Westlaw Journal
EMPLOYMENT
Litigation News and Analysis • Legislation • Regulation • Expert Commentary
VOLUME 28, ISSUE 2 / AUGUST 28, 2013

EXPERT ANALYSIS

Same-Sex Marriages and Benefit Plans After *Windsor*

By Susan Hoffman, Esq., Joni Andrioff, Esq., and Finn Pressly, Esq.
Littler Mendelson PC

Private employer-provided retirement and welfare plans are substantially affected by the U.S. Supreme Court's decision in *United States v. Windsor*, 133 S. Ct. 2675 (June 26, 2013). *Windsor* overturned Section 3 of the Defense of Marriage Act, which limited the term "marriage" for purposes of federal law to marriages between a man and a woman, while leaving intact DOMA Section 2, which permits one state to refuse to recognize same-sex marriages entered into in another state.

Windsor raises questions that have no immediate answers as the employer community adjusts to the myriad types of "marriage" promulgated under state law. Each employer must consider the effects of *Windsor* in light of its own plan designs and business needs, and it should consult with benefits counsel to determine the approach best suited to those needs.

At this writing, 13 states (and the District of Columbia) provide full marriage equality for same-sex relationships.[1] Some states provide for civil unions or domestic partnerships that have all of the legal equivalence of marriage (for state law purposes) other than the name,[2] and others allow for registration of domestic partnerships or civil unions that do not provide all of the incidences or privileges of marriage.[3]

Many states recognize out-of-state marriages of same-sex couples as being equivalent to an in-state marriage, civil union or domestic partnership. Some local governments (including cities and counties) maintain domestic-partner registries that offer nominal or symbolic recognition of same-sex relationships. It remains to be seen whether the federal government (for purposes of the Employee Retirement Income Security Act) will recognize spousal rights only for marriages that are labeled marriages or also for civil unions and domestic partnerships that are legally equivalent to marriage.

If a couple resides in a state that does not recognize same-sex marriages and they travel to a recognizing state to get married, will that marriage be recognized for ERISA purposes in the non-recognizing state where they live? What if they are validly married while residing in a recognizing state and then move to a non-recognizing state? If the couple's state of residence is a non-recognizing state, but the federal government continues to recognize the marriage, the tax treatment for state purposes could be different from the tax treatment for federal purposes.

The Internal Revenue Service is expected to issue guidance on the definition of "spouse" for purposes of the Internal Revenue Code. This guidance may answer most, if not all, of these open questions.[4]

Once the IRS determines which relationships will be recognized under federal tax law, ERISA plans (by definition) will have to treat couples in such relationships as married for the purposes of the spousal benefits prescribed under ERISA. These benefits include survivor benefits under tax-qualified retirement plans and 401(k) plans, as well as qualified domestic relations orders. However, employers will still be able to define "spouse" differently (narrowly or more broadly) for purposes of non-mandated spousal benefits under ERISA plans.

If the employer decides not to offer benefits to non-spouses (as defined in ERISA and the Code), the employer may still have to decide how to address situations in which a state (such as the state of the employee's domicile or the state in which the employer is located) does not recognize the relationship as a marriage but ERISA and the Internal Revenue Code do. Will the employer treat the employee as married for all benefits purposes or only for federally mandated purposes?

IMPACT OF THE *WINDSOR* DECISION ON SPECIFIC BENEFIT PLANS

Qualified retirement plans, including 401(k) plans

Retirement plans that are subject to joint and survivor annuity rules must offer a qualified joint and survivor annuity to a married participant who is entitled to a distribution in excess of $5,000 (present value) and require notarized spousal consent to a distribution in any other form.

If a married participant dies before the starting date of his or her annuity, a surviving spouse must receive a qualified pre-retirement survivor annuity equal to the survivor benefit she or he would have received if the participant retired on the day before his or her death (or on the day after the earliest retirement age, if later) and is entitled to a 50 percent qualified joint and survivor annuity.

A profit-sharing plan or 401(k) plan is exempt from these rules if the plan provides that the default beneficiary for a married participant is the participant's spouse. Such plans require notarized spousal consent to a non-spouse beneficiary.

A same-sex spouse can now benefit from a qualified domestic relations order entered by a state court in a divorce or spousal support proceeding.

Windsor ***raises questions that have no immediate answers as the employer community adjusts to the myriad types of "marriage" promulgated under state law.***

The expenses of a same-sex spouse can be considered in determining a participant's eligibility for a hardship distribution.

Same-sex marriages will have the advantage under Internal Revenue Code Section 415 of excluding a spousal annuity from the participant's maximum benefit limit, as well as treating a joint and survivor annuity with a same-sex spouse as not being subject to the "incidental death benefit" restrictions (which apply when a non-spouse beneficiary is significantly younger than the employee). Similarly, post-death distributions to a same-sex spouse will now be subject to the more lenient spousal minimum distribution rules.

