

# Client Alert

(Update)

A report  
for clients  
and friends  
of the firm August 2004

## Same-Sex Marriage and Domestic Partnerships: Implications for Employers

*Same-sex couples can now legally marry in the Commonwealth of Massachusetts, leading many employers to question whether, and how, the existence of same-sex spouses will, and should, affect their benefit obligations to their lesbian and gay employees and their partners.*

*The purpose of this Alert is to answer some frequently asked questions regarding the provision of domestic partner benefits and to discuss employers' obligations with respect to same-sex marriage. Please contact your employee benefits attorney at Proskauer if you would like more detailed guidance on this subject.*

### A. INTRODUCTORY QUESTIONS

1. What is the legal difference between same-sex partners in a same-sex marriage, domestic partnership or civil union?

Currently, a couple can only legally enter into a **same-sex marriage** in the Commonwealth of Massachusetts. Same-sex spouses married in Massachusetts are entitled to the same protections and benefits that are granted to married heterosexual couples in the Commonwealth of Massachusetts. However, the federal Defense of Marriage Act ("DOMA") prevents same-sex spouses from accessing many federal protections and benefits (as discussed below).

Broadly speaking, a **domestic partnership** is a relationship between two committed partners without the sanction of a legal marriage. No uniform criteria

exist for identifying relationships that constitute domestic partnerships. Whether a couple qualify as domestic partners depends on how a state or local governmental entity or private sector employer defines a domestic partnership, if it does so at all. Currently, California, the District of Columbia, Hawaii, Connecticut, New Jersey and Maine all recognize domestic partnership rights in some limited manner.

A **civil union** is a relationship recognized only in the State of Vermont. In Vermont, civil union couples are entitled to the protections and benefits that are granted by Vermont to heterosexual couples who marry. The Vermont statute establishing civil unions also provides the mechanism by which these unions may be dissolved. Because civil unions are unique to Vermont, it is not clear whether other states will recognize civil unions entered into in Vermont, or the extent to which protections and benefits will be extended to partners entering into a civil union in one state by other states that eventually decide to recognize civil unions.

2. Why is the issue of how a relationship is classified so important for employee benefits purposes?

In many instances, the classification of a relationship will determine whether an employer is required (or even permitted) to extend benefits to an employee's partner.

For example, federal tax law generally encourages employers to provide employee benefits by conferring significant income tax advantages on employers and employees. However, in many circumstances (as discussed below) the tax benefits are available only if the benefits are provided to an employees', "spouse" or dependent," as those terms are defined in the Internal Revenue Code (the "Code"). Moreover, in some instances, extending benefits to an individual who does not qualify as a spouse or dependent may

jeopardize an employee benefit plan's tax exempt status (as discussed below).

In addition, the laws governing the provision of employee benefits include certain protections that only are extended to an employee's spouse and dependents (as discussed below).

**a. How is "spouse" defined?**

The Internal Revenue Service ("IRS") has consistently stated that an individual is considered to be a "spouse" if the applicable state law recognizes the relationship as a spousal relationship. Currently, no state recognizes "domestic partners" as "spouses." Moreover, DOMA provides that, in determining the meaning of any federal statute, ruling or regulation, the term "spouse" can only refer to married persons of the opposite sex.

**b. How is "dependent" defined?**

Section 152 of the Code provides that an individual qualifies as a dependent only if the individual: (a) receives over fifty percent of his or her support from the taxpayer (employee) for the calendar year; (b) has as his/her principal abode the taxpayer's home for the entire calendar year; and (c) the relationship between such individual and the taxpayer is not in violation of local law.

**3. What benefits are typically provided to an employee's spouse and dependents?**

**Pension Benefits.** If an employer sponsors a tax-qualified pension plan, the plan must provide spouses with certain benefits/protections. For example, pension plans are required to provide spouses with certain death benefits upon the employee's death (i.e., a Qualified Joint and Survivor Annuity ("QJSA") and a Qualified Pre-retirement Survivor Annuity ("QPSA")). The Code also requires, with regard to a pension plan, that an employee obtain a spouse's consent to waive a QJSA or a QPSA, or to use his or her accrued benefit as security for a loan. Additionally, under a profit-sharing plan, unless waived by the employee's spouse, the spouse is the automatic beneficiary of the employee's benefit upon his or her death. Finally, the Code's anti-alienation provisions only permit an employee's benefit to be transferred to an individual who is qualified as an "alternate payee," which is defined as a spouse, former spouse, child or other dependent of a participant.

