Proskauer

Special Alert for Employers and Other Benefit Plan Sponsors: How Will the Supreme Court's DOMA Decision Impact Your Employee Benefit Plans?

July 8, 2013

On June 26, 2013, the U.S. Supreme Court issued a decision that will affect virtually all employers across the country. In *United States v. Windsor,* the Court ruled in a 5-4 decision that Section 3 of the federal Defense of Marriage Act (DOMA) is unconstitutional. That section of DOMA defines "marriage" and "spouse" as *excluding* same-sex partners for purposes of determining the meaning of any federal statute, rule or regulation. DOMA has therefore prevented employees in same-sex marriages from receiving equal treatment in terms of the employee benefits provided by their employers, even though these couples have the right to marry in 13 states[1] and the District of Columbia. The law has also stood in the way of granting more than 1,000 federally-protected rights and obligations to same-sex married couples (among them, Social Security benefits, automatic pension death benefits and pre-tax health benefits). Read Proskauer's related client alert regarding federal FMLA Rights post-*Windsor*.

Importantly, while the Court's decision means that the federal government will generally recognize same-sex spouses as married for purposes of federal laws, protections and obligations, it leaves some unanswered questions for employers in connection with benefit plan administration, and notably does not force states to permit or recognize same-sex marriage, which will be significant for employers operating in those states.

What Does the Decision Mean for Employers and their Benefit Plans?

As described in this client alert, the *Windsor* decision raises many issues for employers and other benefit plan sponsors (such as trustees of multiemployer plans) to consider with regard to their retirement and health (and other welfare) benefit plans. The decision impacts employers that already offer benefits to same-sex spouses and also those that do not provide such benefits, though the issues vary depending on the nature of the benefits provided.

Currently, it appears that all of the benefit plan changes described in this client alert will generally apply to validly married same-sex couples regardless of where the employee resides[2] or where the employer is located (i.e., even if the state of residence or employer location is a state that does not permit same-sex marriage). Nevertheless, there is a long-established IRS practice of determining whether a couple is married for federal tax law purposes by applying a residency rule (i.e., looking to the state in which the couple resides). Therefore, this issue is not without question and it is possible that the IRS could apply a "residency" requirement as part of acknowledging the rights of same-sex spouses.[3] Importantly, in a June 28 memorandum from Acting Director Elaine Kaplan of the U.S. Office of Personnel Management to heads of executive departments and agencies providing guidance on the extension of benefits to married gay and lesbian federal employees, the federal government made no distinction based on an employee's state of residency, and this position was expressly confirmed in a July 3 follow-up memorandum to federal benefits administrators (OPM Memos). Moreover, legislation to repeal DOMA (The Respect for Marriage Act), reintroduced in both houses of Congress in the wake of *Windsor*, takes a "place of celebration" approach and provides that if a marriage is valid anywhere, it is valid everywhere.

More relevant for private employers, a note on the IRS website indicates that the agency is reviewing the Supreme Court decision and will be working with the Department of Treasury and Department of Justice to "move swiftly to provide revised guidance in the near future," which will presumably include guidance from the IRS on the residency (and other) issues.[4]

Group Health Benefits

Employers that Currently Offer Group Health Coverage to Same-Sex Spouses

For employers and other plan sponsors that currently offer health benefits to same-sex spouses, the following are among the issues that should be considered in light of *Windsor*:

Tax Consequences. Before the Supreme Court's decision, employers were required, as a matter of federal tax law, to impute as taxable income to an employee the value of health benefits provided to the employee's same-sex spouse (to the extent the benefits were paid for by the employer), unless the spouse qualified as the employee's federal tax dependent for this purpose (which is a difficult standard to meet). This is because a same-sex spouse was not considered a "spouse" for purposes of the income exclusion under the Internal Revenue Code for employer-provided health benefits.[5] In light of *Windsor*, income should no longer be required to be imputed for federal income tax purposes and employers that have been "grossing-up" additional taxes incurred by employees with same-sex spouses should be able to cease doing so.[6] (Note that, depending on where the employee resides, he or she may have imputed taxable income for state income tax purposes and this may have significant administrative and cost implications for employers that operate in multiple states.)

On a related point, due to *Windsor*, it appears that employees may be able to claim refunds for "open years" (generally, three years, meaning tax years 2010 and forward) for FICA and federal income tax paid on employees' imputed income for the value of benefits provided to same-sex spouses. Employees entitled to any refunds may seek the refund from the IRS by filing an amended federal individual income tax return. There is also a mechanism for employers to refund to employees any over-collected employee portions of FICA. If interested in this approach, employers should consult with their tax advisors to ensure that they are taking the correct steps. For prior years, it is possible that the IRS will issue guidance extending the refund filing deadline or, if not, that a court would provide some relief in the event of a challenge. Employees may also consider adjusting their withholdings for the rest of 2013 to make up for any imputed income during the first part of this year. Employers may also consider filing for refunds of employment taxes paid on imputed income, but a question remains as to how many prior years for which they will be entitled to refunds.