Employers should consider revisiting the design and administration of their retirement plan in light of *Windsor.*

- ☑ Review the plan's definition of "spouse." If a plan provides statutorily mandated spousal benefits to spouses recognized under state law (without specifying the gender of the spouse), the plan document is satisfactory. If the plan had specified that only opposite-sex spouses are recognized, the plan must be amended, perhaps retroactively. It is unknown at this time whether the IRS will offer retroactive relief from disqualification for any such amendments.
- ☑ Determine whether any participant with a same-sex spouse received a distribution or died, and, if so, whether the distribution was compliant with the spousal rules of the qualified plan. If the distribution was non-compliant, the participant (or surviving spouse) may be able to claim benefits under ERISA.[5] Although the IRS may provide retroactive relief from disqualification, it cannot prevent lawsuits brought by individuals under ERISA. The employee plan correction program offered by the IRS provides guidance on correcting errors in plan administration. Employers should consult their benefits counsel to address these retroactive compliance issues.
- ☑ Determine whether the plan provides spousal-type rights to civil unions or domestic partnerships. Employer plans can still provide certain spousal-type rights to employees in civil unions or domestic partnerships, provided the Internal Revenue Code and ERISA limitations are satisfied.[6]
- ☑ Review summary plan descriptions and other employee communications to help ensure that employees understand how they can direct benefits to their same-sex spouses or partners, or whether they will need spousal consent for a non-spouse beneficiary.

Health benefits

Internal Revenue Code Section 125 allows employees to pay for certain employer-sponsored health benefits on a pre-tax basis; this is also known as a "cafeteria plan." In addition, under the Code, the value of employer-paid coverage is excluded from an employee's taxable income. This favorable tax treatment extends to benefits provided to the employee's spouse, children and other "tax dependents" under the code. Before *Windsor*, employees in same-sex relationships could not take advantage of the pre-tax premium payment rules unless the partner qualified as a tax dependent under Internal Revenue Code Section 152 . This was a difficult standard to meet where both the employee and his or her partner had full-time jobs. In addition, the employee was required to include the value of coverage provided to the non-dependent same-sex partner as taxable income ("imputed income"), and the employer paid additional federal payroll taxes on the value of such coverage. Some employers provided "gross-up" payments to these employees to cover the additional tax burden.

After *Windsor*, same-sex spouses are eligible for the same favorable tax treatment under the Code as their opposite-sex counterparts. Although, for state tax law purposes, a state that recognizes the marriage will treat the coverage of a same-sex spouse the same as the coverage of an opposite-sex spouse, employees may also be subject to state income tax for income sourced from a state where the same-sex couple do not reside. If the couple commutes to a non-recognizing state or perform services in multiple states, employers still may be faced with the requirement of calculating the value of employer-provided coverage for a same-sex spouse.

- ☑ Employers should adjust their payroll systems to eliminate the additional imputed income for the value of coverage of same-sex spouses under federal tax law. It is unclear whether the employer should adjust future 2013 withholding to take into account the imputed income recognized during the first half of 2013.

- ☑ Employers should determine whether any employees in same-sex marriages recognized by their state of residence have income subject to tax reporting in states that do not recognize the marriage, and they should adjust their payroll systems accordingly.

- ☑ Employers can stop providing tax gross-ups for employees whose same-sex partners are now eligible for favorable tax treatment.

An employer may be able to file an amended return to obtain a refund for employer payroll taxes paid on imputed income for previous years (to the extent the statute of limitations has not expired). It is unclear whether an employer can recoup past gross-up payments made to an employee who elects to file amended returns to seek refunds for overpaid income taxes in previous years.

Neither ERISA nor the Internal Revenue Code requires an employer to provide medical benefits to spouses. If an employer does provide benefits to spouses, it is unclear whether the employer can explicitly limit that benefit to spouses of the opposite sex, or whether other federal laws (such as Title VII) will require that all federally recognized spouses be treated equally for purposes of benefit eligibility.

- ☑ Employers should decide how to treat federally recognized same-sex spouses and same-sex relationships that are not federally recognized (civil unions and domestic partnerships) and communicate these decisions to affected employees.

- ☑ Employers should review insurance policies to determine the definition of "spouse." If the policy is issued in a state that does not recognize same-sex marriages, but the employer has employees in a recognizing state, the policy may have to be revised.

- ☑ Employers should review plan docu-ments, summary plan descriptions, employee handbooks, benefit notices and policy manuals for clear communication regarding treatment of same-sex spouses.

Once the IRS determines which relationships will be recognized under federal tax law, ERISA plans will have to treat couples in such relationships as married for the purposes of spousal benefits.

After Windsor, same-sex spouses are eligible for the same favorable tax treatment under the Internal Revenue Code as their opposite-sex counterparts.

After *Windsor,* ERISA's health care continuation coverage will confer the same independent election rights for same-sex spouses as those for qualified beneficiaries when an employee terminates employment or dies. A divorce will be considered a qualifying event. Before *Windsor*, many employers voluntarily provided coverage to same-sex spouses and also provided continuation coverage rights upon qualifying events. If such rights were not provided before *Windsor*, they will now be required.