**Health Benefits.** It is typical for an employer to provide health benefits to its employees' spouses and children. The cost of providing such coverage is tax deductible for

employers and the cost of such coverage and the amount of benefits received are excluded from an employee's income. If coverage is extended to an individual who does not qualify as a spouse or dependent, the benefit would be treated as taxable income of the employee (although still deductible by the employer).

**COBRA.** If an employer chooses to provide employees' spouses and dependent children with health care coverage, then the plan will be required, pursuant to COBRA, to provide the spouses and dependent children the opportunity to continue their health coverage (on a self-pay basis) for a prescribed period upon the occurrence of certain events which would otherwise result in loss of coverage.

**FMLA.** The Family and Medical Leave Act ("FMLA") requires an employer to provide an employee with up to twelve weeks of unpaid leave in order to care for his or her sick spouse, child or parent.

**Benefits Not Governed by Federal Law/ Voluntary Employer-Provided Benefits.** Certain state regulated benefits, such as unfunded vacation benefits or bereavement leave, or voluntary employer-provided benefits, such as life insurance, may refer to spouses or dependents.

**4. Should an employer recognize a same-sex marriage as a legal marriage?**

*Before an employer can begin to examine its employee benefit obligations to a same-sex spouse, it must first determine whether such relationship should be recognized as spousal. The following subsection provides an overview of the law regarding the recognition of same-sex marriage.*

*In this subsection we distinguish between the "legalization" of same-sex marriage and the "recognition" of same-sex marriage. When discussing legalization of same-sex marriage, we refer to Massachusetts and any state in which a same-sex couple may in the future legally enter into a same-sex marriage. When discussing recognition of same-sex marriage we refer to a state that, even though a couple may not legally enter into a same-sex marriage in that state, will nevertheless recognize a same-sex marriage that is legally entered into in another state.*

**a. In general, if a same-sex marriage is legally entered into in Massachusetts, will it be recognized in all states?**

Not necessarily. Although state legislatures may pass legislation on this subject, it ultimately is the role of a state's judiciary to determine whether the state is legally required to recognize a marital union

legalized in another state. Under the Full Faith and Credit Clause of Article IV of the U.S. Constitution, a state is required to recognize a marriage legalized in another state, even if the marriage would not be legal in its own state, unless such marriage violates the strong public policy of the state. For example, New York will not legally permit a marriage between an aunt and her nephew, but New York courts will recognize the validity of such a marriage if it is entered into in a state that allows such marriages. In contrast, New York State considers polygamy to violate a strong public policy of the state. Thus, if another state were to permit polygamy, a New York court would not recognize the polygamist's marriage.

At this point, no state judiciary has ruled on whether it will recognize a same-sex marriage legally entered into in Massachusetts.

**b. May an employer recognize the same-sex marriages purportedly legalized in other states, such as New York or California?**

The courts in these states have not yet ruled on whether same-sex marriage can legally be entered into. However, New York State Attorney General Elliott Spitzer issued an advisory opinion in which he indicated that current New York State law does not provide for the legalization of same-sex marriage. Moreover, on August 12, 2004, the California Supreme Court voided all same-sex marriages sanctioned by local officials in the State earlier this year. According to the Court, because California law provides that a marriage license can only be issued to a couple comprised of a man and woman, the local officials lacked the authority to issue marriage licenses to same-sex couples and these "marriages" have no legal effect. Accordingly, employers cannot recognize partners in these California "marriages" as spouses. It should be noted that the Court explicitly cautioned that it was not ruling on the constitutional validity of the California law itself.