In addition, due to DOMA's limited definition of spouse, employees have not been allowed to pay for health coverage for same-sex spouses (or children of same-sex spouses) on a pre-tax basis through an employer's Section 125 cafeteria plan in the same manner as employees covering opposite-sex spouses (again, unless a same-sex spouse (or child of a same-sex spouse) qualified as the employee's federal tax dependent, a difficult standard to meet). Due to *Windsor*, same-sex spouses (and their children) will be treated as dependents for purposes of Section 125 of the Internal Revenue Code and, thus, employees will be able to pay for their coverage on a pre-tax basis and enjoy this favorable tax treatment. [7] With regard to past periods, perhaps refunds may also be sought for income tax paid on salary used to pay for these benefits.

Enrollment Rights. Generally, employees may not change pre-tax benefit elections under a Section 125 cafeteria plan after the beginning of each plan year, unless they experience a permissible qualifying "change in status" event. A change in marital status is one such event. Although the IRS has not yet offered guidance on this issue, we believe it is likely that the IRS will conclude that the *Windsor*decision results in a "change in status" event for cafeteria plan purposes. If the IRS reaches that conclusion, employers could then amend their cafeteria plans to allow employees with same-sex spouses to enroll themselves, their same-sex married spouses and children in coverage on a pre-tax basis under the same eligibility guidelines covering opposite-sex marriages. This would include the ability for employees with same-sex spouses to change their benefit coverage options. In fact, the Federal government has already announced (in the OPM Memos) a 60-day window for federal employees to make immediate changes to their coverage under various health and welfare programs sponsored by the Federal government. Of course, going forward, during annual open enrollment periods and in connection with other qualifying mid-year change in status events (like marriage or divorce, or change in a same-sex spouse's coverage or employment status), employers would be permitted to provide same-sex married employees with the opportunity to make enrollment elections to the same extent opposite-sex married employees are given that opportunity. [8]

FSAs, HSA and HRA Claim Reimbursements. Prior to *Windsor*, because DOMA applied for all purposes of federal tax law, expenses of same-sex spouses (and their children) were generally not eligible for tax-free reimbursement under a health or dependent care flexible spending account (FSA), health savings account (HSA), and health reimbursement account (HRA), unless those individuals separately qualified as the employee's federal tax dependents. Now, expenses of same-sex spouses (and their children) can be reimbursed on a tax-free basis under employers' health and dependent care FSAs or HRAs, or the employee's HSA.[9] In addition, as noted above, change in status events involving a same-sex spouse could be recognized as a qualifying change in status event that would allow mid-year election changes under FSAs.[10]

COBRA and HIPAA Rights. Before *Windsor*, same-sex spouses (and their children) covered under group health plans were not treated as "spouses" (and "children") for purposes of having independent rights as "qualified beneficiaries" under COBRA or for purposes of HIPAA's special enrollment rules.[11] Now that they are recognized as spouses (and children) for purposes of these federal laws, assuming they are otherwise covered under a group health plan, plan sponsors must provide them with the same rights given to employees' opposite-sex spouses (and children) to continue group health coverage upon the occurrence of a COBRA qualifying event and to enroll in a group health plan upon the occurrence of certain events recognized under HIPAA's special enrollment rules.[12]

Employers and Other Plan Sponsors that Currently Do Not Offer Group Health Coverage to Same-Sex Spouses

For employers and other plan sponsors that do *not* currently offer group health benefits to employees' same-sex spouses (and their children), the *Windsor* decision may not require any changes to their health benefit plans. For example, it appears that the decision would not require an employer to offer coverage to same-sex spouses under an *insured* health plan governed by the laws of a state that does not recognize same-sex marriage. This is because the *Windsor*decision left intact Section 2 of DOMA, which allows states to define marriage as they wish and not recognize another state's same-sex marriage.) It also appears that an employer sponsoring a *self-insured* health plan may not be obligated to cover same-sex spouses in those states.

