PUBLICATION

Impact of DOMA Ruling on Employers and Individuals

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In the recently-issued opinion in *United States v. Windsor*, the Supreme Court has ruled that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional as a violation of the Equal Protection Clause of the Constitution. Section 3 of DOMA provides that for purposes of federal law, the word "marriage" means "a union of a man and a woman" and the definition of "spouse" is "a person of the opposite sex who is a husband or a wife." This ruling will affect a vast number of federal laws. But this Alert only addresses certain issues under the Employee Retirement Income Security Act of 1974, as amended (ERISA), the Family Medical Leave Act (FMLA), the Internal Revenue Code of 1986, as amended (Code) and certain state income tax issues.

While the full implications of this ruling will take time and regulatory guidance to understand, what is clear at a minimum is that differential treatment of opposite-gender and same-gender married couples is not permissible in the states that allow or recognize same-gender marriages. At present, there are 13 states (California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont and Washington) and the District of Columbia that allow or recognize same-gender marriage.

One of the many issues left unresolved following the court's ruling is the impact on same-gender spouses residing in states that do not recognize or directly ban same-gender marriage. Regardless, unless and until a federal court interprets the *Windsor* decision otherwise, one presumption worth considering is that federal regulatory guidance (when issued) will uniformly recognize all marriages of same-gender couples throughout the United States, provided the marriage is valid in the state where the marriage occurred. There are pros and cons to relying on this presumption, which further underscores the need to seek advice from your legal counsel as to your particular circumstances.

While employers await guidance from the IRS and U.S. Department of Labor, among other federal agencies, there are some considerations to be addressed presently:

Employee Benefit Plan Issues

Health Plan Benefits

1. Tax Treatment of Employer and Employee Contributions for Coverage of Same-Gender Spouses. Prior to the Supreme Court's ruling, employees could not pay for health care coverage for their same-gender spouses on a pre-tax basis and employers were required to impute income to the employees when the cost of coverage was subsidized by the employer for the employees' same-gender spouses (unless they separately qualified as the employee's tax dependent). Under the ruling, the federal tax treatment of same-gender spouses (at least those married and residing in one of the 13 above-referenced states or D.C.) may have to be the same as for opposite-gender spouses, allowing for pre-tax premiums and no requirement to impute income for employer-paid coverage. Accordingly, in those jurisdictions employers should consider ceasing the withholding of federal income, FICA and FUTA taxes on the value of employer-subsidized coverage for same-gender spouses. Again, please consult your legal advisor about your particular circumstances. Depending on regulatory guidance regarding the retroactive effect of the *Windsor* decision, employers and employees may be entitled to

a refund of their share of any FICA and FUTA taxes paid on the coverage of same-gender spouses for periods which presently include up to the prior three years and employees may be entitled to a refund of income taxes which were paid on the value of employer-subsidized coverage.

2. Special Enrollment Rights. Employer-sponsored group health plans are required to allow mid-year enrollments upon certain life events, such as marriage, birth and adoption. Under the Court's ruling, marriage to a same-gender spouse should trigger these special enrollment rights, at least in states which recognize same-gender marriages, and perhaps in other jurisdictions, depending on regulatory guidance.

3. COBRA Continuation Coverage. COBRA requires employers with 20 or more full-time employees to allow covered individuals the right to continue, as their own expense, health coverage for a period of time following a certain qualifying events, such as termination of employment, death and divorce. Individuals protected under COBRA were limited to the employee, the employee's opposite-gender spouse and covered children. Same-gender spouses were not protected with a separate COBRA right unless they qualified as a dependent of the employee for federal income tax purposes. However, under this ruling, a same-gender spouse may have the same protections as an opposite-gender spouse, whether or not he or she qualifies as a dependent. Even given the uncertainties left from the *Windsor* opinion, it may be prudent for employers to consider providing COBRA notices, including initial COBRA notices, to same-gender spouses, after consulting with the third-party insurance carrier(s), if any. (As an additional comment, the model COBRA notice was updated in May 2013 for compliance with provisions of the Affordable Care Act. To that end, it also may be prudent for employers to update their initial COBRA notices and re-send the revised notices to all health plan qualified beneficiaries.)

