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View From Groom: The Impact of Supreme Court's DOMA Decision on Employee Benefit Plans

By Mark C. Nielsen

On June 26, 2013, the U.S. Supreme Court ruled that section 3 of the Defense of Marriage Act (DOMA), which provides that only persons of the opposite sex could be recognized as ''spouses'' and ''married'' for purposes of federal law, was unconstitutional. The Supreme Court's DOMA decision, captioned *U.S. v. Windsor* (570 U.S. __ (2013)), has immediate implications for employers that sponsor retirement, health and welfare, and fringe benefit plans. Among other things, now that section 3 of DOMA has been declared unconstitutional, plan sponsors may need to make changes to their employee benefit plans to recognize same-sex spouses in the same manner that such plans recognize spouses of the opposite sex. Additionally, the Court's decision requires employers to examine, among other things, their payroll systems and practices as well as Family and Medical Leave Act (FMLA) policies to determine if changes are necessary as a result of the DOMA ruling.

This article provides a brief overview of the Court's DOMA ruling, and then addresses specific steps that sponsors of retirement and health plans should take *now* in light of the Court's ruling. It then discusses key operational and compliance issues that are currently unresolved, but about which plan sponsors should be aware and prepared to take action upon the issuance of guidance from federal and state regulators – as well as courts.

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DOMA

DOMA was signed into law in 1996. DOMA has two provisions that address state laws regarding same-sex marriage, both of which significantly impact employee benefit plans:

- Section 2 of DOMA– which was *not* at issue before the Supreme Court – allows states to decline to recognize the validity of same-sex marriages that were legally performed in other states. For example, DOMA allows a state (such as Virginia) to deny recognition of a same-sex marriage legally entered into in another state (such as New York), even though Virginia would be required to recognize an opposite-sex marriage that was legally performed in New York. The result is that employers and plan sponsors must navigate a patchwork of state laws regarding same-sex marriages.
- Currently 13 states and the District of Columbia issue marriage licenses to same-sex couples.[1] And although some states may provide some ''spousal equivalent'' benefits through civil unions,[2]35 states (and Puerto Rico) have enacted ''mini-DOMA'' statutes or constitutional amend-

[1] These jurisdictions are: California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota (effective August 1, 2013), New Hampshire, New York, Rhode Island (effective August 1, 2013), Vermont, Washington and the District of Columbia.

[2] These states include Colorado, Hawaii, Illinois, Nevada, New Jersey, New Mexico, Oregon, and Wisconsin.

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ments that prohibit recognition of same-sex marriages.[3]

■ Section 3 of DOMA defines ''marriage,'' for purposes of all federal laws and regulations, as the legal union between one man and one woman. It also provides that the term ''spouse,'' as used in any federal law or regulation, only refers to a legally-married person of the opposite sex.

Prior to the *Windsor* decision, DOMA's definitions of ''marriage'' and ''spouse'' had an impact on more than 1,300 federal laws, including the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act of 1974 (ERISA), which regulate employer-sponsored retirement and health and welfare benefit plans. For example, DOMA prevented a retirement plan from recognizing a participant's same-sex spouse under state law as the ''spouse'' to which the survivor annuity applies. Instead, federal rules required the plan to treat the participant as unmarried, regardless of the validity of the marriage under state law. And for health plans, DOMA effectively required that benefits provided to a same-sex spouse were generally subject to federal income tax – even though a participant that covered his or her opposite-sex spouse was not taxed on the value of such coverage. Additionally, a same-sex spouse was not considered a qualified beneficiary under COBRA, and thus could not be afforded COBRA continuation coverage upon the participant's termination of employment, or divorce or legal separation (unless the plan was amended to specifically so provide).

