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Effects of Same-Sex Marriage on Employee Benefits

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On May 15, 2008, the California Supreme Court held that same-sex couples have the same right to be married as opposite-sex couples under the California Constitution. Same-sex marriages began on June 15, 2008.[1] In addition, Massachusetts and Connecticut perform same-sex marriages, and the State of New York recognizes marriages between same-sex couples that have taken place elsewhere. The remaining states are divided between those with laws prohibiting the recognition of same-sex marriages performed in other states, and those which may recognize same-sex marriages performed in other states. Although the California Supreme Court decision is groundbreaking in many ways, existing California law provided for equality for same-sex couples in many of the same areas under domestic partnership laws. The California decision does not require that employers offer any particular benefits; it does, however, due to its conflict with the federal Defense of Marriage Act ("DOMA"), require employers to consider the definitions of "spouse" and similar terms in their employee benefit plans and clarify the definitions to avoid fiduciary liability and IRS disqualification issues.

This article discusses some of the challenges in the arena of employee benefits under ERISA[2] and the Internal Revenue Code. This article focuses on California marriages but is equally applicable to Massachusetts and Connecticut unions, as well as to employers in any jurisdictions that employ individuals who have been married elsewhere.

Marriage Law in California

California AB 205, passed in 2003, amended the Family Code to provide that registered domestic partners have the same rights and responsibilities as spouses, including access to family court for dissolution of domestic partnerships, inheritance rights, and child support obligations. In addition, public agencies in California are required to treat domestic partners as equivalent to spouses for employee benefits purposes under AB 205 and extend the same nondiscrimination rights to registered domestic partners as are available to opposite-sex spouses. However, it did not require nongovernmental employers to offer equal employee benefits to domestic partners and spouses.

The May 15, 2008, California Supreme Court decision held that same-sex spouses must be treated the same as opposite-sex spouses for all purposes under California law. This applies to employers with California employees to the extent that California law applies generally to them. However, the majority of employee benefit programs maintained by non-governmental employers are governed by ERISA. ERISA broadly preempts state attempts to regulate the operation of employee benefits, and as a result, it does not appear that state law could require employers to modify their benefit plans to provide additional rights or benefits to married same-sex couples.[3]

However, same-sex marriage does raise a number of important questions for employers, particularly in light of DOMA.[4] Adopted in 1996, DOMA provides that, for purposes of interpreting and applying federal law, the term "marriage" means a "legal union between one man and one woman as husband and wife," and the term "spouse" refers only to "a person of the opposite sex who is a husband or a wife." In addition, DOMA provides that no state is required to give effect to a marriage or marriage-equivalent between same-sex couples that is recognized under the laws of another state. However, DOMA does not generally preclude states or employers from recognizing or

providing benefits and protections to same-sex spouses.

DOMA does, however, limit the tax benefits available to same-sex spouses under the Internal Revenue Code, many of which are only available to "spouses" or "dependents." Its interaction with ERISA is more limited. Rather than requiring or prohibiting coverage of same-sex spouses under ERISA-governed employee benefit plans, DOMA instead shifts the focus to the terms of the plans themselves: if the terms of the plan document provide for coverage of same-sex spouses (whether expressly or arguably), ERISA — rather than DOMA — mandates that the coverage be extended.

Nevertheless, if certain tax-advantaged benefits, discussed below, are granted to same-sex spouses, the sponsoring plan could be disqualified. Thus, the key to determining the tax and administrative consequences will lie in the plan documents.

Action Items for Employers

Employers should carefully review their plan documents for issues arising under California and other states' laws. Most benefit plan issues relating to same-sex marriages turn on the manner in which a plan defines the terms "marriage" and "spouse." Under many benefit plans, a participant's "spouse" is an individual to whom he or she is legally married under applicable state law. For states like Massachusetts, California and Connecticut, where same-sex couples can be married, and for states such as New York (and possibly New Mexico, New Jersey and Rhode Island), where same-sex marriages performed in other states are recognized, such a definition will include same-sex spouses. If the employer's intent is to exclude same-sex spouses, the employer should amend its plans to clarify the definition, to avoid the risk of litigation over this issue.[5] If the employer's intent is to include same-sex spouses, certain administrative actions should be taken to ensure compliance with the Internal Revenue Code.

Since employers may provide certain spousal benefits (those not prohibited by DOMA) even in the states that prohibit recognition of same-sex marriage, one issue for employers to consider is whether they wish to define "spouse" as (i) "wife or husband under applicable state law" or (ii) "wife or husband as defined in any jurisdiction, worldwide". The first of these two definitions would limit same-sex spouses to those married and residing in California or Massachusetts and any of the four other states that do, in fact--or may--recognize same-sex marriage (New Mexico, New York, New Jersey and Rhode Island), while the second definition would cover same-sex spouses married in California, Massachusetts, or a foreign country, even if residing in one of the 43 states that precludes recognition of same-sex marriages from other jurisdictions.

