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Regulatory Brief: The DOMA decision and retirement plans

Vanguard Strategic Retirement Consulting | November 2013

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Earlier this year, the U.S. Supreme Court (the “Supreme Court”) made headlines when it struck down a key provision of the Defense of Marriage Act (DOMA). The Supreme Court’s ruling eliminated the DOMA mandate that federal law recognize only marriages between a man and a woman. Because a number of states have enacted laws permitting same-sex marriages, the Supreme Court’s ruling raised many questions about employer-sponsored retirement plans governed by the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act of 1974 (ERISA).

Recently, the Internal Revenue Service (IRS) and the Department of Labor (DOL) issued guidance clarifying how benefit plans should be administered in cases where participants have entered into legally recognized same-sex marriages. This *Regulatory Brief* describes the relevant provisions of DOMA, outlines the Supreme Court’s ruling this summer and the recent guidance by the IRS and DOL, and identifies the key retirement plan features impacted by the ruling and guidance. The attached checklist also gives retirement plan sponsors a road map for complying with the new guidance.

Background

In 1996, the Defense of Marriage Act was signed into federal law by President Clinton. Section 3 of DOMA provides that a marriage may only be between a man and a woman for purposes of federal law. Additionally, Section 2 of DOMA allows states to disregard legal same-sex marriages performed under the laws of another state.

Under DOMA, even if a same-sex couple lived in a state that recognized same-sex marriage, the marriage was not recognized for federal purposes. As a result, federal benefits and responsibilities associated with marital status were reserved for opposite-sex couples only. DOMA impacted more than 1,000 federal laws and regulations, including ERISA and the IRC.

U.S. Supreme Court issues landmark decision

On June 26, 2013, in *United States v. Windsor*,¹ the Supreme Court declared Section 3 of DOMA unconstitutional. The Supreme Court held that Section 3 of DOMA violated due process and equal protection principles under the Fifth Amendment of the U.S. Constitution. The Supreme Court didn’t

¹ The *Windsor* case involved New York state residents Edith Windsor and Thea Spyer, a same-sex couple that legally wed in Canada in 2007. At the time of Spyer’s death in 2009, New York didn’t allow same-sex marriages to be performed, but it did recognize and give full effect to same-sex marriages performed in other states and jurisdictions (such as Canada). Therefore, Windsor and Spyer were considered married for purposes of New York state law but not for purposes of federal law because of DOMA. Upon her death in 2009, Spyer left her entire estate to Windsor. Because her marriage wasn’t recognized for purposes of the federal tax exemption on estate taxes for surviving spouses, Windsor was required to pay in excess of \$350,000 in federal estate taxes. Windsor filed suit for a refund of the taxes, claiming that DOMA was unconstitutional.

rule on the constitutionality of Section 2 of DOMA, which remains in effect. As such, a state that doesn't recognize same-sex marriage isn't required to do so.

At the time of this publication, 14² states and the District of Columbia recognize same-sex marriage. The 14 states are: California³, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Rhode Island, Vermont, and Washington. Some foreign nations also recognize same-sex marriage.

The Supreme Court's decision raised questions about whether same-sex couples who marry in states or jurisdictions that recognize their marriages ("state of celebration") would be considered married for federal tax and retirement plan purposes if they resided in a state or jurisdiction that doesn't recognize same-sex marriage ("state of residence").

Regulatory guidance

On August 29, 2013, the IRS released Revenue Ruling 2013-17. The Revenue Ruling provides, effective September 16, 2013, that same-sex couples married in a state or foreign jurisdiction that recognizes same-sex marriage will be married for federal tax and qualified retirement plan purposes. Following suit, on September 18, 2013, the DOL published similar guidance in Technical Release 2013-04 that adopted the "state of celebration" rule for purposes of employee benefit plans.

In both cases, the guidance clearly states that it applies only to marriages between same-sex couples, but that it doesn't apply to registered domestic partnerships, civil unions, or similar formal (but nonmarriage) relationships recognized under state law.

