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## Same-Sex Marriages and Benefit Plans After *Windsor*

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On June 26, 2013, the Supreme Court issued its long-awaited decision in *Windsor v. United States*, No. 12-307. The Court ruled (in a 5-4 decision) that the section of the Defense of Marriage Act (DOMA) that required federal laws to ignore same-sex marriages that are legally entered into under an applicable state law is unconstitutional. The *Windsor* decision will have a substantial impact on the design and operation of private employer benefit plans. This Insight reviews the impact of the *Windsor* decision on plan design and administration. In many cases, the decision raises questions that may have no immediate answer, but that need to be considered as the employer community adjusts to the various definitions of marriage in state and federal law. As with all general guidance, each employer must consider these issues in light of its own plan designs and business needs, and should consult with its benefits counsel to determine what approach may be best suited to those needs.

### The State of the Law Before the *Windsor* Ruling

Under Section 3 of DOMA, the Employee Retirement Income Security Act of 1974, as amended (ERISA) and the Internal Revenue Code of 1986, as amended (the Code) had to be interpreted so that the term "spouse" could mean only a spouse of the opposite sex, in a marriage recognized under applicable state law. This meant that an employer could (but was not required to) define the term "spouse" in its ERISA-covered benefit plans to include a spouse of the same sex as the employee. If an employer did provide spousal benefits to same-sex spouses, there were significant tax consequences to the employee because the relationship was not recognized as a spousal relationship for federal tax purposes. Also, certain spousal benefits available under retirement plans (such as assignment of benefits pursuant to a domestic relations order, or survivor benefits that would violate the incidental death benefit rule because the spouse was significantly younger than the employee) could not be provided at all. In addition, if an employer did not carefully define the term "spouse" in its benefit plans, an employee with a same-sex spouse (or a surviving same-sex spouse) could claim benefits based on the ambiguity of the term "spouse" inherent where a marriage is valid under state law but not under federal law. Employers that chose to provide same-sex benefits had the additional administrative burdens of identifying same-sex spouses as such, and then applying differing state and federal withholding and imputed income factors depending on whether an employee's spouse was a same-sex or

opposite-sex spouse. The employer also had to make sure that its insurance policies conformed to its intended (or accidental) provision of same-sex spousal benefits. Plan administration was further complicated if the employer elected to recognize other levels of same-sex relationships (such as domestic partnerships) that often were not given status equal to marriage under state law.

The administrative difficulties were not limited to ERISA benefit plans. Benefits to same-sex spouses provided under non-ERISA benefit programs (such as certain employee-pay-all group life insurance benefits and plans sponsored by public employers or churches) caused the same federal tax consequences as applied to an ERISA-covered plan. Also, an employer would still be faced with the question of whether a particular same-sex marriage should be recognized by a non-ERISA benefit plan, depending on the state of residence of the employee and spouse when the marriage was entered into, where they resided when claiming the benefit, and where the employer is located or its plan administered.

## What the Court Held

After first ruling that it has jurisdiction to hear the case, the majority ruled that the equal protection clause of the Fourteenth Amendment (incorporated into the due process clause of the Fifth Amendment) prevented the federal government from refusing to recognize same-sex marriages that have been entered into under the law of a state. The Court relied primarily on the fact that states have historically defined marriage for themselves. Because New York chose to protect same-sex relationships by allowing same-sex couples to marry, it was a violation of equal protection for the federal government to make unequal a subset of state-sanctioned marriages. More detail on the background and reasoning of the opinion can be found in Littler's ASAP, which was published just after the opinion issued.<sup>1</sup>

## What Should Employers Do Now?

### Identify definitional issues that will arise with same-sex spousal relationships

The *Windsor* decision does not eliminate much of the confusion surrounding the patchwork of state recognition of same-sex relationships and raises additional questions that can only be answered by future regulation or litigation. The confusion arises in large part from the myriad ways that states have chosen to recognize or disavow same-sex relationships, and the fact that the only section of DOMA that was at issue in *Windsor* was the section relating to recognition of such marriages by the federal government. Section 2 of DOMA, which allows one state to refuse to recognize same-sex marriages entered into in another state, is still the law, and it is uncertain how a challenge to that section might fare, given the limited scope of Justice Kennedy's opinion.

