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If you have questions, please contact your regular Groom attorney or any of the attorneys listed below:

Jon W. Breyfogle
jbreyfogle@groom.com
(202) 861-6641

Elizabeth T. Dold
edold@groom.com
(202) 861-5406

Christine L. Keller
ckeller@groom.com
(202) 861-9371

David N. Levine
dlevine@groom.com
(202) 861-5436

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

Mark C. Nielsen
mnielsen@groom.com
(202) 861-5429

IRS "Place of Celebration" Rule For Same-Sex Marriages Expands Rights and Simplifies Plan Administration

On August 29, the IRS and Treasury issued their first wave of guidance regarding the impact of *United States v. Windsor* – in which the Supreme Court declared section 3 of the Defense of Marriage Act ("DOMA") unconstitutional – under the Internal Revenue Code. Specifically, Revenue Ruling 2013-17 (the "Ruling," Sept. 16 *IRS Bulletin*), along with two sets of "Frequently Asked Questions," provide important guidance on two key open issues – the definition of "spouse," and the effective date of the decision, for Federal tax purposes.

As more fully described below, "spouse" is defined broadly in the Ruling to include all same-sex marriages that were performed in a domestic or foreign jurisdiction having the legal authority to sanction marriages – the "place of celebration" principle – without regard to the state law where the spouse is domiciled. (Thirteen states and the District of Columbia currently recognize same-sex marriages, as do roughly the same number of foreign countries, including Canada.) The decision is effective prospectively as of September 16, 2013 (with an optional retroactive effective date for payroll and tax refunds within the statute of limitations). The IRS also promises to issue additional guidance regarding the impact on qualified plans, cafeteria plans, and a streamlined payroll refund process for employers, and issues surrounding possible retroactivity. Our comments on this IRS guidance follow.

We note that DOL guidance is also expected and may impact benefit plans, too, especially in the health area. Incoming DOL Secretary Tom Perez emailed DOL agency heads on August 9 stating that they should "look for every opportunity to ensure that we are implementing this decision in a way that provides the maximum protection for workers and their families." EBSA officials recently indicated they are working on post-*Windsor* guidance, although it likely will take more time due to the need to coordinate with multiple agencies.

Revenue Ruling 2013-17 – In large part, the IRS focused the legal analysis on its long-standing position on common-law marriages first articulated in Revenue Ruling 58-66 – which recognizes a valid common-law marriage even if the taxpayer later relocates to a state that does not – and emphasized the need for a uniform nationwide rule for efficient and fair tax administration, to support its holdings. Notably, in rejecting the "state of domicile" approach, the Ruling recognizes the massive administrative complexities of that position – stating that "plan administration would grow increasingly complex and certain rules, such as those governing required distributions under section 401(a)(9), would become especially challenging."

The Ruling announces the following holdings, effective prospectively as of September 16, 2013, for Federal tax purposes:

- ***"Spouse" Includes Lawful Same-Sex Marriages.*** The term "spouse" (and husband/wife) includes an individual married to a person of the same sex if the individuals are lawfully married under state law, and the term "marriage" includes a same sex marriage. State law includes any domestic or foreign jurisdiction having the legal authority to sanction marriages.

- ***"Place of Celebration" Controls the Definition of "Spouse."*** The IRS adopts a general rule recognizing a marriage of same-sex individuals that was validly entered into in a state whose laws authorize the marriage of two individuals of the same sex – even if the married couple is domiciled in a state that does not recognize the validity of same-sex marriages.

- ***No Impact on Domestic Partnerships.*** The Ruling confirms that the term "spouse" (and husband/wife or marriage) does not include individuals (whether the same or opposite sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state.

The Ruling may (but is not required to) be applied retroactively for purposes of the employees' Federal income tax returns (e.g., Form 1040-X), and employers employment tax returns (e.g., Form 941-X), provided that the statute of limitation is open (generally, 3-year statute of limitations (e.g., 2010 forward)) and a consistent position is taken within the return/claim. The Ruling expressly states that a refund/credit may be requested to recover overpayments of employment and income tax with respect to employer-provided health benefits or fringe benefits that were provided by the employer and are excludable from income under an applicable Code provision, including –

- Section 106 – health care coverage (including dental and vision), *i.e.*, the value of the spousal coverage is no longer taxable income,

- Section 117(d) – qualified tuition reduction,

- Section 119 – meals and lodging for the convenience of the employer,

- Section 129 – dependent care assistance program (i.e., with respect to expenses incurred for the care of a spouse who is physically or mentally incapable of caring for himself/herself), or

- Section 132 – fringe benefits (e.g., the value of the various spousal benefits that now fall under no additional cost services, employee discounts, and retirement planning services, are no longer taxable income to the employee).