The Court's Decision in *Windsor*

The *Windsor* case was brought by Edith Windsor, who sued the Internal Revenue Service (IRS) for a refund of estate taxes that she was required to pay following the death of her same-sex partner, Thea Spyer. Ms. Windsor and Ms. Spyer were married in Canada in 2007, and New York State, where they lived, recognized the validity of their marriage. Ms. Spyer died in 2010, leaving her assets to Ms. Windsor. Under federal tax law, a person who dies can generally leave assets, including the family home, to his or her spouse without incurring estate taxes. But because of section 3 of DOMA, the IRS treated Ms. Windsor as if she was unmarried, and required her to pay estate taxes in excess of $360,000. Ms. Windsor sued for a refund, asserting that section 3 of DOMA violated the Fifth Amendment's guarantee of equal protection as applied to a person of the same sex who is legally married under state law.

In a 5-4 ruling (authored by Justice Kennedy and joined by Justices Ginsburg, Breyer, Sotomayor and Kagan), the Court held that section 3 of DOMA was unconstitutional. The Court noted that the federal government had historically deferred to state law with respect to what constitutes a valid ''marriage.'' The Court found, however, that ''DOMA's unusual deviation from the usual tradition of recognizing and accepting state definitions of marriage . . . operates to deprive same-sex couples of the benefits and responsibilities that come with the federal recognition of marriage.'' And this, the Court ruled, ''impose[s] a disadvantage, a separate status, and so a stigma upon all who enter into same-sex marriages made lawful by the unquestioned authority of the States.'' In so ruling, the Court found that the purpose of DOMAwas to disadvantage same-sex couples based on an impermissible animus toward such couples. Additionally, it found that ''no legitimate purpose overcomes [DOMA's] purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect in personhood and dignity.'' Accordingly, the Court found that DOMA violated the liberty interests protected by the Due Process Clause of the Fifth Amendment.

Impact on Employee Benefit Plans

The *Windsor* decision concerned an estate tax issue, but its impact is far broader; indeed, as noted, it applies to over 1,300 federal laws that reference a ''spouse'' or ''marriage,'' including the IRC and ERISA, which regulate employee benefit plans. The *Windsor* decision means that the differential treatment of opposite-sex and same-sex couples should come to an end – at least in those states that recognize same-sex marriage. This is because the terms ''spouse'' and ''marriage'' as used in federal laws, such as the IRC, ERISA, COBRA, and the FMLA, will no longer be limited solely to opposite-sex spouses. Rather, for many ERISA-covered plans, a ''spouse'' may now be required to include a same-sex spouse residing in a state where such marriages are legal.

As a result of the *Windsor* decision, employers offering retirement and health and welfare benefit plans need to closely examine their plan documents, summary plan descriptions (SPDs), insurance policies, payroll systems, and compliance practices to determine if amendments are required to change the definition of a ''spouse'' or ''marriage,'' and/or toreflect similar treatment of both opposite-sex and same-sex married couples in those states that permit or recognize same-sex marriages. This could require extensive revision to, among other things, retirement plan documents, health plan documents, COBRA and FMLA policies, and an employer's income tax withholding and employment tax payroll practices.

The chart below provides a high-level summary of some of the changes that may be required for retirement and health and welfare plans:

	DOMA	Post-DOMA
I. *Retirement Plans*		
A. Pension Plans – Qualified Joint and Survivor Annuity (QJSA) (Qualified Plans and ERISA 403(b))	Same-sex spouse treated as non-spouse beneficiary – not required to consent to single life annuity, lump sum, etc. payouts (though plan may require)	Same-sex spouse now entitled to 50% survivor annuity protection (and participant may elect 75% survivor annuity), unless consent to form of payout other than QJSA

[3] The National Council of State Legislatures (''NCSL'') has a helpful website that summarizes the status of state laws regarding same sex marriage. *See* http://www.ncsl.org/issues-research/human-services/same-sex-marriage-laws.aspx (last visited July 19, 2013).