At this writing, 13 states (and the District of Columbia) provide full marriage equality to same-sex relationships.<sup>2</sup> 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.<sup>3</sup> Some states allow for registration of domestic partnerships or civil unions for same-sex couples, or for both same-sex and opposite-sex couples, but do not provide all of the incidences or privileges of marriage to those couples.<sup>4</sup> Many of these states also recognize out-of-state marriages of same-sex couples as equivalent to an in-state marriage, civil union, or domestic partnership. Further, 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 ERISA) provides spousal standing only to marriages that are labeled marriages, or also to other relationships (civil unions/domestic partnerships) that may be equivalent to marriages.

Will civil unions/domestic partnerships previously entered into in a state that now recognizes same-sex marriages be treated as a marriage, or must the couple officially marry to obtain recognition by the federal government (and by extension, ERISA plans)? If a couple lives in a state

1 See Susan Hoffman, Jean Schmidt, Stefanie Kastrinsky, and Ethan Zelizer, [Supreme Court Decides the Fate of Same-Sex Marriages](#), Littler ASAP (June 27, 2013).

2 California, Connecticut, Delaware (effective July 1, 2013), Iowa, Maine, Maryland, Massachusetts, Minnesota (effective August 1, 2013); New Hampshire, New York, Rhode Island (effective August 1, 2013), Vermont, Washington, and Washington, D.C.

3 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).

4 Wisconsin, New Mexico, and Wyoming.

that does not recognize same-sex marriages, can they get married in a state that does, and will that marriage be recognized for ERISA purposes even if it is not recognized by the state where they live? What if they were validly married when they lived in the other state, and moved to a state that does not recognize same-sex relationships? If the couple's current state of residence is a state that does not recognize the marriage, the tax treatment for state purposes may 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, and it is hoped that most, if not all, of these open questions may be addressed in that guidance.<sup>5</sup>

Once the IRS discloses 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 (such as survivor benefits under tax-qualified retirement plans and 401(k) plans, and domestic relations orders). But employers will still be able to define "spouse" differently (narrowly or more broadly) for purposes of non-mandated spousal benefits under ERISA plans.

## The Impact of *Windsor* On Specific Benefit Plans

The *Windsor* decision will take effect on July 22, 2013 (25 days after the opinion), but whether it is retroactive is not yet determined. Even if it is retroactive, it is uncertain what effect that retroactivity has on ERISA plans that were operated in accordance with the DOMA definition of marriage. The remainder of this Insight lists some of the key issues that arise with respect to specific benefit plans.

### Qualified Retirement Plans (including 401(k) Plans)

Plans subject to joint-and-survivor annuity rules must offer a qualified joint and survivor annuity to a married participant entitled to a distribution in excess of \$5,000 (present value), and require a notarized spousal consent if the participant wants distribution in any other form. If a married participant dies before his or her annuity starting date, 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 was entitled to a 50% qualified joint and survivor annuity.

A profit sharing plan or 401(k) plan can be exempt from these rules if the plan provides that the default beneficiary for a married participant is the participant's spouse. Such a plan must then permit a participant to designate a non-spouse beneficiary only with notarized spousal consent.

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.

The same-sex spouse's expenses can be considered in determining whether a participant is eligible for a hardship distribution.

A distribution to a participant with a same-sex spouse might be calculated differently after *Windsor* because the limits under Code Section 415 do not take a spousal annuity into account, and a joint and survivor annuity with a spouse is not 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.

### Practice Tip

- Employers should decide how they will treat same-sex relationships that are not clearly required to be recognized as a same-sex marriage under ERISA and the Code.
- 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 where 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 Code do. Will the employer treat the employee as married for all benefit purposes, or only for federally-mandated purposes?

<sup>5</sup> On July 8, the Office of Personnel Management issued a notice for same-sex marriage 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.