Thus, for example, if an employee participated under a cafeteria plan (sec. 125), elected pre-tax salary deferrals for his/her health coverage, and paid on an after-tax basis for same-sex spouse coverage, the affected taxpayer "may" treat the after-tax amounts that were paid by the employee as pre-tax deferrals. This means that an employee can apply for a refund of federal taxes on his/her own by filing Form 1040-X. Presumably, this also means that an employer may, but need not, apply for a refund (on Form 941-X) for prior employment taxes paid. If a refund/adjustment is sought by the employer for the FICA/FUTA (and federal income tax withholding for 2013 only), it should be sought for all impacted employees on a consistent basis. Future guidance is expected to provide a stream-lined filing approach for these refunds.

On the tax-qualified plan front, the Ruling indicates that future guidance will address the retroactive application of the decision to other employee benefits (and related plans/arrangements). This guidance will consider the consequences of retroactive application to all impacted parties – the plan sponsor, the plan, the employer, and employees and beneficiaries. It will also provide sufficient time for plan amendments, and "any necessary corrections" so that the plan and benefits will retain favorable tax treatment.

FAQs – The IRS issued two sets of FAQs – one set for same-sex marriages and one set for domestic partners/civil unions – making it very clear that different rules apply. Most of the same-sex marriage FAQs center around an individual's Federal income tax return refunds, and related credits and filing status. Below, we summarize those relating to employee benefits.

Can an employee file an amended Form 1040 to obtain a refund of the Federal income taxes paid on the value of health coverage for a same-sex spouse that was reported on Form W-2? **FAQ-10:** Yes, the employee can file a Form 1040-X within the statute of limitations to seek a refund of those taxes. For example, if the value of the 2012 employer-funded portion of the spouse's health coverage was $250 per month, the employee can file a Form 1040-X for 2012, excluding the value of the coverage (e.g., $3,000 for 12 months) from income.

Is the answer the same if the employee was covered by a cafeteria plan, and paid for the spousal coverage with after-tax dollars? **FAQ-11:** Yes, the employee can file a Form 1040-X within the statute of limitations (generally 2010 forward) to exclude the after-tax premiums from income.

Can the employer file for a refund of the social security and Medicare taxes paid on such benefits (described above)? **FAQ-12**: Yes, as long as the statute of limitations remains open (generally 2010 forward), employers can seek a refund/adjustment via Form 941-X for the overpayment of the employer and employee portions of the taxes on such benefits. Future guidance is expected to provide for a welcomed stream-lined approach.

Can the employer also file for a refund of Federal income tax withholding on such benefits for prior years? **FAQ-13:** No, the employer can only seek an adjustment for the income tax withholding for 2013 (Form 941-X); the employee needs to file a Form 1040-X to seek a refund for income tax withholding for prior years (see FAQ-10/11 above).

Can the employer seek only the employer portion of the FICA taxes if the former employee with a same-sex spouse cannot be located after reasonable attempts (or the employee declines to give consent to the refund)? **FAQ-14:** Yes, and pending guidance will provide for a special administrative procedure to file these claims.

What rules apply to qualified retirement plans pursuant to Rev. Rul. 2013-17? **FAQ-16:** Qualified retirement plans (presumably, all tax-favored plans – e.g., Code sections 401(a), 403(b), 457(b) and IRAs) are required to treat a same-sex spouse (based on place of celebration) as a spouse for purposes of satisfying the federal tax laws relating to qualified retirement plans, regardless of the applicable state law in the state of domicile. As under prior law, a person who is in a registered domestic partnership or civil union cannot be treated as a spouse for plan purposes.

What are some examples of the consequences of these rules for qualified retirement plans? **FAQ-17:** For a defined benefit plan, even if the employer operates in a state that does not recognize same-sex marriages, the participant is treated as married to a same-sex spouse if the place of celebration rule applies. For a 401(k) or other defined contribution plan that comes under the "profit-sharing plan" exception (i.e., provides for payment of account balance to spouse with no annuity option), upon the death of an employee, the same-sex spouse must be paid the employee's account balance unless the spouse has consented to another beneficiary under the applicable rules. The

plan can provide that the default beneficiary of an unmarried participant is the registered domestic partner (unless the participant elects otherwise).

