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Supreme Court Same-Sex Marriage Ruling Likely to Require More Changes

On June 26, 2015, the United States Supreme Court ("Court") issued its long-awaited opinion in *Obergefell v. Hodges*, ruling in a 5-4 vote that the Fourteenth Amendment to the United States Constitution generally requires states to license a marriage between two people of the same sex, thus completing the march toward recognition of same-sex marriage the Court initiated two years ago in *US v. Windsor*. Specifically, in *Obergefell*, the Court held that the Fourteenth Amendment requires a state to not only license the marriage of same-sex couples but also to recognize a same-sex marriage when the marriage was lawfully licensed and performed outside of the state. The ruling means that state laws that limited marriage to opposite-sex couples are invalid.

We comment below on the key issues for employers to review in determining whether changes are needed to their employee benefit plans and tax and payroll practices.

The Supreme Court Decision

As noted above, the Court held that the Fourteenth Amendment requires a state to license the marriage of same-sex couples and to recognize a same-sex marriage when the marriage was lawfully licensed and performed outside of the state. Justice Kennedy wrote the Court's opinion, and he was joined by Justices Ginsburg, Breyer, Sotomayor, and Kagan. Chief Justice Roberts and Justices Scalia, Thomas, and Alito dissented.

Justice Kennedy wrote that, in recent years, the public's view of same-sex couples has shifted to one of "greater tolerance." He noted that the right to marry is, in accordance with longstanding views of the Court, protected by the Constitution, and that such right is a fundamental right in the liberty of a person. He wrote that, as such, under the Fourteenth Amendment, same-sex couples may not be deprived of that right.

In a strong dissent, Chief Justice Roberts stated that, in accordance with the Constitution, whether same-sex couples should be able to marry should be determined by "the people acting through their elected representatives" rather than by the Court. The Chief Justice's dissent was joined by Justices Scalia and Thomas.

***Obergefell's* Impact on Employee Benefits and Tax and Payroll Practices**

The decision in *Obergefell* follows the 2013 decision of the Court in *U.S. v. Windsor*. In *Windsor*, the Court addressed the constitutionality of Section 3 of the Defense of Marriage Act ("DOMA"), which provided that only opposite-sex individuals could be recognized as "spouses" and "married" for purposes of federal law. Following the Court's decision that Section 3 of DOMA was unconstitutional, the Internal Revenue Service ("IRS") adopted the

"place of celebration" rule. This rule recognizes, for federal tax purposes, a marriage between two same-sex individuals validly entered into in a state that allows same-sex marriage, regardless of whether the individuals live in a different state that does not recognize same-sex marriages. IRS guidance required employers to administer their qualified retirement plans in accordance with the "place of celebration" rule. The guidance did not require other types of benefit plans, such as health and welfare plans, to adopt a particular definition of "spouse," but it did require that any definition of "spouse" that included same-sex spouses apply based on the "place of celebration" rule for federal tax purposes, including payroll tax purposes. The Department of Labor ("DOL") issued similar guidance.

Although the Court's decision in *Windsor* resolved many of the benefit and related tax issues at the federal level for employers and providers, the Court's most recent decision is likely to have significant implications, as follows:

- ***Employers should be aware that state income tax laws should change with respect to health and welfare benefits that cover same-sex spouses.***

Among other potential changes, employers should no longer be required to impute (or withhold) state income tax for the provision of health benefits to a same-sex spouse. This should be true regardless of an employee or same-sex spouse's state of domicile or the state in which the marriage license is/was issued. Significantly, many states' laws track the federal tax law definition of taxable wages, even in many of the states that may not have licensed or recognized same-sex marriages prior to the *Obergefell* decision. Thus, no change in state law tax treatment may be required if state tax law already excluded the coverage from the employee's wages. Employers should carefully review applicable state tax laws to determine what, if any, changes are needed in this regard.