Client planning note: While qualified retirement plans must comply with the guidance effective September 16, 2013, additional guidance is forthcoming with respect to the periods before the September 16 effective date. The additional guidance may also include a grace period for the adoption of plan amendments and may provide sufficient time to implement any necessary corrections.

The practical impact of this guidance is that for employer-sponsored retirement plans, the state where the marriage takes place (i.e., the "state of celebration") and not the state of residence determines if a same-sex couple is entitled to spousal rights and obligations. For example, a same-sex couple married in New York (which recognizes same-sex marriage) and residing in Pennsylvania (which doesn't recognize same-sex marriage), would be considered married for purposes of federal tax law, including qualified retirement plan benefits.

Client planning note: The list of states that adopt same-sex marriage laws is expected to change in the future. For employers whose employees live in a variety of states, it is likely that some employees will live in states that recognize same-sex marriage while other employees will live in states that don't. Additionally, even for employers that have only one work location in a state that doesn't recognize same-sex marriage, it's possible that they employ (same-sex) married individuals who have chosen to get married in a state that recognizes same-sex marriage or who have relocated from a state that did recognize same-sex marriage. This is an anomaly for administering qualified plans under ERISA, which typically rely on a uniform federal standard. Employee communications about same-sex marriage may need to be customized accordingly.

² The Illinois state legislature passed marriage equalization legislation on November 5, 2013. The governor is expected to sign the bill, which would allow Illinois to start recognizing same-sex marriage in June 2014.

³ On June 26, 2013, the Supreme Court also ruled in *Hollingsworth v. Perry*, which is a case involving various procedural issues about the availability of same-sex marriage in California. As a result of the *Hollingsworth* ruling, same-sex marriage is again allowed in California.

Impact for plan sponsors

Effective September 16, 2013, legally married same-sex spouses now have the same spousal rights as opposite-sex spouses under tax-qualified or ERISA-governed retirement plans, regardless of the state in which they live. Spousal rights extended to married same-sex couples include:

- **Qualified joint and survivor annuity (QJSA) and qualified pre-retirement survivor annuity (QPSA) benefits.** Spousal consent rights now apply. A surviving spouse may also be eligible for additional survivor benefits at the time of the participant's death, depending on the terms of the plan.
- **Qualified domestic relations orders (QDRO).** Same-sex spouses may now request a QDRO to protect their retirement benefits in the event of a divorce.
- **Hardship distributions.** IRS safe harbor hardship distribution rules allow a participant to take a distribution to pay for the qualifying expenses of a spouse, such as medical care, tuition, and burial costs.
- **Required minimum distribution (RMD).** Spouses qualify for more favorable treatment under required minimum distribution (RMD) rules, which govern taxable withdrawals from a retirement account after age 70½.
- **Rollover rules.** A spouse who inherits his or her spouse's retirement account is entitled to the same rollover rights as the participant. This enables the spouse to preserve the account's tax-deferred status by rolling the account over into his or her own IRA or other qualified plan (i.e., a spouse isn't limited to a rollover to an inherited IRA).

Client planning note: Generally, plan sponsors should apply the same policies and procedures for legally married same-sex spouses that are applied to opposite-sex spouses for purposes of spousal consent and other impacted transactions/distributions.

Summary and next steps

Because of the *Windsor* decision and subsequent guidance, many same-sex couples now qualify for certain favorable retirement plan provisions previously reserved for opposite-sex couples. To ensure compliance, plan sponsors should evaluate their plan documents, forms, and operations and review plan administration for those services not provided by Vanguard.

- **A post-*Windsor* (DOMA) plan sponsor checklist is provided at the end of this *Regulatory Brief*.**

While Revenue Ruling 2013-17 and Technical Release 2013-04 provided clarity, additional guidance is expected from the IRS regarding retroactive application, the timing of any required plan amendments, and any potential corrections related to operations for periods before September 16, 2013.

Client planning note: Vanguard is committed to assisting plan sponsors in meeting their compliance requirements with respect to the expanded definition of spouse. To that end, Vanguard is reviewing and updating our systems, processes, and forms as appropriate.

Plan sponsors will need to determine how DOMA impacts their benefit plans and their workforce and may consider additional communication about DOMA. Vanguard can provide a sample participant communication for use by plan sponsors.

