approximately 1,100 statutes that specifically mention "marriage," "married" or "spouse," most are either silent on the issue or specify that the applicable state law is the State of Celebration. Other statutes and regulations, most notably the Social Security Act, specify an individual's marital status will be determined based on his or her State of Residence at the time the benefit or obligation applies.

Following the *Windsor* decision, President Obama directed Attorney General Eric Holder to work with other cabinet members "to review all relevant federal statutes to ensure this decision, including its implications for federal benefits and obligations, is implemented swiftly and smoothly." Since the *Windsor* decision, the Department of Defense ("DOD") has announced that the same-sex spouses of military service members are eligible immediately for a wide range of spousal benefits, and the Office of Personnel Management ("OPM") announced that all federal agencies will "extend benefits to federal employees and annuitants who have legally married a spouse of the same sex," apparently, on a pre-tax basis.

Marriage Recognition and Private Employee Benefit Plans

Employee benefit plans are subject to several federal statutes including the Code, ERISA, Health Insurance Portability and Accountability Act ("HIPAA"), Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") and the Family and Medical Leave Act ("FMLA"). Except for FMLA, none of these laws or related guidance includes a choice of law provision, *i.e.*, a State of Celebration or State of Residence rule. In the absence of a choice of law provision, *Windsor* will require the federal government to recognize all legal same-sex marriages. Thus, the State of Celebration rule will apply for such laws. FMLA does not specify which rule applies; however, the FMLA regulations specify that the employee's spouse will be determined under the law of the employee's state of residence at the time of the leave request.

With respect to the income tax provisions of the Code, which include all of the relevant employee benefit sections, there appears to be conflicting authority supporting both a State of Celebration and a State of Residence rule for determining whether a taxpayer is married. The day after the *Windsor* decision, the Internal Revenue Service ("IRS") posted the following notice on its webpage:

> We are reviewing the important June 26 Supreme Court decision on the Defense of Marriage Act. We will be working with the Department of Treasury and Department of Justice, and we will move swiftly to provide revised guidance in the near future.

At this time, the IRS has not provided additional guidance. It is noteworthy, however, that the statements from the DOD and OPM do not suggest that benefits provided to the same-sex spouse of a service member or federal government employee would be subject to imputed income tax if the service member or employee resides in a non-Recognition State. In fact, the OPM letter specifies that employees may

[3] Currently, Massachusetts, Iowa, Connecticut, Vermont, New Hampshire, the District of Columbia, New York, Maine, Maryland, Washington, California, Delaware and, beginning August 1, 2013, Minnesota and Rhode Island.

seek reimbursement of their same-sex spouse's medical or dependent care expenses from their flexible spending accounts. As such reimbursements are controlled by the Code, it may be reasonable to assume that the IRS will be adopting a State of Celebration rule. Until the IRS publishes guidance on this matter, however, we will not know for certain whether the legal marriages of same-sex couples residing in non-Recognition States will be recognized for federal income tax purposes. Accordingly, we have divided our discussion of applicable employee benefit rules into two categories: rules for employees who reside in Recognition States and rules for employees who reside in non-Recognition States.

Employees who reside in Recognition States

With respect to employees married to a same-sex spouse residing in a Recognition State, their marriage will be recognized under all federal laws. Thus, the spouses of such employees must be recognized as follows:

- Tax-favored retirement plans:
    - The spousal consent, qualified pre-retirement annuity ("QPSA") and qualified joint and survivor annuity ("QJSA") rules will apply, including the designation of the spouse as the default beneficiary under the plan.
    - Delayed distributions under the minimum distribution requirements applicable to a surviving spouse will apply and the surviving spouse may roll over a lump-sum distribution to an IRA or other qualified plan.
    - Employees with same-sex spouses should be eligible to take hardship distributions for spousal health care, education and burial expenses, if the plan permits such distributions.
    - In the event of a divorce, a domestic relations order naming a same-sex spouse as alternate payee can be a qualified domestic relations order if the order satisfies the applicable requirements.
- Health and welfare plans:
    - If a same-sex spouse is covered under an employer's group health plan or other tax-favored spousal benefit, the employer should cease imputing income for the value of the employer-paid portion of such benefits.
    - If an employer's plan covers same-sex spouses, the spouse should be treated as a COBRA-qualified beneficiary in the event of a loss of coverage until further guidance is published.
    - Employees may elect to pay for health and other welfare plan coverage for their spouse on a pre-tax basis, as well as receive expense reimbursement from health and/or dependent care flexible spending arrangements, through a cafeteria plan, for the expenses of their spouse and step-children.

- It may be possible to treat the *Windsor* decision as constituting a change of status event that would permit eligible employees to make a mid-year election for spousal or step-children coverage.[4]

- If eligible for coverage, the employee's spouse and step-children will have HIPAA special enrollment rights.

- FMLA leave: If otherwise eligible, the employee is entitled to take 12 weeks of FMLA leave to care for the employee's spouse and step-children.

Employees who reside in non-Recognition States

Until IRS issues guidance, it is unclear how the marriages of same-sex couples who reside in non-Recognition States should be handled for purposes of the Code. In the event the IRS concludes that the State of Celebration controls, the tax favored retirement plan and other tax related rules outlined above would apply. If, however, the IRS applies State of Residence rule, same-sex spouses will continue to be treated as follows:

- Tax-qualified retirement plans:

  - In the absence of guidance from the IRS or if the IRS adopts a State of Residence rule, an employee's same-sex spouse can be designated as the employee's beneficiary (if permitted by the plan) and is eligible to elect non-spousal rollover distributions, but the spousal consent, QPSA and QJSA rules will not apply. The surviving spouse will not be eligible for delayed minimum required distributions.