☑ Employers should determine whether new notices have to be issued for pending Consolidated Omnibus Budget Reconciliation Act elections.

☑ Employers should determine whether notices for qualifying events that preceded *Windsor* must be provided or amended.

If medical and other welfare benefits are provided pursuant to a cafeteria plan, coverage elections are available only once per year (during open enrollment) or upon other life events, including a change in the employee's family status. After *Windsor*, an employee is permitted to make a mid-year change to a pre-tax benefit election under a cafeteria plan (as well as the parallel Health Insurance Portability and Accountability Act special enrollment rules) for a same-sex marriage (or divorce).

- If employees wish to enroll their same-sex spouses because the marriage is now recognized, is this a change in family status that will permit a mid-year enrollment opportunity?[7]
- If employees were eligible for same-sex spousal coverage but chose not to enroll a same-sex spouse because of the adverse tax treatment, is the *Windsor* decision a "change in cost" that would allow for a mid-year enrollment opportunity?

Long-term disability plans

If an employee becomes totally disabled, the employee will be eligible for a same-sex spousal benefit from Social Security. Many long-term disability plans offset the plan's disability benefit by the amount of the Social Security disability benefit (including the spousal benefit). If the employer's long-term disability benefit plan is self-insured:

☑ Consider whether the plan will encourage or assist disabled partici-pants with a same-sex spouse to apply for a spousal benefit.

☑ If so, will the employer be able to claim reimbursement under the plan's offset rule if the participant receives a retroactive spousal award?

☑ How will the plan administrator determine whether participants receiving benefits have same-sex spouses?

Supplemental life insurance

Employers should review employee-pay-all spousal and dependent life insurance descriptions to determine whether benefits must be offered to same-sex spouses and their children, and whether they are eligible for a special open-enrollment opportunity.

Stock transfers to family members

Public companies filing S-8 registrations of stock issued under stock plans (such as option and stock incentive plans) may permit stock transfers under the registration statement to family members and spouses, which now include same-sex spouses.

Linked plans

Spousal rights under a tax-qualified retirement or 401(k) plan may apply to a non-qualified deferred-compensation plan intended to make up the limits on compensation and benefits imposed on the tax-qualified plan.

Ownership attribution

The attribution rules applicable in the definitions of "highly compensated individuals" or "highly compensated employees" now take into account stock or partnership interests owned by same-sex spouses.

Unforeseen emergency

An "unforeseen emergency" under Internal Revenue Code Section 409A will include a severe financial hardship resulting from an illness or accident of an employee's same-sex spouse. WJ

NOTES

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

[2] Four states offer civil unions with full legal rights (Colorado, Hawaii, Illinois and New Jersey) and five offer domestic partnerships with full legal rights (California, Nevada, Oregon, Washington and the District of Columbia).

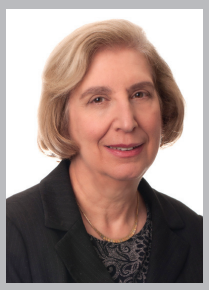
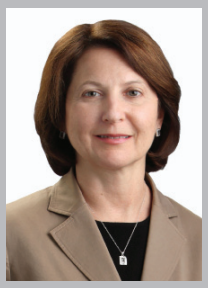
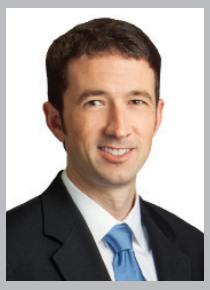
[3] Wisconsin, New Mexico and Wyoming.

[4] On July 8, 2013, the Office of Personnel Management issued a notice for applying *Windsor* to benefit coverage for federal employees. Under the Benefits Administration Letter (No. 13-203), legal marriages are recognized regardless of the state of residency of the employee, but domestic partnerships and civil unions are not treated as marriages.On the other hand, on Aug. 9, the Department of Labor indicated that it would look to state of residency to determine whether a same-sex couple is married for purposes of FMLA leave entitlement.

[5] For example, if a non-spouse beneficiary received a distribution from a 401(k) plan upon the employee's death, but the same-sex spouse did not consent to the designation, does the same-sex spouse have a right to claim the distribution? If a participant who was married for at least one year retired with a single life annuity and then died, the surviving same-sex spouse may have a right to claim the survivor portion of a joint and survivor annuity.

[6] A domestic partner would not benefit from a qualified domestic relations order, and the incidental death benefit rules would apply to a joint and survivor annuity with the domestic partner as joint annuitant.

[7] Under the Benefits Administration Letter that is applicable to federal employees, the change in law means that a same-sex marriage is considered to be a "new marriage," and employees have 60 days from the date of the decision (until Aug. 26, 2013) to enroll same-sex spouses.

Susan Hoffman (L), a shareholder at **Littler Mendelson PC**'s Philadelphia office, is co-chair of the employee benefits litigation practice group. **Joni Andrioff** (C) is a shareholder at the firm's Chicago office. **Finn Pressly** (R) is an associate at the firm's Chicago office.