Employers should be aware that this issue presents an added complication. While a New York or California court might not recognize a same-sex marriage "legalized" in New Paltz, New York or San Francisco, California because those states' laws do not provide for legalization of same-sex marriage, such courts might nevertheless recognize a same-sex marriage legally entered into in Massachusetts (in fact, Spitzer advised in the same advisory opinion discussed above that he believed New York courts would be required to recognize a same-sex marriage legally entered into in Massachusetts). Accordingly, a New York or California employer might be

required to recognize an employee's same-sex marriage legally entered into in Massachusetts, but would be prohibited from acknowledging another employee's same-sex marriage if it was "legalized" in New Paltz, New York or San Francisco, California.

**c. If a same-sex couple legally marries in Massachusetts but lives and works in a state that does not recognize same-sex marriage, should an employer treat the couple as *domestic partners*?**

Yes, but only if the couple's relationship satisfies the criteria identified in either the state's or the employer's applicable definition of "domestic partnership."

## **B. DOMESTIC PARTNERSHIPS AND EMPLOYEE BENEFITS LAW**

*This section is intended to discuss the state of the law only as it relates to domestic partners. Same-sex marriage and employee benefits law are discussed in Section C below.*

**1. Can a "domestic partner" qualify as a spouse or dependent?**

A domestic partner is not a "spouse" for federal tax purposes because, as discussed in Question 2(a) above, the Code defines a spouse as an individual recognized as such under the applicable state law for federal tax purposes. Currently, no state law defines a domestic partner as a "spouse." (And even if any did, DOMA would prohibit the recognition of a same-sex domestic partner as a spouse for federal benefits purposes.)

In order to qualify as a "dependent" under federal tax law, a domestic partner must satisfy the test described in Question 2(b) above. If both partners in a same-sex domestic partnership work full time, it may be particularly difficult for a domestic partner to satisfy the 50% "support" test and, thus, qualify as a dependent under the Code.

**2. What benefits *can be* provided to domestic partners?**

**Pension Benefits.** Because the Code does not restrict who is considered a "survivor," it appears that a plan could define a domestic partner as a required beneficiary for an employee not married to a member of the opposite sex for purposes of a non-qualified joint and survivor annuity, and could require that a domestic partner's consent be given to name anyone but the domestic partner as a recipient of a death benefit or contingent annuity.

**Health Care Coverage.** An employer may voluntarily extend health care coverage to domestic partners, even though a partner does not qualify as a spouse or dependent. However, employees who receive such benefits will not enjoy the same federal income tax advantages as those which flow from health care coverage provided to "spouses" and "dependents." If the domestic partner does not qualify as a dependent, employer contributions to a health plan on behalf of the domestic partner will constitute income to the employee, subject to applicable income tax withholding and federal employment taxes, including Social Security, Medicare and federal unemployment taxes. The amount of the benefit included in an employee's gross income is the excess of the fair market value of the employer-provided group medical coverage over the amount paid (if any) by the employee for such coverage. This applies even if the employee already has family coverage because of children and there is no additional extra cost.

Following is an explanation of alternative methods by which an employer could make health care coverage available for domestic partners and guidance on how such coverage should be structured so an employee benefit plan will not lose its tax exempt status.

**a. Employer Strategies for Providing Domestic Partner Health Coverage.**

The income tax implications of providing domestic partner health care coverage can be addressed by the employer in several ways. Among them are the following: (a) the employer can pay for the coverage, and the value of the coverage would be included in the employee's gross income; (b) the employee can pay for such coverage with after-tax dollars; or (c) coverage can be provided through a combination of employee and employer contributions, and the excess of the value of the coverage over employee contributions would be included in the employee's income. An employee *cannot* pay for domestic partner coverage with *pre-tax* salary reductions under a cafeteria plan. Some employers provide domestic partner coverage and pay the employee's resulting portion of FICA (which reflects the value of the coverage provided to the domestic partner) by "grossing up" the employee's income to the amount necessary to reflect the employer's payment of the employee's portion of the FICA. The employee is taxed on the value of the coverage and the FICA grossed up amount.

**b. Guidance on Structuring Benefits To Protect VEBA Tax-Exempt Status.**

The IRS and the U.S. Department of Labor ("DOL") have each issued rulings providing guidance to employers on how such benefits should be structured

so that a 501(c)(9) voluntary employee benefit plan (a "VEBA") does not lose its tax exempt status, and so that the benefits provided do not violate ERISA's trust and fiduciary provisions.