When does Rev. Rul. 2013-17 apply to qualified retirement plans? **FAQ-18:** Qualified retirement plans must comply with these rules as of September 16, 2013, and future guidance will address the rules prior to such date. (Note that the optional retroactive effective date noted above does not extend to matters relating to qualified retirement plans.)

What will future guidance on qualified retirement plans address? **FAQ-19:** The IRS intends to issue further guidance on how qualified retirement plans and other tax-favored retirement arrangements must comply with the *Windsor* decision and Revenue Ruling 2013-17, including plan amendment requirements and timing, and "any necessary corrections" relating to plan operations for prior periods.

Action Steps – The deadline IRS has set is rather tight. By the September 16, 2013 effective date, employers and plan administrators should take the following steps (while awaiting additional guidance on the potential retroactive application of the decision and on plan amendments).

Retirement Plans

- Regardless of the plan document terms, beginning September 16, 2013, treat all same-sex spouses as "spouses" for plan purposes. This is particularly important for beneficiary designations (obtaining proper spousal consent) and paying plan benefits particularly in the event of death, to ensure that same-sex spouses are entitled to spousal rights and protections. (See our prior chart of impacted plan benefits.) http://www.groom.com/media/publication/1270_Supreme_Court_Rules_on_Same_Sex_Marriage_DOMA_Unconstitutional_Summary_Chart.pdf

- Consider sending a participant communication to notify participants of Windsor and the IRS guidance, and recommend they update participant records (e.g., update their beneficiary designation forms), indicate marital status on the distribution forms, and provide spousal consent, when required.

- Review and update plan distribution forms and administrative procedures to make sure they reflect the new law – generally treating a same-sex spouse as a spouse for plan purposes. This includes a review of the domestic partner/same-sex marriage procedures, and procedures for minimum required distributions, Code section 415(b) limits, QDROs, loans, hardships, rollovers, and, of course, QJSA/QPSA benefits.

Health, Welfare and Fringe Benefit Plans

- If health, welfare and fringe benefits are currently provided to same-sex spouses (e.g., via a domestic partnership designation), stop imputing income no later than September 16, and clarify plan documents and summary plan descriptions to reflect that "spouse" now includes a same-sex spouse and to distinguish between same sex spouses and domestic partners/civil unions.

- If health, welfare and fringe benefits are not currently provided to same-sex spouses (e.g., via a domestic partnership designation), consider whether to add such benefits and clarify plan documents and summary plan descriptions accordingly.

- With respect to coverage under a cafeteria plan, including a health flexible spending account and dependent care flexible spending account, clarify that the term "spouse" now includes same-sex spouse. For certain rules, such as the dependent care assistance plan contribution limits, this is likely mandatory. Additional IRS guidance regarding cafeteria plan administration is expected, including guidance regarding the circumstances under which the *Windsor* decision provides a basis for employees to make a mid-year election change under the cafeteria plan.

- With respect to coverage under a health savings account, notify employees that a same-sex spouse will be considered a "spouse" for purposes of contribution limits and tax-free distributions for qualified medical expenses.

- With respect to coverage under a health reimbursement arrangement, clarify whether a same-sex spouse will be considered a spouse for purposes of tax-free distributions for qualified medical expenses.

- If health benefits are provided to same-sex spouses, clarify that COBRA continuation of coverage and HIPAA special enrollment requirements apply to same-sex spouses in the same manner as any other spouse.

- If health and welfare benefits are funded through a voluntary employees beneficiary association ("VEBA"), determine whether trust document needs to be amended to reflect that "spouse" includes same-sex spouse.

- Determine whether spousal life insurance (including optional purchase provisions), accidental death and dismemberment insurance or beneficiary designations need to be updated to reflect that spouse includes a same-sex spouse, and coordinate with insurance carriers. Perform a similar review self-funded plans and coordinate with third-party administrators.

In all of the above areas, it will be important to update enrollment materials and plan entry paperwork to reflect the new rules and options available to same-sex spouses in light of *Windsor*.

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We hope this information is helpful and look forward to working with our clients to make the changes required or desired in light of the IRS guidance.