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B. Pension Plans – Qualified Pre-retirement Survivor Annuity (QPSA) (Qualified Plans and ERISA 403(b))	Same-sex spouse not treated as spouse for qualified pre-retirement survivor annuity protection (though plan may allow)	Same-sex spouse now entitled to 50% survivor annuity protection unless consent to waive (where plan doesn't subsidize cost)
C. 401(k) Plans – Payment of Account Balance at Death	Same-sex spouse treated as non-spouse beneficiary – not required to consent to another beneficiary designated by participant.	Same-sex spouse now entitled to 100% of account balance at death unless consent to another beneficiary
D. Hardship Distribution (401(k) and 403(b) Plans)	If plan allows, participant may designate same-sex spouse as primary beneficiary when electing hardship distribution for medical, tuition and funeral expenses of such spouse	Plans now required to recognize same-sex spouse as primary beneficiary for purposes of these hardship distributions
E. Rollovers (all Plans)	Same-sex spouse may make direct rollover only to an inherited IRA	Same-sex spouse now able roll over plan distribution to own IRA or employer plan account
F. Qualified Domestic Relations Orders (QDROs) (all Plans)	Same-sex spouse does not have rights of "alternate payees" to obtain QDROs awarding share of participant's benefits	Same-sex spouse now be able to obtain QDRO if state law recognizes the rights of same-sex spouse (or is entitled to share in community property states)
II. *Health and Welfare Plans*		
A. Health Care Coverage (Including Dental and Vision)	Plans that provide for coverage of (non-dependent) same-sex spouse must impute taxable income equal to the value of the coverage	Same-sex spouse may be covered on a tax-free basis the same as opposite-sex spouse
B. Pre-Tax Reimbursements Under HRAs, Flexible Benefit Plans and Health Savings Accounts	Employee may not pay for health coverage of same-sex spouse with pre-tax dollars or reimburse medical expenses from such accounts (Note: HRAs may reimburse for expenses of a same-sex spouse, if the value of coverage is imputed to the employee's income)	Employee may use pre-tax dollars to pay for health, dental and vision coverage – or medical expenses – of same-sex spouse, without imputation of income.
C. Employment Taxes	Social security (FICA) and federal unemployment (FUTA) taxes payable on imputed income associated with coverage of same-sex spouse	No FICA or FUTA tax on employer-provided, including from pre-tax flex account, coverage of same-sex spouse
D. COBRA	Same-sex spouse covered as dependent not entitled to spousal COBRA rights	Same-sex spouse may be entitled to full COBRA rights (up to 36 months of coverage) in the event of participant's termination of employment, divorce or legal separation
E. HIPAA Special Enrollment Rights	Same-sex spouse not entitled to special enrollment rights	Same-sex spouse may be immediately added to employee's coverage, including where spouse loses coverage under another plan
F. Dependent Care Assistance	Employee may not use dependent care account (DCAP) to pay for care of dependent same-sex spouse on pre-tax basis	Employee may use DCAP dollars, on pre-tax basis, to pay for care of same-sex dependent (subject to dollar cap or, if less, earned income of same-sex spouse)

Action Steps

Many employers have already received calls from employees regarding the Court's DOMA decision, asking when benefits will be extended to such employees' same-sex spouses. Although the agencies that regulate employee benefit plans – in particular the IRS and the Department of Labor (DOL), as well as certain state agencies (such as Departments of Insurance and Taxation and Revenue) – have not yet issued guidance as to how the *Windsor* decision will impact plans and what amendments may be necessary, there are specific steps that employers and other plan sponsors should take now. Among other things, plan sponsors should:

■ **Obtain Same-Sex Marriage Information:** To the extent an employer does not currently gather information about employees with same-sex spouses (*e.g.*, same-sex spouses and domestic partners aretreated the same and coded in payroll and HR systems in the same manner), information regarding same-sex spouses should be gathered, and the existing domestic partner information collection and recordkeeping processes should be modified accordingly.

■ Indeed, because same-sex spouses and domestic partners may be subject to differential tax treatment under federal and state law, it is critical that an employer know which employees have same-sex marriages, and in which states same-sex married couples reside.