However, employers and sponsors that do not offer benefits to same-sex spouses (particularly in states that protect such relationships) should proceed with caution and consult with legal counsel regarding this issue in light of *Windsor.* Although self-funded ERISA plans generally have been found to be excepted from state nondiscrimination laws or coverage rules either by virtue of exceptions in the state laws themselves or on ERISA preemption grounds, employers and other plan sponsors should consider whether there might be exposure to such laws or federal discrimination claims now that same-sex spouses are recognized under federal law. Title VII of the federal Civil Rights Act does not currently prohibit discrimination based on sexual orientation; however, this area of the law is evolving. Potential fiduciary issues should also be considered.

Employers and sponsors should also carefully review their benefit plan documents, summaries and other materials to ensure that the plan's definition of "spouse" is consistent with their intent in light of *Windsor*. Careful drafting and documentation will be critical. For example, assume that a health plan currently defines "spouse" as the person to whom an employee is legally married under federal law. Before Section 3 of DOMA was struck down, that definition excluded same-sex spouses, but in the post-DOMA world, that definition might include a same-sex spouse.[13]

Once an employer or sponsor decides on its policy, it should make sure that applicable plan documentation and employee communication materials are clear. They should also ensure that outside administrators, insurers and service providers are administering their benefit plans (including tax consequences) in a manner consistent with the sponsor's intent and the applicable legal requirements that might be engendered by the *Windsor* decision.

Pension Benefits

Under all defined benefit plans and certain defined contribution plans, the automatic form of payment is a qualified joint and spousal survivor annuity, unless the participant's spouse waives the right to the survivor benefit. A qualified joint and spousal survivor annuity provides a lifetime benefit for the participant, and following the participant's death, a lifetime benefit to the participant's spouse. If a participant dies while still employed, the participant's spouse is entitled to an automatic pre-retirement survivor annuity under a defined benefit plan. Under most profit sharing plans and 401(k) plans, a participant's spouse is treated as the default beneficiary of any death benefits due under the plan, unless the participant had designated another beneficiary.

In light of *Windsor*, employers will need to review their plan documents, summary plan descriptions and benefit election forms to ensure that the term spouse is properly defined to ensure that same-sex spouses are afforded all legally required spousal rights. In many plans, the term "spouse" may already be defined by reference to federal law, in which case it would appear to be interpreted to include any marriage (including a same-sex marriage) valid under state law. However, as noted, there is an open question as to whether an employer should look to the law of the participant's state of residence to determine whether the participant's same-sex spouse is entitled to federally-protected spousal rights and benefits and, if so, whether the relevant state is the one in which the participant resided at the time of benefit commencement or death, if different. Until additional guidance is issued, pension plan sponsors may be faced with the administrative burden of tracking the residency of plan participants, including former employees. Of course, spousal equivalent rights could in certain respects be offered nonetheless.

Until IRS guidance is issued, it is also unclear whether plan sponsors will need to retroactively administer their pension plans to account for *Windsor.* Interestingly, as stated in the June 28 OPM Memo, retirees of the federal government who are legally married to same-sex spouses will have a two-year window to inform OPM of the marriage and elect changes to their retiree benefits based on their recognized marital status. Employers will need to consider this issue, and may be faced with questions from same-sex spouses of deceased employees with regard to their benefit entitlement.

Another issue that arises in the context of pension benefits relates to the Internal Revenue Code's required minimum distribution rules. These rules generally allow a surviving spouse of a deceased participant to defer payment of pension benefits until the April 1st of the year following the year in which the participant would have reached age 70-1/2, but require all other beneficiaries to begin to receive payments within a year of the participant's death or to receive the full benefit within five years of the participant's death. Same-sex spouses will now be entitled to the more favorable spousal treatment under the required minimum distribution rules.[14]

Same-sex spouses who divorce will also have the right to an award of pension benefits under a qualified domestic relations order (QDRO), and employers may now be presented with QDROs by couples who divorced prior to *Windsor*. In addition, employees participating in defined contribution plans will now be able to submit hardship distributions for their same-sex spouses (and their children).[15]

What is the "Effective Date" of the Decision?

In the absence of guidance from the federal government, an important and complicated question arises as to the retroactivity of *Windsor*. In some respects, the answer to this question may vary depending on the reason for which the question is being asked. Technically, the decision is effective 25 days after it was decided (June 26). Once it is effective, though, employers should begin modifying their benefit plans and related policies on a prospective basis (effective as of the date of the decision) in cases where the application of *Windsor* is clear (e.g., there are no "residency" issues). In states where same-sex marriage is not recognized, as noted, there are issues to consider regarding the scope of the Court's decision, which may impact an employer's ability to implement the decision with respect to its benefit plans until further guidance is issued.

