

EMPLOYEE BENEFITS UPDATE

July 2013

The Impact of the Supreme Court's DOMA Decision On Your Employee Benefit Plans and Policies

Executive Summary

- The Supreme Court in United States v. Windsor recently struck down Section 3 of the Defense of Marriage Act, effectively creating a patchwork of different state laws that determine who qualifies as a “spouse”. This ruling will result in significant changes to the administration of employer-sponsored retirement plans, health and welfare plans, payroll practices, and FMLA policies. However, significant questions also remain unanswered until the government issues guidance for the employer community.

What You Should Do

- Review the charts in this Employee Benefits Update, and the checklist of next steps, so that you can determine how the Supreme Court's decision is likely to change your benefit plans and policies, as we wait for further guidance from the government about the details of how these changes will be implemented.

On June 26, 2013, the U.S. Supreme Court in United States v. Windsor ruled as unconstitutional Section 3 of the Defense of Marriage Act of 1996 (“DOMA”), which provided that federal law did not recognize same-sex marriages. The Windsor decision effectively leaves the definition of marriage up to the states, so that in states where same-sex marriage is legal (i.e., California, Connecticut, Delaware, District of Columbia, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont and Washington), same-sex spouses are entitled to the same benefits under federal law as opposite-sex spouses. However, the Supreme Court did not address Section 2 of DOMA, which permits states to refuse to recognize same-sex marriages performed in other states. Accordingly, DOMA Section 2 remains in force for the time being. The demise of Section 3 but the survival of Section 2 of DOMA leaves a great deal of uncertainty for

employers in states that do not recognize same-sex marriage, or for employers who have employees and operations in multiple states, because they must now determine how to provide benefits to same-sex spouses going forward.

This Employee Benefits Update provides you with the following tools to help you figure out how you and your organization should respond to this latest change in the landscape of your employee benefit plans and policies:

- 4 charts summarizing the impact of the Supreme Court’s decision on:
 - Tax-qualified retirement plans;
 - Medical, dental, vision and prescription drug plans;
 - Welfare and fringe benefit plans; and
 - Payroll practices and employment policies.
- FAQs reflecting some of the more significant unanswered questions.
- A checklist of action steps that you should consider taking to help your organization respond to the Supreme Court decision.

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There are many moving parts to understanding how the Windsor decision will affect your employee benefit plans and policies. If we can assist in analyzing how your plans may be impacted and helping you to develop an effective communication and project management strategy for your organization, please contact us.

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Impact on Tax-Qualified Retirement Plans

Plan Feature	Impact
<p><i>Annuity distribution options</i> (required in a traditional defined benefit pension plan, cash balance plan, or money purchase pension plan; optional in a profit sharing plan or 401(k) plan)</p>	<p>Same-sex spouses will be eligible for these annuity options (Qualified Pre-Retirement Survivor Annuities; Qualified Joint & Survivor Annuities; and Qualified Optional Survivor Annuities).</p> <p>It remains unclear how this will be handled, retroactively, for participants who have made benefit distribution elections or who are already in pay status.</p>
<p><i>Death Benefits</i></p>	<p>Same-sex spouses will now be a participant's beneficiary for any death benefits that are payable from a retirement plan, unless they consent to the designation of an alternate, non-spouse beneficiary.</p>
<p><i>Required Minimum Distributions</i> (which generally begin by April 1st of the year after the participant turns 70-1/2)</p>	<p>Because same-sex spouses will be named as the participant's beneficiary, the participant's lifetime distributions will be able to be based on the joint life expectancies of the participant and spouse; if the participant dies before starting benefits, the same-sex spouse will have the right to defer the start of the RMDs.</p>
<p><i>Qualified Domestic Relations Orders</i></p>	<p>QDROs will be recognized on the dissolution of legal same-sex marriages.</p>
<p><i>Hardship Distributions</i></p>	<p>Hardship distributions for the medical, tuition, and funeral expenses of a same-sex spouse will be permitted.</p>
<p><i>Spousal Consents for Plan Loans and Other Distributions</i> (Not provided or required in all plans)</p>	<p>If a plan requires spousal consent for loans and other distributions (and not all plans have this requirement), then this obligation will be extended to same-sex spouses.</p>
<p><i>Rollover Rights for Plan Distributions</i></p>	<p>Same-sex spouses will be able to rollover eligible distributions to their own IRAs or another qualified plan.</p>