Furthermore, although the Internal Revenue Code obligates employers providing employee benefits to a nondependent same-sex spouse to value those benefits and report them as additional income to the employee spouse for Federal income tax purposes, these benefits are are not subject to state income tax under California, Massachusetts, Connecticut or Vermont law tax laws.[6] The amount subject to federal income tax is the fair market value of the benefits (i.e., the cost to COBRA beneficiaries). Benefits to same-sex spouses are also subject to tax withholding and FICA and FUTA. Note that the tax benefits associated with many employee benefits may be available to same-sex spouses who satisfy the definition of "dependent" set forth in Section 152 of the Internal Revenue Code.[7]

Employers must also be aware of the need to track coverage elections relating to same-sex spouses. Employers should ensure that their computer systems and communication materials and enrollment forms are designed to elicit sufficient information to allow them to track and report contributions made to purchase benefits for same-sex spouses in order to reconcile differing state and federal tax treatment obligations.

Issues for Retirement Plans

Divisions of Retirement Assets in Connection with Divorce

Same-sex spouses are entitled to community property rights for property acquired during a marriage in California. While California judges may grant domestic relations orders[8] dividing the assets of the couple, including assets held under a retirement plan benefits held by an employee, pursuant to a divorce, it appears that ERISA preempts recognition of such a domestic relations order issued in a same-sex divorce proceeding by a qualified retirement plan. Therefore, benefit plan administrators should caution participants with same-sex spouses to structure divisions of assets without reliance on QDROs. It may, however, be possible for a QDRO for a former same-sex spouse to be recognized by a plan if the former spouse was also an IRS-qualified dependent[9] of the participant.

Spousal Annuity Benefits and Death Benefits
Both the Internal Revenue Code and ERISA require qualified retirement plans to provide a pre-retirement surviving spouse's pension in defined benefit pension plans. These benefits are not required to be granted to same-sex spouses, but employers may choose to amend their qualified retirement plans to provide comparable benefits to same-sex spouses. However, the default marital pension benefit (a qualified joint and survivor annuity, or "QJSA") required to be provided in defined benefit plans may not apply to a participant with a same-sex spouse; rather, the IRS requires that his or her default pension be in the form of a single life annuity unless the participant elects another form of payment. However, a participant with a same-sex spouse may affirmatively elect a marital or joint pension with a spouse. Moreover, the IRS does not require a same-sex spouse to consent to the participant's election of an optional form of benefit, although the plan may require consent if the employer desires.

Rollovers
The IRS rollover rules require qualified retirement plans to exclude same-sex spouses from the definition of spouse for purposes of rollovers. However, an employer may amend its qualified retirement plan to permit non-spouse (including same-sex spouse) beneficiaries to roll over eligible rollover distributions to an "inherited IRA" (not, however, to any other type of qualified retirement plan).

Hardship distributions
Section 401(k) plans may permit participants to receive distributions in the event of certain situations involving financial hardship. These events include incurring medical care, tuition and burial expenses for family members, among other items. For this purpose, a "family member" includes only a spouse, children or other dependents, and the term "spouse" excludes same-sex spouses. However, in some cases a same-sex spouse is considered a dependent under the Internal Revenue Code and may therefore be considered a "family member" for purposes of hardship distributions. Also, employers may amend their 401(k) plans in order to allow a participant the ability to take a hardship distribution when his or her beneficiary is the one having the hardship; therefore if the spouse is designated as the participant's beneficiary, the hardship eligibility rules will apply to the spouse. Although these provisions are not necessarily aimed at same-sex spouses, they may address some of the issues facing those in a same-sex marriage.

Required Minimum Distributions
A qualified retirement plan may not consider a same-sex spouse to be a "spouse" under the required minimum distribution rules because the IRS requires that different mortality tables must be used for married participants (as defined under DOMA) versus single participants.

Issues for Health and Welfare Plans

Coverage of Same-Sex Spouses
Health and welfare plans governed by ERISA, such as medical, dental and vision benefit plans, may cover domestic partners and same-sex spouses. Employers should confirm that the plan definitions of eligible individuals correspond with their administrative practices.

COBRA
COBRA[10] requires group health plans that cover 20 or more employees to make healthcare continuation coverage available to employees, their spouses, and dependent children in various specified circumstances when it would otherwise end. Same-sex marriages can complicate the administration of these requirements if health plan documents are not clearly drafted to indicate which, if any, continuation benefits will be made available. COBRA indicates that "spouses" of covered employees are eligible to continue their health care following a qualifying event, but includes no specific definition of that term. Under DOMA (and ERISA, which generally preempts the direct application of California law to health plans), a spouse is an individual who is legally married to a covered employee of the opposite sex. Thus, California law will probably not require the extension of COBRA coverage to registered domestic partners, but employers may choose to offer COBRA-like continuation benefits through their health plans.

