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BENEFITS BRIEF

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# IRS Guidance on Application of Federal Tax Law to Employee Benefit Plans in Light of *Obergefell* Decision

On December 9, 2015, the Internal Revenue Service ("IRS") issued Notice 2015-86 ("Notice"), which provides guidance on the application of federal tax law to qualified retirement plans and to health and welfare plans, including cafeteria plans, in light of the decision of the United States Supreme Court ("Court") in *Obergefell v. Hodges*, 576 U.S. __, 135 S. Ct. 2584 (2015).

As discussed in more detail below, solely for federal tax law purposes, *Obergefell* does not require additional amendments to be made to qualified retirement plans or to health and welfare plans. However, the Notice provides helpful guidance in the event that an employer wishes to make discretionary changes to its plan and/or to allow employees to make mid-year cafeteria plan election changes in light of *Obergefell* – and it reminds employers that there may be changes in the operation (as opposed to the form) of their health and welfare plans as a result of *Obergefell*.

**Background**

In *U.S. v. Windsor*, 570 U.S. __, 133 S. Ct. 2675 (2013), the Court addressed the constitutionality of Section 3 of the Defense of Marriage Act ("DOMA"), which provided that only opposite-sex individuals could be recognized as "spouses" and "married" for purposes of federal law. Following the Court's decision that Section 3 of DOMA was unconstitutional, the IRS adopted the "place of celebration" rule. This rule recognizes, for federal tax purposes, a marriage between two same-sex individuals validly entered into in a state that allows same-sex marriage, regardless of whether the individuals live in a different state that does not recognize same-sex marriages. IRS guidance required employers to administer their qualified retirement plans in accordance with the "place of celebration" rule. The guidance did not require other types of benefit plans, such as health and welfare plans, to adopt a particular definition of "spouse," but it did require that any definition of "spouse" that included same-sex spouses apply the "place of celebration" rule for federal tax purposes, including payroll tax purposes. The Department of Labor issued similar guidance.

On June 26, 2015, the Court issued its long-awaited opinion in *Obergefell*, ruling that the Fourteenth Amendment to the United States Constitution generally requires states to license a marriage between two people of the same sex, thus completing the march toward recognition of same-sex marriage the Court initiated in *Windsor*. Specifically, in *Obergefell*, the Court held that the Fourteenth Amendment requires a state to not only license the marriage of same-sex couples, but also to recognize a same-sex marriage when the marriage was lawfully licensed and performed outside of the state. The ruling means that state laws

that limited marriage to opposite-sex couples are invalid. Please see our prior Benefits Brief for our initial discussion of the *Obergefell* decision.[1]

**The Notice**

The Notice relates solely to the application of federal tax law to retirement plans qualified under section 401(a) of the Internal Revenue Code ("Code") and to health and welfare plans, including Code section 125 cafeteria plans. Importantly, the Notice provides that no inference should be drawn therefrom as to the application of any law other than federal tax law, such as the United States Constitution or Title VII of the Civil Rights Act of 1964, to the treatment of same-sex spouses under employee benefit plans.

- **With respect to qualified retirement plans, employers should be aware that, for federal tax law purposes, no additional changes to plan terms or operation are required to be made as a result of *Obergefell*. Discretionary amendments may be made, but must conform to certain rules set forth in the Notice.**

The Notice confirms that, for federal tax law purposes, a qualified retirement plan is not required to make additional changes as a result of *Obergefell*. The Notice states that plans were required to be amended to recognize same-sex spouses and their marriages with respect to qualified plan requirements pursuant to *Windsor* and IRS Notice 2014-19 no later than December 31, 2014 (or possibly later for governmental plans). However, the Notice provides that a plan sponsor may amend its plan following *Obergefell* to make certain optional changes or clarifications, *e.g.*, to provide new rights or benefits with respect to participants with same-sex spouses, subject to applicable plan qualification requirements and the adoption-timing requirements set forth below.