Impact on Medical, Dental, Vision and Prescription Drug Health Plans

Plan Feature	Impact
<p><i>Eligibility and Coverage</i></p> <p>(ERISA does not require that spouses be covered by health plans, and most health plans look to state law to define “spouse”)</p>	<p>Fully-insured health plans in states that recognize same-sex marriage will be required to offer coverage to same-sex spouses if the plans offer coverage to opposite-sex spouses.</p> <p>Self-funded health plans (exempt from state insurance law) in states that recognize same-sex marriage will likely be required to offer coverage to same-sex spouses if the plans offer coverage to opposite-sex spouses.</p> <p>It remains unclear whether a plan must cover a same-sex spouse if the marriage was performed in a state that recognizes the same-sex marriage, but the plan is sponsored (or the employee and spouse are domiciled) in a state that does not recognize same-sex marriage.</p> <p>Employers will need to determine how changes to coverage for same-sex spouses will impact their decision about offering coverage to same-sex domestic partners or civil union partners, and what documentation may be required (if any).</p>
<p><i>Tax Treatment of Coverage</i></p>	<p>Employees with same-sex spouses who are covered on an employer health plan will no longer have income imputed on the value of employer-paid coverage for federal tax purposes.</p> <p>Imputed income for state tax purposes remains unclear.</p>
<p><i>HIPAA Special Enrollment Rights</i></p>	<p>Employees with same-sex spouses will be able to add their spouses to health coverage, and to change elections in the case of marriage, divorce, legal separation, or the loss of coverage under the spouse’s plan.</p> <p>Guidance is expected on whether the <u>Windsor</u> decision itself will be considered a special enrollment event for a limited period of time.</p>
<p><i>COBRA Rights</i></p>	<p>Covered same-sex spouses will have COBRA rights. However, COBRA rights are not required to be provided to domestic partners or civil union partners (although many plans voluntarily provide COBRA-like rights to them).</p>
<p><i>Medical Flexible Spending Accounts (FSAs), Health Reimbursement Accounts (HRAs), and Health Savings Accounts (HSAs)</i></p>	<p>Eligible medical expenses incurred by same-sex spouses will be reimbursable.</p>

Impact on Welfare and Fringe Benefit Plans

<p><i>Section 125, Cafeteria or Flexible Benefit Plans</i></p>	<p>Mid-year qualifying change of status events, which permit election changes, will now include applicable events related to same-sex spouses.</p> <p>Guidance is expected on whether the <u>Windsor</u> decision itself will be considered a qualifying change of status event for a limited period of time.</p>
<p><i>Dependent Care Flexible Spending Accounts</i></p>	<p>If an employee’s same-sex spouse becomes unemployed and is available to take care of their children, the employee will no longer be eligible to obtain reimbursement for dependent care expenses.</p> <p>Expenses to care for an incapacitated same-sex spouse who is the employee’s dependent may be eligible for reimbursement if the expenses are incurred in order to enable the employee to continue working.</p>
<p><i>Life & AD&D Insurance</i></p>	<p>Same-sex spouses will automatically be named the beneficiary of any group-term life and AD&D insurance plan, to the extent that the plan otherwise provides that spouses are the default beneficiaries, unless the employee designates an alternative beneficiary.</p> <p>Same-sex spouses will likely be able to obtain spousal life insurance coverage, if that is offered to opposite-sex spouses.</p>
<p><i>Fringe Benefits</i></p>	<p>Fringe benefits such as no additional cost services, employee discounts, retirement planning services, reduced tuition or tuition assistance, and gym facilities will now be able to be provided to same-sex spouses without imputing income for federal tax purposes.</p>

Impact on Payroll Practices and Employment Policies

<p><i>Payroll: W-4 Withholding Exemptions</i></p>	<p>Employees with same-sex spouses will be able to file new W-4s if they wish to change their withholding exemptions and file joint Federal tax returns.</p> <p>The impact on state income tax withholding (and state versions of the W-4) will vary depending on whether the state in which the employee and his/her same-sex spouse are domiciled recognizes same-sex marriage for state tax purposes.</p>
<p><i>Family Medical Leave Act</i></p>	<p>Employees with same-sex spouses will be entitled to federal Family and Medical Leave Act rights with respect to family leave events or medical conditions involving the same-sex spouse.</p> <p>Equivalent state family and medical leave rights will depend on whether the state recognizes same-sex spouses.</p>

Open Questions

Could a plan choose to define “spouse” to exclude a same-sex spouse?