4. Affordable Care Act Implications. While the ACA and other laws require health plans that provide dependent coverage to extend that coverage to adopted children, children placed for adoption and children up to age 26, there is no mandate to provide spousal coverage. Accordingly, the *Windsor* decision should not affect how and to what extent an employer offers spousal coverage. At present, employers should still have discretion as to how to provide spousal coverage.

5. Flexible Spending Accounts, Health Savings Accounts and Health Reimbursement Accounts. Federal tax laws generally prohibited the reimbursement of expenses of a same-gender spouse or the spouse's children under any of these plans. In light of the Court's ruling, employees can certainly claim a right to have their same-gender spouses and the spouses' children covered by the employer's cafeteria plan, FSA, HSA and HRA.

6. Dependent Care Reimbursement Accounts (DCRA). These accounts, which allow for an employee to pay for dependent care on a pre-tax basis have excluded a same-gender spouse's children, unless those children met a tax dependency test. Now it appears that step-children, regardless of through opposite-gender spouse or same-gender spouse, may have to be treated the same and may be eligible for coverage under a DCRA plan.

Retirement Plans

7. Rights of Spouses over Form of Distribution. Applicable law requires certain types of retirement plans to provide for Qualified Joint and Survivor Annuities and Qualified Preretirement Survivor Annuities whereby the employee's spouse is entitled to certain rights with respect to the payment of benefits. In general terms, an employee cannot elect a form of payment other than an annuity which provides a

contingent annuity to the surviving spouse, unless the spouse properly waives the right. Under *Windsor*, at least in jurisdictions where same gender marriages are recognized and perhaps in all jurisdictions depending upon regulatory guidance, same-gender spouses could claim entitlement to these same rights. Thus, if an employee is currently entering pay-status under a pension plan subject to these rules, where applicable, the employer should verify if there is a same-gender spouse and confirm compliance with these rules for that spouse. Such verification can be complex in certain circumstances and should not be attempted without advice of counsel. An open issue that should be addressed by regulators is the impact of the *Windsor* decision on distributions occurring prior to the Court's opinion and whether the rights of same-gender spouses have any retroactive protection and if so, in what manner. Numerous open issues revolve around employer plans that offer annuities but are not required to do so, such as certain church and government plans not subject to the same federal rules, among others.

8. Spousal Consent Rights. Distributions, including loans and hardship withdrawals, from most pension plans cannot be made to married participants absent a consent by the spouse. The Supreme Court's ruling may extend this consent requirement to same-gender spouses.
9. Payment of Death Benefits. Absent a proper waiver, certain retirement plans must provide that death benefits be paid to the surviving spouse. Under DOMA, this applied only to opposite-gender spouses. In light of the Supreme Court ruling, same-gender spouses will or may be entitled to the same protections. Accordingly, employers would be wise to consult with legal counsel about requiring employees to execute new beneficiary designation forms and, if a non-spouse is elected as beneficiary, having the employee affirmatively indicate that the employee is not married. As set forth above, there are open issues as to any retroactive application of the *Windsor* decision and whether same-gender spouses for whom death benefits have been paid to non-spouse beneficiaries were appropriate.
10. Spousal Rollover Rights. Both spouses and non-spouses who are beneficiaries of a retirement plan participant's account balance may roll over a distribution from the retirement plan to an IRA; however, only spouses can roll over the death benefit to another qualified employer plan. Same-gender spouses may also be allowed to roll over an inherited plan benefit to their employers' qualified plans -- in particular where the marriage and residence is within one of the 13 states mentioned previously.
11. Age 70½ Required Minimum Distributions. Surviving spouses may have special rights to defer distribution of death proceeds from a retirement plan. Under the Court's ruling, these rights may also apply to same-gender spouses. Again, the open issue of retroactive application of the Court's ruling may impact these distributions.
12. Qualified Domestic Relations Orders (QDROs). Under an exception to ERISA's anti-alienation rules, a participant's retirement plan benefits can be required to be paid to a former spouse incident to a court-ordered QDRO. This same requirement may now be claimed to apply in the context of same-gender spouses; although state specific statutes may present obstacles to obtaining or enforcing a QDRO.

Welfare Benefit Plans

In general, there are no special protections for spouses under other benefit plans such as life, disability and AD&D. These benefits are typically provided through policies of insurance which are subject to state regulation. Accordingly, the *Windsor* decision may have no significant impact on these benefit plans.

