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New IRS DOMA Guidance for Retirement Plans

Recent IRS Notice 2014-19, along with website FAQs, provide additional anticipated guidance (in Q&A format) on the impact of United States v. Windsor for qualified plans. Importantly, the guidance clarifies the impact of the change, the effective date of the change, and the need for (and timing of) plan amendments. The related FAQs also provide examples of the impact of the Windsor decision and appropriate corrective action, including for plans described in section 403(b) of the Internal Revenue Code (“Code”).

In general, the new guidance avoids imposing substantial burdens on plan sponsors, while leaving open some choices to make. We summarize the guidance below.

Background

On June 26, 2013, the Supreme Court held that section 3 of the Defense of Marriage Act (DOMA) – which, for federal law purposes, required a marriage between only a man and woman – was unconstitutional. Thereafter, the IRS issued Revenue Ruling 2013-17, which held that, effective September 16, 2013 (and prior to such date, if so elected), the term “spouse” for all Federal tax purposes includes individuals who have entered into a legal marriage under the laws of the state or foreign country where the ceremony was performed, without regard to the place the participant resides or works. Accordingly, for federal income tax purposes, same-sex couples are treated as married if the couple is lawfully married under the laws of one of the 50 states, the District of Columbia, a U.S. territory or a foreign jurisdiction (“place of celebration” rule). (The DOL adopted the same position in Technical Release 2013-04 (Sept. 18, 2013), but did not address effective dates.) This IRS guidance (and related FAQs) indicated that additional guidance would be forthcoming for qualified plans, including on plan amendments and effective dates.

Notice 2014-19

The Notice –

- summarizes the key qualified plan rules impacted by the Windsor decision,
- provides guidance regarding the applicable effective date, and
- addresses the need for, and timing of, plan amendments.

This guidance is expressly limited to retirement plans qualified under section 401(a) of the Code, but the IRS FAQs extend the guidance to 403(b) plans. The Notice is silent on its applicability for purposes of Title I of ERISA.

A. Impacted Plan Requirements

The Notice summarizes the key provisions impacted by the Windsor decision, and expressly provides that any retirement plan qualification rule that applies because a participant is married must be applied with respect to a participant who is legally married to an individual of the same sex. (Note that the following is not an exhaustive list, for example, it does not mention the favorable section 415 treatment of subsidized QJSA benefits.)

QJSA/QPSA (Code § 401(a)(11)). Certain qualified plans (e.g., defined benefit plans, money purchase pension plans) must provide for payment of plan benefits in the form of a qualified joint and survivor annuity (QJSA) with the spouse, or must provide for a qualified preretirement survivor annuity (QPSA) to the surviving spouse, if the employee dies before retirement. If these rules apply, the QJSA or QPSA may only be waived by a married participant with spousal consent. Moreover, if a pension plan permits loans, then spousal consent must be obtained before making a participant loan. Thus, for example, a participant in a plan subject to the QJSA rules who is married to a same-sex spouse cannot now waive the QJSA without obtaining spousal consent.

“Profit-Sharing Exception” Plans (Code § 401(a)(11)(B)(iii)). Code section 401(k) and certain other qualified defined contribution plans are exempt from QJSA and QPSA requirements provided that, on the death of the participant, a married participant’s benefit is payable in full to the participant’s surviving spouse, unless the spouse previously consented to the designation of a different beneficiary.

Required Minimum Distributions (Code § 401(a)(9)) and Rollover Rules (Code § 402(c)). Additional distribution alternatives are provided for surviving spouses that are not available to non-spouse beneficiaries. For example, a surviving spouse can roll over the benefit to their own IRA or qualified plan, and does not need to take a minimum required distribution (MRD) until the year the participant would have reached age 70-1/2.

QDROs (Code § 401(a)(13)(B)). The anti-alienation rules do not apply to the creation, assignment, or recognition of an “alternate payee’s” right to receive benefits pursuant to a qualified domestic relations order (QDRO), which includes a spouse or former spouse of the participant.

Controlled Groups (Code § 414(b)). Generally, a spouse is treated as owning shares owned by the other spouse for purposes of determining whether corporations are members of a controlled group, pursuant to Code sections 1563(e)(5) and 414(b).