While ERISA and the Code generally allow employers broad discretion in choosing who is entitled to benefits, certain federally mandated benefits (such as certain annuity distribution rights for retirement plans and COBRA rights for health plans) are required to be provided to a “spouse”, even though there is no longer a statutory definition of that term after Windsor. Accordingly, could a plan sponsor define “spouse” narrowly to only mean opposite-sex spouses? While this is currently unclear, this approach seems particularly risky, and plan sponsors should be extremely leery of adopting this approach pending further guidance.

Can plans treat same-sex spouses and domestic partners differently?

The Windsor decision addresses only the treatment of legally married, same-sex spouses and does not address the status of domestic partners or civil union partners. Therefore, employers should evaluate what changes, if any, they wish to make to their policies on coverage of domestic partners and civil union partners, as well as to procedures regarding the level of documentation that may be required for an employee to verify coverage for the employee’s spouse (whether same-sex or opposite-sex), domestic partner, civil union partner, and dependent in any employer-sponsored benefit plan.

How should a plan treat the same-sex spouse of an employee who was married in a state that permits same-sex marriage, but now lives in a state where same-sex marriages are not recognized?

While the Windsor decision struck down DOMA Section 3, it left intact DOMA Section 2, which permits states to refuse to recognize same-sex marriages performed in other states. After Windsor, a same-sex spouse who is legally married to an employee and continues to reside in a state that allows same-sex marriage should be entitled to spousal treatment and benefits, for purposes of federal law. However, absent further guidance, it is not clear whether federal law will continue to treat a same-sex partner as a “spouse” if the same-sex couple moves to a second state that does not recognize same-sex marriage.

Will a plan administrator have to revisit past benefit decisions in the light of Windsor?

The retroactive application of Windsor is unclear, especially with respect to retirement plan distributions. Guidance is expected on this point, as well as on the extent to which employees, and their employers, might be able to file refund claims for income taxes and payroll taxes that were paid on imputed income on the value of medical coverage and other fringe benefits provided to domestic partners.

Will there still be discrepancies between state tax administration and federal tax administration?

Prior to Windsor, the discrepancy between state tax administration and federal tax administration (with respect to issues such as imputed income and withholding) occurred in states that recognized same-sex marriage. Pending further guidance from the IRS, Windsor potentially reverses that, creating a discrepancy in states that do not recognize same-sex marriage.

Checklist of Action Steps

As noted above, a number of significant legal issues remain unsettled, and we encourage employers to wait for further guidance from the government before taking formal action to amend their benefit plans and employment policies. The federal government has already announced how the benefit plans covering federal workers will be impacted, so we are hopeful that guidance for the private employer community will be issued in the near future. In the meantime, we encourage employers to take the following steps:

- ✓ Prepare and distribute a high-level communication to your employees, letting them know that you are reviewing all of your plans in light of the Supreme Court decision, that you are monitoring the situation, and that you will be communicating any changes to your plans and policies as soon as guidance is issued.
- ✓ Inventory all of your benefit plans and employment policies and determine which ones are likely to be impacted. It is likely that changes will need to be made to the following:
 - Benefit plan documents
 - Summary plan descriptions
 - New hire kits and benefit enrollment materials
 - Employee handbooks, especially FMLA policies
 - QDRO procedures
 - COBRA forms
 - Beneficiary forms
 - Distribution notices
- Determine what changes, if any, you might make to your policies that recognize domestic partners and civil union partners.
- Determine what changes, if any, you might make to your policies that employees verify dependents enrolled in a plan by providing documentation of their spouses, dependents, domestic partners, and civil union partners, since many employers currently require documentation of domestic partners only and not spouses.
- Determine the extent to which you, as an employer, will monitor an employee's marital status and state of residence or domicile. If you have employees from multiple states, or if you conduct business operations in multiple states, determine the extent to which you want your benefit programs to differentiate among your employees due to the differences in state recognition of same-sex marriage.
- ✓ Coordinate with your payroll vendor:
 - Changes to W-4 (and state equivalent forms), especially if an employee wants to change his or her withholding exemptions for federal tax purposes but not state tax purposes.
 - Adjustments to imputed income for any medical coverage or fringe benefits that might have been offered to domestic partners and will now be available to same-sex spouses.
 - Retroactive refunds that your organization might seek (if any) on payroll-related taxes that were withheld on imputed income.
- ✓ Coordinate with your vendors (including flex plan administrators, COBRA administrators, leave administrators, etc.) how any changes will be implemented to formal plan documents and summary plan descriptions, as well as to informal and administrative manuals or guides that are often used to process benefits.
- ✓ Once guidance is issued, update all required plans and related documents, and develop an employee communication strategy about changes for current employees, new hires, and former employees who still have benefit rights, such as COBRA rights and retirement plan distributions.
