Expert Q&A on Employee Benefits After the US Supreme Court's DOMA Ruling

Employee Benefits & Executive Compensation

In June 2013, the US Supreme Court ruled in *United States v. Windsor* that Section 3 of the Defense of Marriage Act (DOMA), which defined marriage for federal law purposes to mean opposite-sex marriage, is unconstitutional. The IRS, the Department of Labor (DOL) and other federal agencies have since begun issuing guidance reflecting the *Windsor* decision. Practical Law asked Howard Bye-Torre of Stoel Rives LLP to discuss the implications of the *Windsor* decision and subsequent guidance for employers who sponsor retirement and health plans for their employees and family members.

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What did the US Supreme Court decide in *Windsor*?

Ms. Windsor sued when she was forced to pay more than $360,000 in federal estate taxes after her wife's death, which she would not have been required to pay had she been married to a man. The US Supreme Court concluded that the federal government's failure to recognize her marriage, which was recognized by New York law, violated her constitutional rights to liberty and equal protection. The Court held that the federal government must look at state law, not DOMA Section 3, to determine whether she was married.

The Court noted that there are more than 1,000 federal laws that give rights and obligations to spouses and married couples, including federal laws relating to employee benefits. Under *Windsor*, marriages recognized under controlling state law will be recognized by federal law, and spouses in those marriages will have the same rights and obligations under these federal laws as spouses in opposite-sex marriages.

The *Windsor* Court did not rule that there is a constitutional right for same-sex couples to marry in the US. Therefore, states that do not allow same-sex couples to marry:

- Are not required to do so.
- Currently do not need to recognize the marriages of same-sex couples married in one of the 14 US jurisdictions allowing same-sex marriages. (The issue of the constitutionality of Section 2 of DOMA, which allows states to refuse to recognize same-sex marriages from other states, was not before the Court in *Windsor*.)

However, it seems likely that these issues will be brought before courts based on *Windsor* in the months and years to come.

Which states allow same-sex marriage?

Currently, California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont, Washington and the District of Columbia allow same-sex couples to be married (Same-sex Marriage States). In general, Same-sex Marriage States recognize same-sex marriages from other states and foreign countries, such as Canada.

Will the federal government recognize all same-sex marriages in all situations?

No. Under *Windsor*, the federal government must look to state law to determine whether a same-sex couple is married. However, *Windsor* did not rule on which state law controls for federal purposes. This is important for employees in same-sex marriages and their employers, since the majority of states do not recognize same-sex marriages.

To determine whether a couple is married, the federal government has historically used the marriage laws of either:

- The state in which the marriage occurred (state of celebration).
- The state in which the couple currently resides (state of residence).

For example, assume a same-sex couple was married in New York (where same-sex marriage is recognized) and now lives in Texas (where it is not). If the federal agency looks to the marriage laws of New York, it would consider the couple married. However, if the federal agency looks to the marriage laws of Texas, this same couple would not be recognized as married under federal law.

Some federal agencies have announced that they will use the marriage laws of the state of residence, while other federal agencies will apply the laws of the state of celebration to determine whether the couple is married for federal law purposes. In other words, a same-sex couple residing in Texas who was married in New York will be considered married for purposes of some federal laws and not married for others. A same-sex married couple residing in a Same-sex Marriage State will be considered married for all federal law purposes.

Which state law will the IRS, Treasury Department and DOL use in determining whether a same-sex marriage is recognized for federal tax purposes?

On August 29, 2013, the IRS issued Revenue Ruling 2013-17 and two sets of FAQs (IRS Windsor Guidance) in which the IRS announced it will look to the marriage laws of the state or country in which the marriage was celebrated to determine whether a same-sex couple is validly married under the Internal Revenue Code (IRC) and for federal tax purposes, including employee benefit issues.

This means that all same-sex marriages validly entered into in any state or foreign country allowing same-sex marriages will be recognized by the IRS for income, estate and other tax purposes, even if the couple does not live or work in a state that recognizes the marriage. The IRS Windsor Guidance became effective September 16, 2013.