Top-Heavy Provisions (Code § 416). Generally, a spouse is treated as owning shares owned by the other spouse for purposes of determining whether an employee is a key employee under Code section 416(i)(1), including whether an employee is considered a 5% owner, applying the attribution rules of section 318(a)(1).

ESOPs (Code § 409(n), (p)). An employee stock ownership plan (ESOP) that acquires certain employer securities generally must prohibit the allocation or accrual of those shares for the benefit of certain individuals, including the spouse of the seller and the spouse of any individuals who own 25% or more of such shares. Moreover, no portion of the assets of an ESOP attributable to S corporation stock may generally accrue during a non-allocation year for the benefit of any disqualified person (or certain family members thereof), which includes the spouse.

B. Effective Date – June 26, 2013 (Unless Plan Sponsor Elects an Earlier Date)

The Notice expressly provides that qualified retirement plan operations must reflect the outcome of Windsor as of June 26, 2013. Pursuant to the Service’s broad authority under Code section 7805(b)(8) to provide for application of any judicial decision without retroactive effect, no plan qualification issues are raised for failure to treat same-sex

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spouses as spouses prior to such date. Moreover, from June 26, 2013 through September 15, 2013, a retirement plan will still be treated as tax-qualified, even though during this period it treated the same-sex spouse of a participant as a spouse only if the participant was domiciled in a state that recognized same-sex marriages. (Notably, there is no relief for following any “choice of law” provision under a plan document.)

The Service explained that plan sponsors can elect to extend the retroactive effective date of the Windsor decision to any date earlier than June 26, 2013 (but presumably no earlier than 1996). Such a retroactive amendment can be limited to certain purposes, provided that the amendment complies with applicable qualification requirements (e.g., it must be nondiscriminatory). For example, the plan sponsor can elect to apply the Windsor decision earlier solely for purposes of the QJSA and QPSA requirements, and only for annuity starting dates (or dates of death) on or after a specified date.

C. Plan Amendments

The plan document may need to be amended to reflect the holding in Windsor, depending on the existing plan language. Specifically, if a plan’s terms (1) define “spouse” with respect to requirements under Code section 401(a) as consistent with Section 3 of DOMA (e.g., it references DOMA or is limited to a person of the opposite sex), (2) are otherwise inconsistent with the outcome of Windsor, Revenue Ruling 2013-17 or Notice 2014-19, or (3) if the plan sponsor is going to voluntarily adopt an effective date before June 26, 2013 (for some or all plan purposes), then a plan amendment is required. Otherwise, a plan amendment is not required. For example, if the term “spouse,” “legally married spouse” or “spouse under Federal law” are used in the plan without any distinction between a same-sex spouse and an opposite-sex spouse, no amendment is needed. However, IRS notes that a clarifying amendment may still be useful for purposes of plan administration.

In general, the deadline for plan amendments is the later of (1) the interim amendment deadline pursuant to section 5.05 of Rev. Proc. 2007-44 (e.g., the tax filing deadline (including extensions) for the year the change is effective), or (2) December 31, 2014 (or, for a governmental plan, the close of the first regular legislative session of the legislative body with the authority to amend the plan that ends after December 31, 2014). However, in the case of discretionary amendments, for (a) new rights (see IRS FAQ below) or (b) pre-June 26, 2013 effective date for a plan that does not include DOMA type language, the deadline is the end of the plan year the change is effective (or December 31, 2014, if later).

IRS FAQs

The IRS website also includes a summary of these rules, along with “frequently asked questions” touching on some other issues and which are highlighted below:

- **Profit-Sharing Exception** – How does Windsor affect beneficiary designations for Profit Sharing Exception Plans – which require the death benefit to be paid to the surviving spouse? **FAQ-1**

If a participant is lawfully married on the date of death to a same-sex spouse, and the date of death is on or after June 26, 2013, the death benefit must be paid to the same-sex spouse (unless he or she consented to another beneficiary or a QDRO provides otherwise). Note, for deaths prior to September 16, 2013, the definition of spouse can be limited to a same-sex spouse that was recognized as a spouse in the state of domicile of the participant.