With regard to past periods, the issue is more complicated and, in the absence of further guidance, many unanswered questions remain. Employers should carefully review with legal counsel all requests and inquiries by employees, particularly if the request involves retroactive benefits. Different answers and considerations apply whether one is inquiring as to medical or other welfare benefits as opposed to retirement or 401(k) benefits, as well as whether the facts involve a deceased individual, a claim for benefits, or a change in beneficiary.

For example, employees may ask whether medical claims incurred by a same-sex spouse before the *Windsor* decision are eligible for reimbursement under a health care FSA. Similarly, if an employee already divorced the employee's same-sex spouse and COBRA-like rights were not provided to the spouse, the employer will need to consider the potential risks of not offering that coverage, in the absence of further guidance. Similar questions might apply to the extent initial general COBRA rights notices were not provided to same-sex spouses in the past.

What Employers and Plan Sponsors Should Be Doing Now

The *Windsor*decision is historic in many ways, and there is much work to do with regard to employee benefit plans. As an initial matter, employers and other plan sponsors should:

- review all benefit plans and HR policies to determine the impact of *Windsor* on their plans and policies;
- determine whether current plan eligibility rules, definitions and policies need to be changed in light of *Windsor* and revise all applicable documents and forms (as necessary) to ensure that they reflect the sponsor's intent and the applicable legal requirements;
- send appropriate communications to employees about how the decision impacts their benefits and the changes being made to the benefit plans or policies;
- ensure that outside administrators, insurers and service providers are administering the plans in a manner consistent with the sponsor's intent and the applicable legal requirements, including with respect to payroll and tax issues; and
- if the sponsor provides domestic partner/civil union partner health benefits, consider whether to continue those benefits now that same-sex spouses will be recognized as spouses for purposes of federal law, and consider applicable state law requirements and risks.

Proskauer's Employee Benefits Practice Center's DOMA Task Force, which is comprised of lawyers from our offices nationwide, regularly advises employers and other plan sponsors on the myriad benefits issues that arise in the context of domestic partner benefits, and is assisting employers and other benefit plan sponsors in analyzing the additional issues that are presented by the Windsor decision. If you have any questions regarding these matters, please contact your Proskauer relationship lawyer or any member of Proskauer's DOMA Task Force listed in this Alert.

* * *

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this document is 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 that is contained in this document.

[1] These states are Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota (effective August 1, 2013), New Hampshire, New York, Rhode Island (effective August 1, 2013), Vermont, Washington and California, where the Supreme Court's decision in *Hollingsworth v. Perry* (released the same day as *Windsor*) has reinstated same-sex marriage in California. Although several other states, such as Illinois and New Jersey, recognize same-sex civil union partnerships and yet others recognize same-sex domestic partnerships, the Court limited its holding to lawful marriages. It remains to be seen whether federal agencies or courts will extend *Windsor* to other same-sex relationships, but the federal government has stated (in the July 3 OPM memorandum discussed later in this client alert) that it will not do so with respect to its employees.

[2] Interestingly, Edith Windsor, the plaintiff in the *Windsor* case, and her partner were residents of New York state but were married in Canada in 2007. Their marriage was recognized in New York following the state's enactment of a law allowing and recognizing same-sex marriages.

[3] In the analogous context of common law marriages, it appears that the IRS considers a couple married for tax filing purposes if the couple is living together in a common law marriage that is recognized within the state of residence **or** the state in which the marriage began.

[4] It is possible that the residency issue could end up back at the Supreme Court, with challenges to state mini-DOMA laws expected.

[5] Similarly, prior to *Windsor* employers had to impute income for the value of benefits paid by an employer for children of same-sex spouses (who are not the children of an employee married to a same-sex spouse), unless such children were treated as the employee's stepchildren under state law (in which case they are considered "qualifying children" for federal tax purposes). See our blog post for a further discussion of the potential impact of *Windsor* on the definition of children for employee benefit plan purposes.

[6] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[7] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[8] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[9] One negative impact of *Windsor*is thatemployees with same-sex spouses will now be subject to the family contribution limit for HSAs, rather than separate limits applicable to each spouse.

[10] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[11] Although not required, some employers already voluntarily extend COBRA-"equivalent" and HIPAA special enrollment-equivalent rights to same-sex spouses, domestic partners and civil union partners of employees.

[12] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[13] It is also possible that a plan fiduciary's past interpretation (including pre-DOMA interpretations) of "spouse" (assuming no caveat in the plan as to which law applies) as meaning only opposite-sex spouses could prevail even post-*Windsor* as a reasonable interpretation of the plan document.

[14] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

[15] This is subject to the issues described above concerning employees residing in states that do not recognize same-sex marriage.

Related Professionals

- **Roberta K. Chevlowe**
  Senior Counsel