Citing concerns for uniformity and ease of administration, the DOL, in Technical Release 2013-04 (September 18, 2013), also adopted a rule recognizing the terms "spouse" and "marriage" based on the validity of the marriage in the state of celebration, as opposed to the married couple's state of residence. The DOL's rule applies for purposes of regulations, rulings, opinions and exemptions in Title I of ERISA and the IRC for which the DOL has interpretative jurisdiction, and DOL regulations governing issues including ERISA reporting and disclosure and fiduciary responsibility. However, the DOL's rule does not extend to domestic partnerships or civil unions.

What must an employer that offers health coverage for its employees' same-sex spouses do to comply with the IRS Windsor Guidance for its group health plan coverage?

Before *Windsor*:

- The value of employer-provided health coverage to an employee's same-sex spouse was usually treated as wages or imputed income to the employee, and was subject to federal income and employment taxes.
- An employee could not pay the premium for a same-sex spouse's health coverage on a pre-tax basis through a cafeteria plan.

Health coverage for same-sex spouses could be provided to the employee on a tax-free basis (and employee contributions for the spouse's coverage paid on a pre-tax basis) only if the same-sex spouse qualified as the employee's tax dependent for health plan purposes. Few same-sex spouses qualified as tax dependents under these rules. After *Windsor*, health coverage that employers provide to an employee's same-sex spouse is tax-free to the employee, without any showing of tax dependency.

Under the IRS Windsor Guidance, employers should observe the following rules for all employees with a same-sex spouse participating in the employer's group health plan, even if the state in which the employee works or resides does not recognize the employees' marriages. If an employer imputes income to the employee (and withholding taxes for this income) on the value of health coverage provided to the employee's same-sex spouse and/or the employee is paying his portion of the premium for the spouse's health coverage on an after-tax basis, the employer should:

- Immediately stop imputing income and withholding taxes on the value of the spouse's coverage.
- Allow the employee to pay for the spouse's health coverage on a pre-tax basis through the employer's cafeteria plan, if applicable.

These rules apply to all same-sex married couples, even those currently residing in a state that does not recognize their marriages.

If an employer has already over-withheld income taxes in 2013 due to imputing income to the employee during 2013 for the same-sex spouse's health coverage and requiring the employee's premiums for this coverage to be paid on an after-tax basis, the employer can make adjustments to correct the over-withholding in 2013 if the employer repays or reimburses the employee for the over-withheld income tax by the end of the year. The IRS Windsor Guidance does not require that these adjustments be

made in any specific manner, so it appears the employer can use any reasonable method to make the adjustments.

The IRS Windsor Guidance prohibits employers from making adjustments for excess income tax withheld from the employee's compensation for prior years, so employers do not need to issue amended Form W-2s for the prior tax years. However, an employee may file amended tax returns for tax years for which the limitations period has not run (for most persons, 2010, 2011 and 2012) to recover the excess income, Medicare and social security taxes paid by the employee because the employer:

- Imputed income.
- Required the employee to pay his portion of the premiums on an after-tax basis in these prior tax years relating to the health coverage of the employee's same-sex spouse.

The IRS Windsor Guidance also provides that the state of celebration rule for same-sex married couples will apply throughout the IRC. Certain other federal rights given to spouses in health plans, such as independent rights to COBRA continuation coverage and certain HIPAA special enrollment rights, appear in the IRC. Thus, these federal IRC rights are now available to all same-sex spouses who participate in an employer's group health plan to the same extent they are available to opposite-sex spouses.

Can an employer recover the excess employment taxes the employer paid in previous years due to imputing income to the employee for a same-sex spouse's health coverage?

Yes. The IRS Windsor Guidance provides that an employer may claim a refund for the excess social security and Medicare taxes which the employer paid on the imputed income. In the near future, the IRS will announce a "special administrative procedure" for employers to file refund claims (or make adjustments) for these excess social security and Medicare taxes.

For an employer in a state that does not recognize same-sex marriage and that does not offer health coverage to employees' same-sex spouses, how do *Windsor* and the IRS Windsor Guidance affect the employer's group health plans?

It is unclear what effect, if any, *Windsor* will have on the employer's group health plans. The ruling only requires that the federal government recognize same-sex marriages, it does not require that state governments recognize them.