Employers will wish to revisit their retirement plan design and administration in light of *Windsor*:

- Review the plan's definition of "spouse." If a plan provides these 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. We do not yet know if the IRS will offer blanket retroactive relief from disqualification for such retroactive amendments (if required).
- The employer should determine if any participant with a same-sex spouse received a distribution or died, and, if so, whether the distribution was compliant with the qualified plan spousal rules. If the distribution was non-compliant, the participant (or surviving spouse) may be able to claim benefits under ERISA. The IRS may provide retroactive relief from disqualification (assuming the *Windsor* decision is considered retroactive), but that would not prevent lawsuits under ERISA.<sup>6</sup> The employee plan correction program offered by the IRS provides guidance on correcting an error in plan administration, but that program may require duplication of certain benefits, depending on the circumstances. Employers should consult their benefits counsel to address these retroactive compliance issues.
- Note that a plan can still provide certain spousal-type rights to employees in civil unions or domestic partnerships, provided that the Code and ERISA limitations are satisfied.<sup>7</sup>
- Review summary plan descriptions and other employee communications to ensure that employees with same-sex spouses, domestic partnerships, and civil unions understand how they can direct benefits to their spouses or partners, or whether they will need spousal consent for a non-spouse beneficiary.

### Health Benefits

The Code allows employees to pay for certain employer-sponsored health benefits on a pre-tax basis through a "Section 125 Plan" (sometimes also called a "cafeteria plan"). Additionally, the Code also provides that 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 and certain of his or her dependents—including his or her 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 their partner qualified as a tax dependent under Section 152. (This was often a difficult standard to meet, particularly if both the employee and his/her partner held full-time jobs.) In addition, the employee would be required to include the value of coverage provided to the non-dependent same-sex partner as taxable income ("imputed income"). Further, the employer would be required to pay additional federal payroll taxes on the value of coverage provided to non-dependent same-sex spouses. Some employers provided additional payments to these employees to cover the additional tax burden (a "gross-up" payment).

Post-*Windsor*, same-sex spouses will now be eligible for the same favorable tax treatment under the Code as their opposite-sex counterparts. However, it remains to be seen how the value of coverage provided to same-sex spouses will be taxed under state income tax laws. While a state that recognizes the marriage will treat the coverage of a same-sex spouse the same as coverage of an opposite-sex spouse, many employees are subject to state income tax for income sourced from a state in which they do not reside (if they commute to a non-recognizing state, or perform services in multiple states). So employers may still 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 how (or if) 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 with same-sex spouses recognized in their state of residence have income subject to tax reporting in states that do not recognize the marriage, and adjust their payroll systems accordingly.

<sup>6</sup> For example, if a non-spouse beneficiary received a distribution from a 401(k) plan on death, but the same-sex spouse had not consented to the designation, the same-sex spouse may have the right to claim the distribution. If a participant married to a same-sex spouse for at least one year retired with a single life annuity and then died, the surviving spouse may have a right to claim the joint-and-survivor annuity that should have been provided.

<sup>7</sup> For example, a domestic partner who is not a spouse under federal law cannot 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.

- If the employer has been providing a gross-up, the employer can stop the gross-up for employees whose same-sex partners are now eligible for favorable tax treatment.

In the event that the Code's favorable tax treatment of same-sex spousal benefits is applied retroactively, an employer may be able to file an amended return to obtain a refund for employer payroll taxes paid on imputed income for prior years (to the extent the statute of limitations has not expired). It remains unclear whether an employer will be able to recoup any portion of past "gross-up" payments made to an employee who elects to file amended returns to seek refunds for overpaid income taxes in prior years. Neither ERISA nor the 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 limit that benefit to spouses of the opposite sex going forward, or if other federal laws (such as Title VII) will require that all federally-recognized spouses be treated equally for purposes of benefit eligibility.