The IRS has ruled that a VEBA that provided health coverage for an employee's same-sex domestic partner would not jeopardize its tax exempt status so long as the benefits afforded to domestic partners do not exceed three percent of the total benefits paid by the health fund.

Moreover, the DOL has ruled that, provided that such payments are clearly identified as plan benefits in the plan document, a VEBA's payment of FUTA taxes and the employer portion of the FICA taxes on the taxable domestic partner amount would not violate ERISA's benefit provisions, party in interest rules or fiduciary obligation provisions. The DOL also ruled in the same advisory opinion that a trust fund's payment of gross-up amounts would not violate these ERISA provisions, so long as such payments were clearly identified as plan benefits in the plan document.

**COBRA.** An employer may choose to, but is not required to, extend COBRA-like benefits to a domestic partner. If a plan does provide health care coverage for domestic partners, it should consider whether it wishes to extend continuation rights to domestic partners as well, and whether to treat separating domestic partners similar to divorcing spouses. Before extending such coverage, however, an employer providing health care coverage through an insured plan must ascertain that its insurer company is willing to provide such continuation rights to domestic partners.

**FMLA.** An employer may choose to, but is not required to, provide this benefit to an employee in order to care for a sick domestic partner. However, an employer extending this benefit should be aware that if an employee takes a leave to care for his/her domestic partner, such leave will not count against the employee's twelve weeks under FMLA, and the employee would nevertheless be entitled to subsequently take FMLA leave to care for a sick child or parent.

## **C. SAME SEX MARRIAGE AND EMPLOYEE BENEFITS LAW**

*In this section we distinguish between employer programs, policies and practices required, permitted by, or subject to, federal law (collectively referred to hereafter as "federal benefits") and employer programs, policies and practices required, permitted by, or subject to, state law (collectively referred to hereafter as "state benefits").*

Employers should note that the analysis of federal benefits which may be provided to same-sex spouses is similar to the analysis included in Section B regarding federal benefits which may be provided to domestic partners.

### **1. Must an employer extend federal benefits to a same-sex spouse recognized as a "spouse" under state law?**

No. As a result of DOMA (as discussed above), an employer cannot be *required* to recognize a same-sex spouse for federal benefits purposes, *even* if recognized as a spouse under state law.

In addition, the Employee Retirement Income Security Act of 1974, as amended ("ERISA") may preempt any state law requiring the recognition of a same-sex marriage for federal benefits purposes. ERISA Section 514(a) preempts any State law that "relates to" any employee benefit plan covered by ERISA. The United States Supreme Court has broadly interpreted this section to preempt state laws of general application.

### **2. Can an employer choose to make federal benefits available to same-sex spouses?**

DOMA and ERISA notwithstanding, it appears that an employer could *choose* to treat a same-sex spouse as a "spouse" for federal benefits purposes, but subject to significant limitations. If an employer provides federal benefits to a same-sex spouse, such benefits may be provided in a manner similar to the previously discussed manner for providing federal benefits to domestic partners.

First, as previously discussed, the IRS has ruled that an employer can extend health care coverage to domestic partners. However, the employee cannot receive the favorable tax benefits afforded to spouses or dependents under the employer's health plan. Given this IRS position, it seems likely that the IRS would allow an employer to extend health care benefits to an employee's same-sex spouse, but the employee would not receive the associated federal tax benefits with respect to his or her same-sex spouse.

Second, an employer's ability to grant benefits to a same-sex spouse as a "spouse" would be limited where the extension of such benefits would contravene the Code or ERISA. Where an expanded spousal definition restricts a participant's specifically guaranteed right under the Code or ERISA, such definition would violate these laws. For example, as previously discussed, tax-qualified pension plans are required to provide a QJSA as the normal form of benefit to a married participant, and provide a single life annuity as

the normal form of benefit to an unmarried participant. If a plan were to treat a same-sex spouse as a "spouse" for purposes of determining the applicable normal form of benefit, the plan would likely violate the Code because it would require a participant, whom federal law regards as unmarried (according to DOMA), to be treated as married, and thus subject the participant to QJSA's spousal consent rules. DOMA would thus prohibit this result because it would violate the Code's provision that an unmarried participant must receive a single life annuity as the normal form of benefit.