Therefore, if an employer does not provide health coverage to same-sex spouses and the employer sponsors an insured health plan, *Windsor* will not likely have any effect on that health plan. This is because *Windsor* does not require the employer's state's insurance commission to mandate coverage of same-sex spouses in health insurance policies. If the employer's health plan is self-insured, it is likely, unless guidance from the federal government or future court cases provide to the contrary, that it can continue to provide benefits for only opposite-sex spouses (in a state that does not recognize same-sex marriage).

Also, the IRS Windsor Guidance does not require an employer to offer group health plan coverage to an employee's same-sex spouse. The guidance merely addresses the tax rules if an employer does offer this coverage.

Since the IRS will look to the state of celebration to determine if a same-sex couple is married for tax purposes, will the federal government follow the same rule for all purposes?

No. The other federal agencies do not need to adopt the same state of celebration rule as the IRS. As noted, however, the DOL has now adopted a state of celebration rule for ERISA and DOL purposes. Earlier, the DOL announced in DOL Fact Sheet #28F that it will look to the state of an employee's residence to determine whether a same-sex couple is married for purposes of the Family and Medical Leave Act. We expect *Windsor* guidance from more federal agencies in the upcoming months.

What are the new rules under the IRS Windsor Guidance for qualified retirement plans?

Under the IRS Windsor Guidance, effective September 16, 2013, all qualified retirement plans throughout the US must treat a same-sex spouse as a spouse for purposes of satisfying the federal tax laws relating to qualified retirement plans. This is the case even if the employer operates only in states that do not recognize same-sex marriages and the employer does not otherwise offer benefits for an employee's same-sex spouse. Also, all employers sponsoring qualified retirement plans must recognize both employees' same-sex and opposite-sex spouses for purposes of the federal laws granting rights to spouses in qualified retirement plans.

For example, beginning September 16, 2013, qualified retirement plans:

- May not honor beneficiary designations of persons other than the employee's same-sex spouse unless the employee's spouse has consented to the different beneficiary.
- Must honor QDROs (qualified domestic relations orders) relating to same-sex spouses.

Depending on the type of qualified retirement plan an employer sponsors, spouses (including now same-sex spouses) may have other federal rights regarding these plans. However, the IRS Windsor Guidance did not address the decision's effect on qualified retirement plans for periods before September 16, 2013. Guidance on this topic, including any plan amendments that may be required, will be issued in the future.

How does the IRS Windsor Guidance affect health spending accounts and other cafeteria plan benefits?

Before *Windsor*, unless the same-sex spouse was the employee's tax dependent for health plan purposes, an employee generally could not use funds:

- Available through health flexible spending accounts (health FSAs) or health reimbursement arrangements (HRAs) for medical expenses incurred by a same-sex spouse.
- In a health savings account (HSA) to pay for a same-sex spouse's medical expenses on a pre-tax basis.

Under general principles announced in the IRS Windsor Guidance, an employee can use funds in his health FSA, HRA or HSA to pay medical claims relating to the employee's same-sex spouse, beginning September 16, 2013. Also, an employee with a same-sex spouse will be subject to the IRC's HSA limits for married couples.

However, the IRS Windsor Guidance did not specifically address spending account and other cafeteria plan issues, and therefore many questions remain. For example, it is unclear whether:

- It is acceptable for a health FSA to pay a claim for a medical expense that was incurred by a same-sex spouse prior to September 16, 2013.
- An employee can change his cafeteria plan elections as of September 16, 2013 to add health coverage for a same-sex spouse.

We expect further guidance from the IRS on these issues.

There are also special rules that apply to married couples and spouses under the federal law governing cafeteria plans, dependent care assistance plans and adoption assistance benefits that will now apply to employees and their same-sex spouses.

Does the IRS Windsor Guidance affect employees and their same-sex partners who are not married, such as partners in a domestic partner relationship?

No. Several states (including Colorado, Hawaii, Illinois, Nevada, New Jersey and Oregon) have domestic partnership or civil union laws that grant couples in these relationships all the rights and privileges of married couples, but withhold the right to be called "married." However, under the IRS Windsor Guidance, the IRS will not consider couples in domestic partnerships or civil unions to be married for purposes of federal tax law.