- Decide how to treat federally-recognized same-sex spouses and non-federally-recognized same-sex relationships (civil unions, domestic partnerships) and announce these decisions to affected employees.
- Review insurance policies to determine how same-sex spouses are treated or defined. If the policy is issued in a state that does not recognize same-sex marriages, but the employer has employees in a state that does, the policy may have to be revised to provide coverage.
- Review plan documents, summary plan descriptions, employee handbooks, benefit notices, and policy manuals for compliance with federal and state laws, and to ensure clear communication regarding treatment of same-sex spouses.

The continuation coverage requirements of ERISA (COBRA) will now apply to same-sex spouses, so that they will have independent election rights as qualified beneficiaries when an employee terminates employment or dies, and a divorce will be a qualifying event. In many cases, if an employer has been providing coverage to a same-sex spouse, the plan also has been providing continuation coverage rights upon qualifying events (even though not required before *Windsor*), but if such rights have not been provided, they will now be required.

- Determine whether new notices have to go out for pending COBRA elections.
- Determine if notices for qualifying events that preceded the decision may now need to be provided or amended.

Leaves of absence relating to serious health conditions of a same-sex spouse or the spouse's parents now fall under the Family and Medical Leave Act (FMLA). Medical benefits must continue (on same terms as active employment) during a FMLA leave, and COBRA benefits do not begin until the end of the FMLA leave (if the employee does not return to work).

- Determine whether any employees now on leave or former employees on COBRA as a result of a failure to return from leave must have their leaves reclassified as FMLA leaves.
- Does the employer owe them reimbursement for the employer share of premiums during the leave?
- Does COBRA have to be extended by the period of the leave (because the maximum COBRA period should not have started until the leave ended)?

If medical and other welfare benefits are provided in conjunction with a cafeteria plan, elections are available only once per year (open enrollment) or upon other events, including a change in the employee's family status. Pre-*Windsor*, an employee generally was not permitted to make a mid-year change to his or her pre-tax benefit elections under a cafeteria plan after a same-sex marriage (or divorce). Post-*Windsor*, the Code's mid-year election change rules (as well as the parallel HIPAA special enrollment rules) will include changes with respect to a same-sex marriage.

- If employees with federally-recognized same-sex spouses are now going to be permitted to enroll their spouses for the first time, is this a change-in-family-status that will permit a mid-year enrollment opportunity?<sup>8</sup>
- If employees with federally-recognized same-sex spouses had spousal coverage available to them but chose not to enroll because of the adverse tax treatment, is the *Windsor* decision a change in cost that would allow for a mid-year enrollment opportunity?

<sup>8</sup> Under the Benefits Administration Letter applicable to federal employees, the change in law is being treated as a "new marriage" so employees are given 60 days from the date of the decision (i.e., until Aug. 26, 2013) to enroll spouses in the plan.

## Other Benefit Plans

*Long-term disability plans.* Same-sex spouses will now be recognized as spouses for Social Security purposes. This means if an employee becomes totally disabled, the employee will be eligible for a spousal benefit from Social Security. Many long-term disability plans offset the 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 participants 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 if participants receiving benefits have same-sex spouses?

*Supplemental Life Insurance Programs.* Many employers offer employee-pay-all spousal and dependent life insurance. Insurance policies and program descriptions should be reviewed to determine if benefits can or should be offered to same-sex spouses and their children, and whether a special open enrollment opportunity can or should be provided.

*Stock Transfers to Family Members.* Public companies filing S-8 registrations of stock issued under stock plans (e.g., option and stock incentive plans) may permit stock transfers under the registration statement to family members and spouses, which may now include same-sex spouses.

*Linked Plans.* The same challenges that apply to a spouse's rights under a tax-qualified retirement or 401(k) plan may apply to a non-qualified deferred compensation "make up" plan that is intended to make up the limits on compensation and benefits imposed on the tax-qualified plan.

*Family Aggregation of Ownership.* The ownership criteria and attribution rules in the definitions of "highly compensated individuals" or "highly compensated employees" will now take into account stock or partnership interests owned by same-sex spouses.

*Unforeseen Emergency under Code Section 409A.* The definition of an "Unforeseen Emergency" for Internal Revenue Code Section 409A will include a severe financial hardship resulting from an illness or accident of an employee's same-sex spouse.

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