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The Demise of DOMA and Employee Benefit Plans

In *U.S. v. Windsor* the United States Supreme Court struck down Section 3 of the Defense of Marriage Act ("DOMA"). Section 3 of DOMA provided a federal definition of marriage as a legal union between one man and one woman as husband and wife. The Supreme Court ruled that the federal government should defer to state law with respect to the definition of marriage. The effect of *Windsor* is that, in states that recognize same sex marriage, a same sex spouse will be recognized in the same manner as an opposite sex spouse under the federal laws that govern employee benefit plans such as ERISA, the Internal Revenue Code ("Code"), COBRA, and HIPAA and the FMLA. As of August 1, 2013, there will be 13 states and the District of Columbia that recognize same sex marriages.

As explained below, employers in states that do not recognize same sex marriage, such as North Carolina, will have to wait for further guidance on what effect, if any, a valid same sex marriage in another state would have on a same sex spouse that now resides in a state that does not recognize same sex marriage.

A. Open Issues

What the *Windsor* decision did not do was strike down Section 2 of DOMA which provides that one state is not required to recognize the same sex marriage from another state. This leaves open the question of what are the ***federal*** benefit consequences of same sex couples who legally marry in one state but move to a different state that does not recognize same sex marriage. Taking this further, it is also possible that a same sex couple who were legally married in one state now live in two different states-- one that recognizes same sex marriage and one that does not. As of right now, there is no guidance for these situations.

Since this is a federal matter, however, it is likely that the Treasury Department and possibly the Department of Labor will issue regulations or other

guidance which clarifies the issue of same sex spouses validly married in one state residing in states that do not recognize same sex marriage. Given the Obama Administration's stance on same sex marriage, there is a good probability that such guidance may expand the definition of spouse for federal purposes to any same sex marriage that was valid under state law where the marriage was performed even if the couple now resides in a state that does not recognize same sex marriage. The argument would be that such regulations do not violate Section 2 of DOMA because states are not being required to recognize the same sex marriage only the federal government is recognizing the marriage. Also, the federal government *is* deferring to the states in defining marriage, as directed in *Windsor,* but this deference looks to the state where the marriage is performed. Of course, any such regulations or guidance will likely be subject to challenge in the courts. Also, especially in the welfare benefits area, there are instances where spousal benefits are not mandated by federal law and plan documents might refer to marriage as recognized under a particular state's laws.

There are unresolved issues in states that recognize same sex civil unions and domestic partnerships that do not rise to the level of "marriage" under state law. For now, it would seem that those unions would not be considered marriages under *Windsor* but there is at least the potential for federal regulatory action on this issue as well.

Retroactivity is another open question. If *Windsor* was determined to be retroactive, then past distributions from certain qualified retirement plans might be invalid based on the failure to obtain spousal consent. Also, could an employer be sued for failing to offer COBRA rights to a same sex spouse in the past? We believe that is likely that there will be guidance that sets a prospective effective date for *Windsor* and applicable dates for amendments to qualified plans and other regulatory compliance deadlines. Whether this guidance would also govern any legal action by plan participants is unclear, but we believe it is unlikely that the courts would invalidate benefit elections and payments that were made prior to Section 3 of DOMA being found unconstitutional.

Retroactivity issues also arise for employers that have been providing benefits, such as group medical benefits, to same sex spouses but on a non-tax favored basis involving imputed income and post-tax contributions by employees.

Whether, in these situations, employees can now claim income tax refunds and employers claim payroll tax refunds is unclear.

B. Qualified Plans Issues

Windsor impacts many facets of employer sponsored qualified plans (401(k) plans, profit sharing plans, ESOPs, defined benefit pension plans, money purchase pension plans, etc.) in instances where same sex spouses will now be recognized under federal law. The following is a summary of some of the issues for qualified plans:

1. QJSAs, QOSAs, QPSAs, Beneficiary Designations and Death Benefits: In qualified plans, spouses are given protections depending on the type of plan. In pension plans, and certain other plans that offer annuity options, these protections are known as qualified joint and survivor annuities ("QJSAs"), qualified optional survivor annuities ("QOSAs") and qualified pre-retirement survivor annuities ("QPSAs"). These provisions prevent certain distributions without spousal consent and provide other protections for spouses in the event of a participant's death. Where same sex spouses are federally recognized, they will be entitled to these protections. Also, for 401(k) plans and profit sharing plans that do not have annuity options a spouse is entitled to 100% of the death benefit unless the spouse consents to another beneficiary. *Windsor* would therefore invalidate any beneficiary designation of a person other than the federally recognized same sex spouse unless that spouse provides consent.

2. Default Beneficiaries: Many retirement plans provide for a spouse as the first default beneficiary in the event that a participant does not name a beneficiary.

3. QDROs: A federally recognized same sex spouse would be eligible as an "alternate payee" under a qualified domestic relations order ("QDRO"). QDROs divide retirement plan assets in the event of a divorce.