■ **Review Plan Documents:** Plan sponsors should carefully review all qualified retirement plan documents, health and welfare documents (including insurance policies and COBRA and HIPAA procedures) and all summary plan descriptions (''SPDs'') to identify any changes to such plans' definitions of ''marriage'' and ''spouse'' that may be required following the Supreme Court's DOMA ruling.

■ References to DOMA in a plan document, whether explicit or implicit (such as a statement that a ''marriage'' or a ''spouse'' will be determined in accordance by federal law), should probably be removed.

■ Employers should also review the plan documents and SPDs more generally for the use of the term ''spouse'' and consider what plan operation changes may be needed to extend coverage to same-sex spouses.For example, plan sponsors should consider whether existing plan language restricting the definition of ''spouse'' or ''marriage'' to only those of the opposite-sex should be removed – especially if the company has employees residing in states that recognize same-sex marriage or, perhaps, employees who were married in such states.

■ Employers should also review their supplemental executive retirement plans, deferred compensation and other nonqualified plans for the potential impact of plan terms such as ''spouse'' and ''marriage'' in light of *Windsor*.

■ **Modify Plan Policies and Procedures**: Employers should review and update plan operations and payroll systems to treat lawful same-sex marriages as spouses, and reflect the same in updated policies and procedures, including HR manuals.

■ Administrative practices that may be impacted include benefit distribution packages, minimum required distributions procedures, QDRO procedures, open enrollment materials, and beneficiary designation forms. Any plan changes should also be reflected in a Summary of Material Modification and/or the SPD.

■ **Update Payroll Practices**: An employer's payroll practices will likely be impacted in numerous ways, including some immediate changes or action steps:

■ Employers may stop reporting otherwise tax-free health and fringe benefits as imputed income to employees with same-sex spouses, to the extent that the IRC extends the benefit to a spouse. Additionally, employers should no longer be required to pay employment taxes (such as FICA) on the value of imputed income with respect to such employees.

■ As discussed below, in the absence of guidance to the contrary, it seems that employers may now voluntarily stop imputing income to employees with same-sex spouses who reside in states where such marriages are recognized. And some employers may choose to stop imputing income to employees with same-sex spouses in all states, although it is unclear if future IRS (or state) guidance will so permit.

■ Plan sponsors should consider filing IRS refund claims (Form 941-X) for employment taxes paid on imputed income for same-sex spouse benefits for open tax years (which generally goes back three years).

■ Employers should perform a general overview of all employee fringe benefits, and consider whether changes are necessary to these policies and procedures (including any employee handbooks) to treat lawful same-sex marriages as spouses.

■ **FMLA**: Employers should review their FMLA policies, given that employees in states recognizing same-sex marriages may now be entitled to up to 12 weeks of unpaid leave to care for a same-sex spouse who is ill, in the same way that an employee may do so with respect to an opposite-sex spouse.

Open Issues

Although *Windsor* makes it clear that section 3 of DOMA is unconstitutional, the decision has impact far beyond the estate tax issue that was addressed in that case – and there are a number of important but unresolved issues with which plan sponsors must grapple pending further guidance from key federal agencies, including the IRS and the DOL, as well as state regulators. President Obama has instructed the Department of Justice to consider the impact of the *Windsor* decision on federal laws and regulations, and we expect a number of agencies – including the IRS and DOL – to issue guidance addressing key questions, including:

■ **Which State Law Governs?**The most common question asked by plan sponsors in the aftermath of*Windsor* is whether plans must recognize same-sex spouses who reside in states where such marriages are *not* permitted or recognized. For example, if an employee resides and marries a same-sex spouse in Maryland (where such marriages are permitted), but the couple then moves to Texas(where the marriage is not recognized), does the plan determine the validity of the marriage based on the ''place of celebration'' (Maryland) or the ''place of residence'' (Texas)? Neither the IRS nor the DOL has yet issued guidance on this issue, although President Obama has indicated his preference that the law of the ''state of celebration''control, and the federal government has adopted this position with respect to benefits for federal employees who have same-sex spouses.[4]

■ At a minimum,it seems that qualified retirement plans will be required to recognize same-sex spouses in the 13 states (and the District of Columbia) that allow such marriages.It is open question whether health plans may continue to limit coverage only to spouses of the opposite sex. Plan sponsors may want to wait for guidance from federal and state regulators when considering the redesign of plans to account for the Court's DOMA ruling.

