THOMPSON COBURN LLP

Thompson Coburn LLP |One US Bank Plaza | St. Louis, MO 63101

U.S. Supreme Court Strikes Down DOMA: What It Means For Plan Sponsors

On June 26, 2013, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA), which denied federal recognition to same-sex marriages. The Court's decision in U.S. v. Windsor has an immediate impact on employers who sponsor and administer benefit plans. Some implications are clear. Health plans will no longer need to impute the value of coverage of same-sex spouses into an employee's income. Same-sex spouses have rights to benefits under qualified retirement plans unless they waive those rights.

Many questions, however, were not answered by the Court in Windsor and employers await future guidance in the form of regulatory reaction, executive orders or advice from agencies as to their interpretations of the decision and its impact. In particular, there is a need for guidance on whether plans must recognize same-sex marriages retroactively, which could give same-sex spouses claims for benefits for past periods. Clarity is also needed on how to administer benefits for same-sex couples who have been legally married in a state that recognizes same-sex marriage but reside in a state that does not.

This alert provides an overview of the Windsor ruling and what we know today about its implications for plan sponsors.

What Did the Court Rule?

Although Windsor will have far-reaching impact, the ruling itself was narrow: the Court ruled that federal law must recognize the same-sex marriages of individuals who were legally married under state laws. Specifically, the Court ruled that Section 3 of DOMA – which provided that, for purposes of all federal laws and

regulations, "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife – was unconstitutional. The Court ruled that Section 3 violated the Fifth Amendment's guarantee of liberty as applied to persons of the same sex who are legally married under state law. After Windsor, whether a "marriage" exists or whether a person is a "spouse" within the meaning of a federal statute or regulation will be determined by state law.

What Didn't the Court Rule?
Because the Court's ruling addressed only the narrow issue above, a number of very important issues remain to be addressed.

The Court Did Not Provide Federal Recognition to All Same-Sex Relationships
The Windsor decision recognized that marriage was traditionally and historically defined by state law. The decision does not require all states to recognize same-sex relationships. Currently, the majority of states do not. States remain free to permit or deny recognition to same-sex marriages under their own state laws and constitutions. This means the status quo will remain in place for many same-sex couples under employee benefit plans.

Many companies have amended their employee benefit programs to provide same-sex couples with benefits that are similar to the benefits provided to opposite-sex couples. For example, some benefit programs provide health plan coverage to same-sex individuals who enter into a domestic partnership agreement, even if that domestic partnership is not recognized or registered under any state law. Since the Windsor decision did not grant federal recognition to relationships that are not recognized as "marriage" under state law, most non-marriage relationships (such as civil unions, registered domestic partnerships and domestic partnership agreements) will likely not be affected by the decision.

Further complicating the matter are the fine distinctions drawn by some state laws. Some state civil union laws provide that same-sex civil unions are granted the same status as "marriage" for state law purposes, even though they are not designated as "marriage." It remains to be seen whether such relationships will be recognized as "marriage" at the federal level. We expect further guidance under the Employee Retirement and Income Security Act of 1974, as amended ("ERISA") and the Internal Revenue Code will address this issue.

Which State's Law Will Apply for Employee Benefits?
The Court did not strike down Section 2 of DOMA, which provides that no state shall be required to recognize a same-sex marriage that is recognized by another state. This raises a number of issues for couples who move from state to state or who live in a state that does not recognize same-sex marriage but travel to a state that does and marry there. Let's assume that a same-sex couple lives and marries in State A, which recognizes same-sex marriage. The couple them moves to State B, which explicitly does not recognize same-sex marriages performed in any other state. The Windsor decision did not address whether the couple is still considered married for purposes of federal law. President Obama has expressed his desire

that a same-sex marriage performed in a state that recognizes such marriage should continue to be honored by the federal government even if the couple then moves to a state that does not recognize the marriage. It remains to be seen whether and to what extent that desire can or will be translated into official policy.

What About Retroactivity?
Windsor did not specifically address whether same-sex couples have any retroactive rights to the benefits described below. For example, suppose a 401(k) plan participant entered into a same-sex marriage, designated someone other than the same-sex spouse as beneficiary (without obtaining the spouse's consent), and died before the decision. Does the surviving spouse have a claim against the plan for survivor benefits? Do same-sex couples have a right to claim refunds for health plan benefits that were previously treated as taxable? We anticipate that the IRS will provide guidance on retroactivity in the near future.

Which States Recognize Same-Sex Marriage?
Licenses for same-sex marriages are currently issued in California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont, Washington and the District of Columbia. In Rhode Island and Minnesota, same-sex marriage legislation was passed this year and takes effect on August 1, 2013. Although New Mexico does not grant licenses for same-sex marriage, it recognizes same-sex marriages entered into in a state that does.

Colorado, Hawaii, Illinois, Nevada, New Jersey, New Mexico, Oregon and Wisconsin have civil union laws.

What Are the Implications for Employee Benefit Programs?

Health and Welfare Plans

- *Imputation of Income.* Employees will no longer pay federal taxes on income imputed for an employer's contribution to a same-sex spouse's medical, dental or vision coverage and employers will no longer be required to pay federal payroll taxes on such amounts. Employers may be entitled to a refund for payroll taxes previously paid. Employers may be required to continue to impute income for state law purposes in states that do not recognize same-sex marriage.

- *Coverage*. Windsor does not address whether plans that provide spousal coverage must cover same-sex spouses. Employers with self-insured plans subject to ERISA are not required to cover spouses and if they do cover some spouses, are not necessarily required to cover all spouses. Arguably, such an employer would not be required to provide coverage to same-sex spouses, although such treatment might be challenged. Employers with plans not subject to ERISA would be subject to any applicable state laws regulating coverage.