The above is not an exhaustive list of all issues pertaining to employee benefits that may be impacted by the Supreme Court's ground-breaking decision, but is intended to identify some of the more commonly-occurring issues. Employers are urged to consult with counsel for specific advice on how to assess the *Windsor* decision on their particular benefit plans.

Family and Medical Leave Act

Under the Family Medical Leave Act (FMLA), covered employers must allow employees to take up to 12 weeks of unpaid leave in order to take care of certain relatives, such as spouses. While DOMA was in effect, "spouse" was limited to opposite-gender spouses. Under the Supreme Court's ruling, the FMLA leave protections may extend to care for same-gender spouses.

Estate and Gift Tax Planning Opportunities for Same-Gender Spouses

As a result of the Court's decision, same-gender spouses will begin receiving the estate and gift tax benefits that are available to their opposite-gender counterparts. This is for **federal** estate and gift tax purposes only.

Questions remain concerning how federal laws will apply to same-gender couples who were validly married in one state, but are filing as residents of another state that does not recognize same-gender marriage. Regardless and subject to the comments earlier in this Alert, one presumption is that federal law will uniformly recognize all valid marriages of same-gender couples throughout the United States, unless and until a federal court hold otherwise.

Accordingly, same-gender spouses may now benefit from many federal estate and gift tax advantages, including: (a) portability, which allows a surviving spouse to benefit from the unused estate tax exemption of a deceased spouse under certain circumstances; (b) tax-free transfers between spouses during life and at death; and (c) gift-splitting, which allows one spouse to make a tax-free gift to someone else on behalf of both spouses equal to twice the annual gift tax exclusion amount, provided the appropriate election is made. These examples represent just a few of the federal tax planning privileges now available to same-gender spouses.

Likewise, though it is not yet clear whether the ruling will be applied retroactively, consideration should be given to filing amended gift or estate tax returns where same-gender couples were married under their state's law at the time they made gifts from one to the other (either during life or at death). Such amended returns possibly would claim the re-establishment of lifetime exemption previously applied or a refund of amounts previously paid for estate or gift taxes that they might not be liable for under this ruling. Of course, it is important that a protective claim for refund or an amended return seeking re-establishment of previously applied exemption be considered promptly to ensure compliance with the applicable statute of limitations.

State Income Tax Issues

Most states imposing an individual income tax use a taxpayer's federal income tax return as the starting point for the state income tax return. In the past, this has placed a burden on same-gender couples who are married under their state's law, because states that allow or recognize same-gender marriages generally require all married couples to file their individual income tax returns as either "married filing jointly" or "married filing separately."

Before the Court's decision, same-gender married couples were required to file their federal income tax returns as "single" or "head of household," so states recognizing their marriage would generally require that they recalculate their federal income tax as if they filed their federal income tax returns as "married filing jointly" or "married filing separately." The recomputed federal income taxes were then used as the basis for determining state income taxes.

It is not yet clear what requirements states that do not allow or recognize same-gender marriage will impose on same-gender couples who file federal income tax returns as "married filing jointly" or "married filing separately." It is likely, however, that at least some states will require same-gender couples to recalculate their federal

income tax as if they filed their federal income tax returns as "single" or "head of household," and will use the recomputed federal income taxes as the basis for determining state income taxes.

Summary

There are very few unequivocally clear take-aways from the *Windsor* decision. Based upon the facts of that case, those clear mandates are grounded in facts where the marriage of the same-gender couple is recognized under state law but yet federal law dictates an unequal treatment in comparison to same-gender couples. Outside that set of facts, legitimate presumptions are the only real guidance available to employers, employees, spouses in same-gender marriages and children in such marriages, among others.

As stated numerous times throughout this Alert, we sincerely encourage employers to be proactive in seeking legal counsel regarding the impact of the *Windsor* decision upon their particular facts and circumstances. Delays in seeking such counsel (such as hoping for guidance from the Internal Revenue Service, Department of Labor or any other federal agencies, or certainly waiting for definitive court decisions on any one of a number of topics) could place the employer at jeopardy. At least where the rules are now relatively clear, employers should revise their plans, policies, practices and procedures.

Should you wish to discuss the impact of the Windsor decision on your particular facts and circumstances, please do not hesitate to contact any one of the attorneys within the Firm's Tax Department.