Cal-COBRA
California has enacted law similar to COBRA that is applicable to fully-insured health plans and HMOs covering from 2 to 19 employees ("Cal-COBRA").[11] For the smaller health plans to which Cal-COBRA applies, insurance carriers and HMOs are obligated to treat same-sex and opposite-sex

spouses in an identical manner for coverage purposes. Thus, same-sex spouses who experience qualifying events under Cal-COBRA should be entitled to 36 months of continuation coverage. However, "extended" Cal-COBRA coverage under AB 1401[12] applies by its terms to both large and small fully-insured health plans, and the manner in which ERISA, DOMA, Cal-COBRA, and California marriage laws will interact in this context is unclear. For large health plans, extended Cal-COBRA coverage is available only to individuals who have exhausted their COBRA continuation rights. As noted above, same-sex spouses have no entitlement to COBRA coverage and may therefore have no way to access the extended Cal-COBRA coverage that insurance carriers and HMOs are obligated to provide even if their employers otherwise offer COBRA-like continuation benefits.

HIPAA

The portability provisions of HIPAA[13] provide special health plan enrollment rights to "spouses" and "dependents." These rights allow the enrollment of eligible individuals outside a health plan's annual open enrollment period. DOMA effectively limits these rights where the individual at issue is a same-sex spouse. However, because HIPAA confers special enrollment rights for "dependents" as well, a same-sex spouse who qualifies as a dependent may also be entitled to these rights.

Cafeteria Plans

Cafeteria plans (also known as Section 125 flexible benefit plans) are primarily governed by federal law. As a result of the Internal Revenue Service's application of DOMA, events affecting same-sex spouses will not qualify as "change in status events" permitting changes to participant contribution and coverage elections under cafeteria plans. Employers are not free to adopt more liberal provisions in this context. Moreover, reimbursements under health care flexible spending accounts for nondependent same-sex spouses cannot be permitted; nor can pre-tax payments for insurance premiums be made for nondependent same-sex spouses.[14]

Voluntary Employee Beneficiary Associations

Voluntary employee beneficiary associations ("VEBAs") can provide only a de minimus amount of their benefits to same-sex spouses or risk losing tax-exempt status.

Conclusion

Employers in all states should be aware of how their employee benefit plans are written and administered to ensure that their plan terms are being followed and that their plans remain qualified under the Internal Revenue Code and in compliance with ERISA and other applicable law.

Footnotes

[1] We note that a proposition to amend the California Constitution to prohibit same-sex marriage is on the ballot for November of 2008. However, even if it passes, the marriage licenses obtained by same-sex couples prior to that date may remain effective, since the California Attorney General has opined that the amendment does not appear to be retroactive.
[2]Employee Income Retirement Security Act of 1974, as amended.
[3]ERISA preempts state laws and regulations that "relate to" employee benefit plans, with the exception of those that regulate the business of insurance, banking, or securities. ERISA § 514. As a result, ERISA supercedes state laws and regulations whether or not they actually conflict with its provisions.
[4]1 U.S.C. § 7.
[5] ERISA generally requires benefit plan fiduciaries to administer their plans in strict accordance with their terms. For tax-qualified retirement plans, the Code imposes a similar obligation. Thus, if a benefit plan incorporates a typical definition of "spouse" but excludes same-sex spouses who arguably fit within that definition, the plan's fiduciaries could be regarded as failing to follow the terms of the plan, thereby potentially breaching their fiduciary duties. Note, however, that many benefit plan documents provide that fiduciaries possess discretion to interpret ambiguous plan terms; this discretionary authority could be used effectively to rebut a claim of benefit entitlement by a married same-sex couple. Nevertheless, clarity in plan drafting can prevent the assertion of such a claim in the first place.
[6]CAL. REV. & TAX. CODE § 17021.7.
[7]See, e.g., IRS Letter Ruling 200339001.
[8]Domestic relations orders are issued by state courts in domestic relations proceedings, and provide for the payment of all or a portion of a participant's assets in a retirement plan to be paid to

the former spouse or dependents. If such an order complies with the requirements of the Internal Revenue Code and ERISA, the order is a qualified domestic relations order ("QDRO"). Retirement plans are generally required to make distributions in accordance with QDROs.
[9]A same-sex spouse may be considered a "dependent" for purposes of a QDRO if all of the following criteria are met:

- The individual has no dependents.
- The individual has the same principal place of abode as the plan participant and is a member of the participant's household.
- The individual's gross income is less than the personal deduction amount ($3,500 in 2008).
- The participant provides over one-half of the individual's support.
- The individual is not a dependent of any other individual.

Internal Revenue Code § 152.

[10]Internal Revenue Code § 4980B; ERISA §§ 601-609.
[11]CAL. HEALTH & SAFETY CODE § 1366.27; CAL. INS. CODE § 10128.57.
[12]CAL. HEALTH & SAFETY CODE § 1366.29; CAL. INS. CODE § 10128.59. Among other things, AB 1401, enacted in 2002, mandates that all California insurance carriers and HMOs offer supplemental Cal-COBRA coverage to individuals whose COBRA coverage ends less than 36 months after their qualifying events occur.
[13] The Health Insurance Portability and Accountability Act of 1996.
[14]For purposes of health care reimbursement accounts and the pre-tax payment of insurance premiums through a cafeteria plan, a "dependent" is defined as discussed in footnote 9, above, except that the individual may have an income exceeding the exemption amount, and may have his or her own dependents. Internal Revenue Code §§ 105(b), 152.