■ **Should Employers Stop Imputing Income for Health Benefits Extended to Same-Sex Spouses?** We expect the IRS to issue guidance on this issue, but in the meantime, it seems that an employer may stop imputing income now – at least with respect to those employ-

[4] *See*http://www.chcoc.gov/transmittals/TransmittalDetails.aspx?TransmittalID=5700 (last visited July 19, 2013).

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ees who reside in states where same-sex marriages are recognized.

- Note that employers may still be required to impute income for employees who reside in states that do not recognize same-sex marriages(although an employer could stop imputing income prior to the issuance of IRS guidance, and then make a ''true up'' payment for any imputed income that should have been taxed if the IRS so requires).And even if the IRS adopts a ''place of celebration'' rule that allows employers to stop imputing income for employees residing in states where same-sex marriages are not recognized, the employee could nonetheless have income imputed under state law. Employers should therefore pay close attention to both federal and state guidance regarding the impact of *Windsor* on income and employment tax liability.

■ **Does Windsor Apply Retroactively?** Given that DOMA has been declared unconstitutional, employers now face the question of whether its invalidation is retroactive back to 1996 – and whether this could mean that same-sex spouses may now seek benefits for past periods. Regulators are expected to provide guidance on this issue. But based on the manner in which they have previously treated laws impacting plans that were later declared illegal, it would be surprising if regulators took the position that the *Windsor* decision, as applied to employee benefit plans, has retroactive effect.

- Notably, IRC section 7805(b) grants the IRS broad authority to administer the Supreme Court decision prospectively. Given the significant plan amendment and operational changes that *Windsor*may trigger for plan sponsors, the IRS is expected to issue guidance regarding its effective date as applied to qualified plans and the applicable timing of plan amendments to preserve the tax-qualified status of the plan, since many plans currently include DOMA language within the plan document—sometimes at the request of IRS reviewers. The IRS took a similar approach following the Supreme Court's decision in *Central Laborers' Pension Fund v. T.E. Heinz*, where IRS Revenue Procedure 2005-23 limited the retroactive application of the Supreme Court's June 2004 decision.

■ **Are State Laws Prohibiting Recognition of Same-Sex Marriages Still Valid Following Windsor?** As noted above, many states have adopted their own version of DOMA, prohibiting the issuance of marriage licenses to same-sex couples within the state, and/or denying recognition of same-sex marriages that were validly performed in other states. These state laws are expressly permitted by section 2 of DOMA, and the Supreme Court did *not* address the validity of section 2 in the *Windsor* decision. Accordingly, these state laws are still in effect.

- That said, the *Windsor* decision contains sweeping language about the negative impact of these types of laws on same-sex couples, and at least two lawsuits to strike down state DOMA laws (in North Carolina and Pennsylvania) have already been filed.[5]We expect similar lawsuits will be filed in many other states, with potentially conflicting results – perhaps requiring future Supreme Court review to resolve the conflict. As such, employers should be prepared for changes in the laws of the various states in which they operate.

Conclusion

The Supreme Court's DOMA decision and its impact will grow as more states are likely to recognize same-sex marriages. The decision requires careful analysis by employers as to its full implications. Plan amendments will need to be drafted to address the impact of *Windsor*, and payroll and HR policies and procedures will need to be reviewed and revised to address the extent to which same-sex spouses may now have to be recognized by employers and their plans. Employers should stay tuned for a flood of guidance from agencies, and potentially courts, as the *Windsor* decision is implemented.

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[5] *Fisher-Borne v. Smith*, Case No. 1:12-cv-589 (M.D.N.C.) and *Whitewood v. Corbett*, Case No. 1:2013-cv-01861) (M.D.Pa.).