• *Pre-tax premiums.* Employees with same-sex spouses may pay the cost of spousal health coverage by reducing pay on a pre-tax basis.

• *COBRA.* Same-sex spouses have the same independent COBRA rights as opposite-sex spouses.

• *Special Enrollment Rights.* Marriage to or divorce from a same-sex spouse is now a HIPAA special enrollment event under plans offering spousal coverage. Whether or not the Windsor decision itself gives rise to special enrollment rights is a question on which we expect guidance from regulators. The federal Office of Personnel Management has announced that federal employees are being given the opportunity to make changes in health benefits enrollment to add their same-sex spouses.

• *FSAs, HSAs and HRAs.* Eligible medical expenses incurred by a same-sex spouse at least since the date of the Windsor decision are eligible for tax-free reimbursement under health care flexible spending accounts, health reimbursement arrangements, and health savings accounts. An employee and a same-sex spouse will share the deduction limit for HSA contributions. Mid-year changes in elections that are otherwise permitted may be based on events involving the same-sex spouse. We expect additional guidance on whether or not a change in the election amount is permitted as a result of the issuance of the Windsor decision and whether or not medical expenses incurred by a same-sex spouse prior to the date of the decision are eligible for reimbursement.

• *Dependent Care Assistance*. The amount contributed to a dependent care assistance account cannot exceed the lesser of the earned income of the employee or the employee's spouse. The income of a same-sex spouse (or lack of income) may make the employee ineligible for a dependent care account or reduce the amount that can be contributed. Whether or not there should be any retroactive reduction in an election amount is not clear.

Qualified Retirement Plans

Spouses have a number of rights under qualified retirement plans (such as defined benefit and 401(k) plans) subject to ERISA. Some examples of these rights, which must now be provided to same-sex spouses, are listed below:

• *Qualified Joint and Survivor Annuities.* For plans subject to the requirement to offer a QJSA (typically defined benefit pension plans), the same-sex spouse must consent to any other form of payment.

• *Surviving Spouse Rights.* Qualified Pre-Retirement Survivor Annuities are required for same-sex spouses when the participant dies prior to retirement (unless the plan allows a participant to waive the QPSA, in which case the waiver must be consented to by the spouse). Profit-sharing, 401(k) and

other defined contribution plans must treat the surviving same-sex spouse as the default beneficiary, and participants must obtain spousal consent if they wish to designate another beneficiary.

• *QDROs*. Same-sex spouses who are divorced can obtain a qualified domestic relations order dividing retirement benefits.

• *Required Minimum Distributions.* The same-sex spouse of a participant who dies prior to commencing benefits will be able to defer distribution to the date the participant would have attained age 70½ instead of being required to commence benefits within one year following the year of death.

• *Hardship Distributions.* For 401(k) plans that follow the safe-harbor distribution standards, an employee with a same-sex spouse will be able to take a hardship distribution due to the spouse's medical, tuition and funeral expenses.

• *Rollover Distributions.* Same-sex spouses will be able to roll over plan distributions to their own IRAs or employee benefit plan accounts rather than only to an inherited IRA.

Next Steps - What Should Plan Sponsors Do Now?

Employers will want to await future guidance before making many of the decisions they will need to make on how to implement the Supreme Court's decision in Windsor. There are certain steps that employers can and should take in the interim, however. Employers should:

• Evaluate the information available to the employer about employees' same-sex spouses. The employer will want to ensure that same-sex spouses are identified by the employer for its records in the same manner opposite-sex spouses are identified. If the employer does not currently distinguish between same-sex spouses and domestic partners in company records, for example, or identifies opposite-sex spouses, but not same-sex spouses in its recordkeeping, the employer should consider modifying its practices.

• Review all plan documents, in particular the eligibility provisions, to determine if provisions that were designed to provide coverage to domestic partners or same sex spouses or designed to restrict coverage to opposite-sex spouses should be changed or modified.

• Be sure that, at least after the date of the Windsor decision, retirement plans in operation provide lawfully married same-sex spouses residing in states where same-sex marriages are recognized the benefit rights to which opposite sex spouses are entitled. (See the lists above.)

• Cease imputing income on health coverage and other benefits provided to same-sex spouses residing in states that recognize same-sex marriage if

income imputation is not required for opposite-sex coverage.

• Permit employees to pay the 2013 cost of health care coverage for lawfully married same-sex spouses residing in states where same-sex marriages are recognized with pre-tax reductions in pay.

• Consider whether to seek a refund for employment taxes paid on imputed income for same-sex spouse benefits for open tax years.

• Begin a review of all employee benefit plans, policies, procedures and handbooks to consider whether changes are needed or desirable.

If you have questions regarding any aspect of this development, or other employee benefits issues, feel free to contact your Thompson Coburn attorney or any member of our Employee Benefits Group.

Cathryn A. Conrad	314-522-6021	cconrad@thompsoncoburn.com
Paul G. Griesemer	314-552-6400	pgriesemer@thompsoncoburn.com
Lori W. Jones	314-552-6568	ljones@thompsoncoburn.com
Michael D. Lane	314-552-6522	mlane@thompsoncoburn.com
Richard J. Pautler	314-552-6470	rpautler@thompsoncoburn.com
Ruth A. Streit	314-552-6381	rstreit@thompsoncoburn.com
Patricia A. Winchell	314-552-6217	pwinchell@thompsoncoburn.com

Thompson Coburn LLP
Chicago | St. Louis | Southern Illinois | Washington, D.C.
www.thompsoncoburn.com