- **Choice of Law** – Can the plan document limit the definition of spouse under a choice of law provision to exclude same-sex spouses? **FAQ-2**

No, the plan would fail to be tax-qualified if it does not recognize a same-sex spouse of a participant on or after June 26, 2013. A choice of law provision cannot restrict the definition of spouse, though the plan can limit the term “spouse” to a spouse recognized in the state of domicile prior to September 16, 2013. After that, the “place of celebration” principle applies.

- **Retroactive Corrections** – How is a retroactive Windsor plan amendment implemented? **FAQ-3**

A retroactive plan amendment must be implemented as of the effective date of the amendment, and any corrective action should be consistent with the voluntary correction principles of Revenue Procedure 2013-12 (EPCRS). For example, if spousal consent was not obtained prior to the distribution, a plan may obtain spousal consent to remedy a prior lack of consent following the principles of section 6.04(1) of EPCRS. This section provides for notification to the affected participant and spouse (to whom the participant was married at the time of distribution) so that the spouse can provide spousal consent to the distribution actually made or the participant may repay the distribution and receive a qualified joint and survivor annuity.

- **Additional Rights** – Can a plan be amended to provide new rights or benefits for participants with same-sex spouses? **FAQ-4**

Yes, in light of the Windsor decision, a plan sponsor may choose to amend the plan to provide new rights or benefits for participants with same-sex spouses – such as a new opportunity to elect a qualified joint and survivor annuity. This amendment must otherwise comply with plan qualification requirements (e.g., nondiscrimination provisions and benefit restrictions). Presumably, a plan sponsor could elect to provide new election rights for participants in pay status with annuity starting dates prior to June 26, 2013, but taking into account benefits paid to date (e.g., actuarially reduce the annuity and survivor benefits by amounts already received by the participant) or otherwise allow the participant to repay a lump sum and elect to receive a QJSA form of payment with the spouse.

- **403(b) Plans** – How does Windsor impact 403(b) plans? **FAQ-5**

The same definition of “spouse” under Revenue Ruling 2013-17 and Notice 2014-19 (Q&A 1-3) applies to 403(b) plans, with a plan amendment due by the deadline set forth in Section 21 of Rev. Proc. 2013-22. Thus, unless ERISA also applies, section 403(b) plans are not subject to the spousal protections for qualified plans. They are subject to direct rollover and special MRD rules, however. No guidance is provided for eligible section 457 plans or IRAs.

- **Multiemployer Plans** – Do the restrictions of Code section 432 apply to this amendment? **FAQ-6**

To the extent that a multiemployer defined benefit plan is amended as of June 26, 2013 (but no earlier) to reflect the Windsor decision, the amendment is treated as an IRS-required amendment, provided it is made during the funding improvement period or rehabilitation period – and, therefore, is not subject to the Code section 432 restrictions.

Action Steps

Sponsors and administrators of tax-qualified plans should consider the following action steps:

1. Decide on an Effective Date. The plan sponsor has a number of options:
 - June 26, 2013 – “place of celebration” controls thereafter.
 - June 26, 2013 – September 15, 2013 – if same-sex marriage is recognized in the participant’s place of domicile; “place of celebration” controls thereafter.
 - Prior to June 26, 2013 – for all or selected purposes (e.g., QJSA, QPSA, MRD or rollover purposes). Here, it is important to keep in mind the potential associated corrective actions, additional liabilities/restrictions, impact on nondiscrimination testing, and perhaps even changes in tax liabilities. For example, the plan sponsor may elect to provide a new distribution election (to include a QJSA) for participants in pay status as of a specific date (for annuity starting dates prior to June 26, 2013), if it gets notice of the same-sex marriage (under either the place of celebration or place of domicile test, as elected by the employer).
2. Adopt Plan Amendment. The Plan amendment, if any, should generally be adopted by December 31, 2014, and may impact the SPD/SMM, too.
3. Operational Compliance – EPCRS. Ensure operational compliance with the plan document and any plan amendment (and applicable effective date), and, if not, take corrective action pursuant to Rev. Proc. 2013-12.
4. Forms and Instructions. Confirm that all beneficiary designation forms and enrollment and distribution packages reflect the outcome in Windsor, along with the plan’s policies and procedures regarding spousal treatment.

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