  - Employees who designate their same-sex spouse as their beneficiary are eligible to take hardship distributions for the health care, education or burial expenses of the spouse as a designated beneficiary, if the plan permits such distributions.

  - In the event of a divorce, a domestic relations order naming a same-sex spouse as alternate payee may not be a qualified domestic relations order even if the order satisfies other applicable requirements. In such cases, we recommend proceeding with extreme caution until further guidance from the Department of Labor ("DOL") or IRS is provided.

- Health and welfare plans:

  - If a same-sex spouse is covered under an employer's group health plan or other tax-favored welfare benefit, the employer should continue imputing income for the value of the employer-paid portion of such benefits unless the IRS adopts a State of Celebration rule.

  - If an employer's plan covers same-sex spouses, the spouse should be treated as a COBRA-qualified beneficiary in the event of a loss of coverage until further guidance is published.

  - The employee may not elect to pay for group health coverage on a pre-tax basis unless the spouse is also the employee's dependent. Similarly, the employee cannot be

[4] The OPM letter indicates that mid-year change-of-status elections may be made within 60 days of the date of the *Windsor* decision.

reimbursed for medical expenses of a same-sex spouse from a health care flexible spending arrangement unless the spouse is also a dependent.

- The employee cannot obtain reimbursement from a dependent care flexible spending arrangement for the dependent care expenses of a same-sex spouse or the children of the spouse that the employee has not adopted.

- If eligible for coverage, the employee's spouse and step-children will have HIPAA special enrollment rights.

- FMLA leave: It is possible that the DOL will issue alternative guidance that would adopt a State of Celebration rule for purposes of FMLA leave. In the absence of such guidance, however, the current regulations include a State of Residence rule. Thus, even if otherwise eligible, the employee residing in a non-Recognition State is not entitled to take 12 weeks of FMLA leave to care for the employee's same-sex spouse and step-children.

Unresolved Issues

In addition to the question of which marriages will be recognized for purposes of the Code, there are several other unresolved issues. Perhaps most significant is the issue of whether the *Windsor* decision is retroactive. In general, rulings striking down statutes as unconstitutional are retroactive. Many tax advisors believe that a married same-sex couple should be able to file a claim for refund of excess taxes with respect to any open tax year (generally 2010, 2011, and 2012). Code section 7805(b) permits the Secretary of the Treasury to "prescribe the extent, if any, to which any ruling . . . related to the internal revenue code shall be applied without retroactive effect." At a minimum, the Secretary should rule that the *Windsor* decision will apply prospectively with respect to the tax qualification requirements of the Code. In the absence of such ruling, plans previously prohibited by DOMA from recognizing same-sex spouses could have retroactive qualification failures to the extent the plans disregarded a same-sex spouse when processing distribution elections and death benefit payouts for affected participants.

A more complicated scenario might occur if the same-sex spouse of a retiree who has commenced single-life annuity payments files a claim for benefits on the basis that the plan "failed" to obtain the spouse's consent prior to the annuity starting date. As the claim for benefits would arise under ERISA, which does not have a provision similar to Code section 7805(b), it is not clear how such a claim should be resolved.

It is unclear how plan sponsors should respond to a domestic relations order from a Recognition State that designates a same-sex spouse as an alternate payee with respect to the retirement benefit of an employee living and working in a non-recognition state. In general, plan sponsors must comply with valid court orders. It is not clear, however, that a same-sex spouse of a participant residing in a non-Recognition State can be an alternate payee if the IRS and the DOL adopt the State of Residence rule. In the absence of additional guidance, plan sponsors should proceed with caution in processing such domestic relations orders with respect to participants residing in non-Recognition States.

Lastly, it is uncertain whether annuitant retirees who were married on their annuity starting date and were not eligible to elect a QJSA can adjust their remaining annuity payments to provide a survivor benefit. However, the OPM letter provides this option for federal retirees and presumably a plan sponsor could amend its plan to allow such a change on a one-time basis.

Steps Employers Should Take Now

1. Stop imputing income for at least those employees who reside in a Recognition State and have elected spousal coverage.

2. Review all plan documents to identify how the terms "marriage," "married" and "spouse" are defined and used. If such terms are defined with reference to DOMA or a specific state law, determine whether plan amendments will be necessary.

3. Review plan procedures for spousal consent (including, if applicable, plan loans), beneficiary designations and required minimum distributions to determine if adjustments are necessary.

4. Retirement plan administrator's need to know if a participant is married to a same-sex spouse.

   NOTE: Many gay and lesbian employees may not have informed the plan administrator when they became married (possibly because their marriage would be disregarded for plan purposes or fear of discrimination). To remedy this, consider sending a general notice to all participants in retirement plans requesting that they notify the plan administrator if they are married to a same-sex spouse. This notice should advise employees that if they are legally married to a same-sex spouse, the *Windsor* decision may mean that, effective on the date of the decisions, their spouse is their default beneficiary and all prior beneficiary designations are void. Assurances of confidentiality may be necessary to obtain the most complete response.

Legal recognition of same-sex marriages is expanding and quickly evolving. The marriage laws in several non-Recognition States have been or will soon be challenged. We will keep you informed as guidance from the IRS and other federal agencies is announced. If you have any questions about the *Windsor* decision and its impact on employee benefit plans, please contact Marc Purintun or Leslie Hansen or the Hunton & Williams attorney with whom you regularly work.