In contrast, because the Code does not restrict who is considered a "survivor," it appears that a plan could define a same-sex spouse as a "spouse" for purposes of a non-qualified joint and survivor annuity, and could require that a same-sex spouse's consent be given to name anyone but the same-sex spouse as a recipient of a death benefit or contingent annuity. Because of this distinction, plans that use a definition of "spouse" that specifically references state law should consider the impact and clearly define the intended result in the plan's provisions.

Finally, where coverage of same-sex spouses is not mandated by law or prohibited by DOMA, plan sponsors may wish to consider amending their plans to clarify whether same-sex spouses are intended to be covered, in order to avoid confusion among participants and to avoid any argument that coverage was intended.

### **3. Must an employer provide state benefits to same-sex spouses?**

An employer operating in a state legalizing same-sex marriage must extend state benefits, such as unfunded vacation benefits or bereavement leave, to same-sex spouses of employees. In contrast, an employer operating in a state in which the state judiciary has refused to recognize same-sex marriages legalized in another state cannot be *required* to recognize a same-sex spouse for state benefits purposes.

An employer operating in a state that has not yet decided whether same-sex marriages will be recognized must decide whether to extend these benefits to same-sex spouses, or to wait until the appropriate state judiciary has ruled on the recognition of same-sex marriages. However, where a state legislature has adopted legislation on the subject, the employer should follow such legislation until the state's judiciary rules on the subject.

It should be noted that even if a state determines not to recognize same-sex marriage, it appears that an employer

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<sup>1</sup> However, it should be noted that the Ohio Legislature is currently considering legislation which would arguably prohibit private entities from recognizing same-sex marriages.

would not be precluded from *voluntarily* extending state benefits to same-sex spouses.<sup>1</sup>

## D. IMPLICATIONS

### I. Administrative Issues.

#### a. Employer Operating in State Legalizing Same-Sex Marriage.

An employer must determine which of its employees have same-sex "spouses", under which circumstances benefits must be extended to these spouses (*i.e.* state benefits) and under which circumstances the extension of such benefits is either prohibited by DOMA or preempted by ERISA.

#### b. Employer Operating in Many States.

Once state judiciaries begin to rule on whether same-sex marriage will be recognized in individual states, an employer operating in several states may well be subject to conflicting decisions on the recognition of same-sex marriage. In a state that recognizes same-sex marriages as legal, an employer will have to keep track of federal benefits that, because of DOMA and ERISA, cannot be extended to same-sex spouses, and benefits that can be extended to same-sex spouses, same-sex spouses that must be recognized as spouses, and same-sex relationships that cannot be recognized as spousal (depending on whether or not the employee lives in a state recognizing the legality of the same-sex marriage).

### 2. Suggested Employer Actions.

#### a. An Employer Should Consider Whether It Wants to Provide Benefits to Same-Sex Spouses or Civil Union Partners, and Which Benefits It Wishes to Provide.

In making this decision, an employer should consider whether it is already offering benefits to domestic partners. For example, if an employer is currently providing health care benefits to domestic partners, the employer might want to consider providing these benefits to same-sex spouses and civil union partners as well.

#### b. An Employer Should Review the Definition of "Spouse" in its Plan of Benefits.

Currently, many benefit plan documents simply define "spouse" as an individual who is recognized as a "spouse" under applicable law, without identifying what constitutes "applicable law." If an employer wishes to provide benefits to a same-sex spouse or partner in a civil union, the employer may wish to expand its definition of "spouse" to include a same-sex spouse, if such relationship is formalized in a state legalizing a same-sex marriage or civil union. However, for plans subject to ERISA, such definition should also include language specifying that the term "spouse" does not include a same-sex spouse, to the extent prohibited by DOMA.

#### c. An Employer Should Make Sure its Plan of Benefits is Consistent.

Once an employer has decided to extend benefits to a domestic partner, same-sex spouse or member of a civil union, such employer should review related benefits to ensure that these individuals are treated uniformly. For example, if a plan provides *health care* coverage for domestic partners, it should consider extending COBRA benefits to the domestic partner as well.

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#### Client Alert

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