The Notice reiterates that, in general, under *Windsor* and IRS Notice 2014-19, a retirement plan fails to meet the applicable plan qualification requirements (such as the qualified joint and survivor annuity requirements) if it does not recognize the same-sex spouse of a participant as a spouse on and after June 26, 2013 (the date of the *Windsor* decision), but that a plan will not lose its qualified status if it also applies *Windsor* prior to June 26, 2013. The Notice provides that a plan may still adopt a retroactive amendment to apply *Windsor* prior to June 26, 2013 so long as the amendment otherwise complies with Q&A-3 of IRS Notice 2014-19, which generally requires that applicable plan qualification requirements be satisfied and describes how a plan sponsor may decide to amend its plan retroactively in this regard only for certain purposes.

Any amendments to qualified retirement plans that are contemplated by the Notice are discretionary (rather than interim) amendments. As a result, pursuant to Rev. Proc. 2007-44, they must generally be adopted by the end of the plan year in which the amendment is operationally effective. In the case of a governmental plan, however, the deadline for any amendment made pursuant to this Notice is the later of (1) the end of the plan year in which the amendment is operationally effective, or (2) the last day of the next regular legislative session beginning after the amendment is operationally effective in which the governing body with authority to amend the plan can consider a plan amendment under the laws and procedures applicable to the governing body's deliberations.

The Notice clarifies that an amendment to a single-employer defined benefit plan that is intended to respond to *Obergefell* or the Notice (for example, by extending certain rights and benefits to a same-sex spouse) is subject to the

[1] *See* Groom Benefits Brief, Supreme Court Same-Sex Marriage Ruling Likely to Require More Changes (July 21, 2015), available at http://www.groom.com/media/publication/1608_Supreme_Court_Same-Sex_Marriage_Ruling_Likely_to_Require_More_Changes.pdf.

requirements of Code section 436(c), which generally provides that a discretionary amendment to a single-employer defined benefit plan that increases the liabilities of the plan cannot take effect unless the plan's adjusted funding target attainment percentage is sufficient or the plan sponsor makes the additional contribution specified under Code section 436(c)(2).

- **With respect to health and welfare plans, employers should be aware that federal tax law does not generally require that any specific rights or benefits be offered to a participant's spouse. Mid-year cafeteria plan election changes may be permitted if, as a result of *Obergefell*, the terms or operation of a plan change to allow coverage of same-sex spouses.**

The Notice states that federal tax law generally does not require health and welfare plans to offer any specific rights or benefits to the spouse of a participant. To the extent that a health or welfare plan provides benefits to the spouse of a participant, the federal tax treatment of such benefits as provided to same-sex spouses has already been addressed in prior guidance. The Notice notes, however, that *Obergefell* could require changes in a plan's operation to the extent the decision results in a change in the group of spouses eligible for coverage under the terms of the plan (for example, where a plan covers "spouses" as defined by reference to applicable state law, and it is determined that applicable state law has expanded to include same-sex spouses as "spouses" as a result of *Obergefell*, then the terms of the plan would require coverage of same-sex spouses).

The Notice provides that a cafeteria plan may permit a participant to make a mid-year election change if, as of the beginning of a plan year, a health or welfare plan that is offered under a cafeteria plan does not permit coverage of same-sex spouses, and the terms or operation of the plan change during the plan year to permit coverage of same-sex spouses. However, such a mid-year change may only be made if the terms of the cafeteria plan allow (or are amended to allow as described below) a participant to make a change in coverage due to a significant improvement in coverage during the coverage period under an existing coverage option. The IRS notes that the mid-year election change may be an election by a participant (1) to add coverage for a same-sex spouse to a benefit option in which the participant is already enrolled, or (2) who had not previously elected coverage to add coverage for the participant and a same-sex spouse.

The cafeteria plan may be amended to allow mid-year election changes due to a significant improvement in coverage during the coverage period under an existing coverage option, so long as the amendment is adopted no later than the last day of the plan year including the later of (1) the date same-sex spouses first became eligible for coverage under the plan, or (2) December 9, 2015. Such amendment may be retroactive to the date same-sex spouses first became eligible for coverage under the plan.

**Observations**

The Notice makes clear that, solely for federal tax purposes, no additional amendments are required with respect to either qualified retirement plans or health and welfare plans as a result of *Obergefell*. However, employers should consider whether they want to make any discretionary changes to their plans or allow mid-year cafeteria plan election changes in certain permitted circumstances. In addition, employers should determine whether changes to their health and welfare plans in operation (as opposed to form) are necessary or desirable as a result of *Obergefell*.