Vanguard will continue to inform plan sponsors and participants of further developments regarding the impact of the *Windsor* decision. In the meantime, please contact your Vanguard representative if you have any questions or need additional information.

Post-Windsor (DOMA) plan sponsor “checklist”

Plan documents

- Review plan documents, including Summary Plan Descriptions (SPDs), to determine if there’s a definition of “spouse”. And if a definition of “spouse” exists, make sure it’s compliant. Also review provisions around domestic partnerships or civil unions.
- Because neither ERISA nor the Internal Revenue Code requires that plan documents define the term “spouse,” many plans don’t include this definition in their plan documents and SPDs. If the plan documents don’t define “spouse”, there’s no plan amendment required.
- Examples of definitions requiring amendment:
 - “Spouse as defined by federal law or as defined by the Defense of Marriage Act.”
 - “Spouse is a member of a marriage between a man and a woman.”
- Example of a definition that doesn’t need to be amended:
 - “Spouse is anyone who marries another person in a state or foreign jurisdiction that recognizes the marriage (same sex or opposite sex), regardless of state of residence.”

If a plan amendment is necessary, there is uncertainty regarding the timing of when the amendment must be adopted. Additional guidance is expected that will confirm whether plan sponsors have beyond the end of the current plan year to adopt amendments. Operational compliance with the regulatory guidance is required as of September 16, 2013, regardless of the timing requirements for plan amendments.

Beneficiary determination

- When reviewing or approving beneficiary payments, plan sponsors may want to verify marital status of participants at the time of their deaths. However, plan sponsors should ensure they request the same proof of marital status for all surviving spouses (opposite sex and same sex).
- Additional review may be required beginning September 16, 2013, for participants who were members of legally recognized same-sex marriages at the time of their deaths.
 - If a same-sex spouse was named as primary beneficiary, no further review is required.
 - If a nonspouse beneficiary was named as primary beneficiary, payment may not be made to the nonspouse beneficiary unless the same-sex spouse waived his or her spousal rights.

Qualified domestic relations orders (QDROs)

- Most plans have QDRO procedures. The QDRO procedures are either a stand-alone document or may be incorporated into the SPD. Legally married, same-sex couples will have the same rights and obligations as opposite-sex couples if their marriage is dissolved. The QDRO procedures should be reviewed to make sure there are no gender-specific references. Any gender-specific references should be removed.

Hardship withdrawals

- Hardship withdrawals are now available for certain financial hardships of a legally married same-sex spouse.
- Plan sponsors should apply the same procedures to processing hardship withdrawals for legally married same-sex spouses as apply to opposite-sex spouses.

Required minimum distributions (RMDs)

- Any gender-specific references to RMDs in plan documents will need to be removed. Spouses generally have more options regarding the treatment of RMDs received as beneficiary payments.

Rollovers

- Any gender-specific references to rollovers in plan documents or distribution forms will need to be removed. Spouses generally have more flexibility than nonspouses in how they treat rollover distributions. For example, as a beneficiary, a spouse can choose to roll over a plan distribution in his or her name, rather than in the name of the deceased plan participant.

Participant communications

- Participant communications that seek to explain plan features or are geared toward general education related to retirement savings should be reviewed to ensure that they don't include gender-specific references.
- Plan sponsors may want to consider targeted communication to those employees most likely affected by these changes (e.g. employees identified as being part of a domestic partnership through the company's health and welfare plans).
- Plan sponsors should remind all participants about the importance of updating beneficiary designations including a message that legally married same-sex spouses now need spousal consent to designate a nonspouse beneficiary.

Previous payment/Denial of benefits based on marital status

- An open issue remains with respect to retroactivity and the impact of the *Windsor* ruling and the regulatory guidance on previously paid benefits.
 - For example, it's unclear whether a legally married same-sex spouse who was denied an annuity benefit under a QJSA plan before September 16, 2013, would receive this benefit following the *Windsor* decision.
- The IRS has indicated that guidance on retroactivity is forthcoming. Plan sponsors should wait for future guidance before determining if corrective action is needed.

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