4. Required Minimum Distributions and Rollovers: Certain favorable tax treatment is given to death distributions to surviving spouses including different distribution tables, timing, etc. Also, for example, spouses who roll over death benefits to an IRA are not required to begin distributions in certain circumstances where a non-spouse beneficiary would be required to commence distributions. This favorable tax treatment will now be provided to federally recognized same sex spouses.

5. Hardship Distributions: Certain hardship distributions are allowed for hardships incurred by a spouse in connection with tuition, medical expenses or funeral expenses. Such hardships would presumably also have to be provided in the event of a hardship by a federally recognized same sex spouse.

6. Attribution Rules: Attribution of stock ownership between spouses is used for many purposes in qualified plans such as determining highly compensated employees, top heavy rules, determination of controlled groups, etc. Stock will now be attributed between federally recognized same sex spouses.

C. Group Medical and Welfare Plans Issues

Windsor also has significant issues for group medical plans and other welfare benefit plans.

1. Tax Treatment and 125 Plan Elections: One of the most significant effects is the tax ramifications of providing group medical and other welfare benefits to same sex spouses. For employers that wanted to cover same sex spouses in the past, that coverage involved complicated issues of imputed income to the employee for the employer's contribution toward coverage. Employers incurred additional payroll tax liability because of this imputed income. Also, employees were generally not permitted to pay their share of the premium for same sex spouses on a pre-tax basis thorough a cafeteria/125 plan. Post-*Windsor* favorable federal tax treatment would be available in instances of federally recognized same sex spouses. Further, 125 plans that allow

benefit election changes in the event of a "change in status" will be able to allow such changes in the event of a federally recognized same sex marriage or a change in the same sex spouse's employment status. Because of Section 2 of DOMA, there might not be similar treatment for state tax purposes even if federal recognition ultimately extends to same sex married couples who move to a state that does not recognize same sex marriage.

2. Coverage of Same Sex Spouses: In the medical and welfare benefits area, eligibility is generally covered by the terms of the plan and there is no federal law requirement to cover spouses. *Windsor* does not mandate coverage for medical and welfare plans for federal purposes. So, it should be possible to treat same sex spouses differently than opposite sex spouses in states that do not recognize same sex marriage. Such distinctions should be viewed with caution and may be subject to attack under states that do recognize same sex marriage law. To what extent an ERISA preemption defense would be available in such circumstances is unclear. Also, ***once coverage is provided to a same sex spouse*** who would be recognized under federal law, certain other protections would then be provided as detailed below.

    a. *HIPAA Special Enrollment Rights*: Same sex spouses would have the same right to enroll in a group medical plan sponsored by the employer as opposite sex spouses, which includes immediate coverage upon marriage and enrollment rights in other situations such as where the spouse loses coverage under another employer plan.

    b. *COBRA:* A same sex spouse would have the same COBRA rights as an opposite sex spouse.

3. FSAs, HRAs and HSAs: Qualified medical expenses incurred by a federally recognized same sex spouse may be reimbursed on a tax free basis under a flexible spending arrangement (FSA), health reimbursement arrangement (HRA) or a health savings account (HSA).

4. DCAPs: Earned income of a federally recognized same sex spouse would be taken into account in determining limits under a dependent care assistance plan (DCAP) and an incapacitated same sex spouse may be a "qualifying individual" under a DCAP.

5. FMLA: FMLA affects welfare benefit plans in areas such as cafeteria plans and coordination with COBRA. But the FMLA effects of *Windsor* are much broader. For any federally recognized same sex spouse, an employee will be entitled to leave to care for that spouse who has a health condition recognized under FMLA.

D. Next Steps

For employers who have employees who reside in states that recognize same sex marriages the impact of *Windsor* will be much more immediate.

1. Those employers will want to start to review all plan documents and summary plan descriptions in preparation for amendments.

2. Immediate changes may be required both operationally and to operational documents such as QDRO procedures, beneficiary designation forms, distribution applications, minimum required distribution documents, etc. Operationally, same sex spouses should be treated the same as an opposite sex spouse for these purposes as well as for things such as COBRA rights and testing where spousal attribution may come into play.

3. Imputation of income for welfare benefits offered to same sex spouses should cease and employers should consider whether employees with same sex spouses should immediately be able to pay their share of premiums on a pre-tax basis through a 125 plan.

4. Reimbursement of expenses for same sex spouses from FSAs and HRAs should be allowed.

5. FMLA rights should be extended to employees with respect to the care for a same sex spouse.

6. Employers have no affirmative obligation to seek out an employee's marital status, but it is probably wise to send out materials describing how the employer's benefit plans are implicated by the *Windsor* decision and reminding employees about beneficiary designations, etc.

For employers whose employees reside exclusively in states that do not recognize same sex marriage, like North Carolina, further guidance is needed and a more cautious approach is warranted. Examination of plan documents and SPDs concerning the definition of spouse is advisable. Further guidance is needed however, on the treatment of same sex spouses who are validly married in one state but move to another state that does not recognize same sex marriage.

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