Questions have arisen regarding the specific date upon which an employer should cease imputing income for state tax purposes in light of the *Obergefell* decision. We are expecting some states to provide express guidance regarding when an employer may and/or must stop imputing income (including possibly on a retroactive basis) with respect to employer-paid same-sex spousal coverage. In the absence of such guidance, it appears employers should cease imputing income on a prospective basis in light of the Court's holding.

While the *Obergefell* decision will require some employers to revisit their states' tax treatment of employer-paid same-sex spousal coverage, the Court's prior holding in *Windsor* and the administrative guidance that followed largely resolved the federal tax treatment of such coverage by providing that an individual is a "spouse" for purposes of federal law based upon the couple's "state of celebration," regardless of the state of domicile. Thus, post-*Windsor*, coverage provided to an employee's same-sex spouse generally is already excludable from an employee's income for federal income and payroll tax purposes.

The *Obergefell* decision does not require a change to federal or state tax law regarding employer-paid health care with respect to an employee's non-spouse, non-dependent domestic partner. Thus, this coverage generally will remain subject to federal income and payroll taxation, as well as state taxation, depending on applicable state law.

- ***The "place of celebration" rule no longer needs to be taken into account in determining whether to recognize a same-sex marriage.***

Prior to the Court's decision in *Obergefell* and following its decision in *Windsor*, benefit and related tax considerations were based upon the employee's "place of celebration," which is the state in which the marriage was validly entered into, rather than a couple's current state of domicile. The Court's decision in *Obergefell* makes it unnecessary for an employer or plan provider to consider an employee's state of celebration in making tax and benefit determinations

for an employee and/or his or her same-sex spouse (but presumably an employer will still want evidence and/or representations from the employee that he or she has entered into a valid same-sex marriage under an applicable state's laws).

- ***Employers and issuers that do not already provide same-sex spousal benefits may need to determine the extent to which they must now offer such benefits if they provide for opposite-sex spousal benefits.***

While many employers and issuers may already have begun offering same-sex spousal benefits, some employers and issuers may not currently be offering such benefits. In light of the Court's decision in *Obergefell*, depending on the nature of the health coverage as insured or self-funded, and depending on applicable state insurance laws, employers and issuers may be required to extend same-sex spousal benefits to the extent they are providing any opposite-sex spousal benefits.

Regarding private employers specifically, to the extent an employer self-funds its health plan benefits, it appears based upon existing law that these employers may be able to continue to offer only opposite-sex spousal benefits. Federal laws governing an employer's self-funded plan generally do not require that an employer offer any spousal benefits at all. Moreover, existing federal case law has generally held that state-based nondiscrimination rules are preempted with respect to self-funded ERISA plans.

Very recently, the U.S. Equal Employment Opportunity Commission ("EEOC") concluded as part of an administrative ruling that discrimination based upon sexual orientation does give rise to a valid claim for sex discrimination under Title VII of the Civil Rights Act of 1964. *See ____ v. Foxx,* Agency No. 2012-24738-FAA03 (July 15, 2015). Specifically, the EEOC stated:

> [W]e conclude that sexual orientation is inherently a 'sex-based consideration,' and *an allegation of discrimination based on sexual orientation is necessarily an allegation of sex discrimination under Title VII*. A complainant alleging that an agency took his or her sexual orientation into account in an employment action necessarily alleges that the agency took his or her sex into account.

Id (emphasis added).

The EEOC's most recent finding is quite notable as it appears to deviate from existing federal case law, which generally has not found a basis for a Title VII claim based upon discrimination against individuals based upon their sexual orientation. In light of the Court's holdings in *Windsor* and *Obergefell*, and certainly as a result of the EEOC's recent findings, we expect to see further litigation and EEOC enforcement actions on these issues in the coming years.

With respect to employers who sponsor insured plans, the legal and business landscape is perhaps even less clear. As noted above, ERISA preempts many state laws; however, ERISA does not preempt state laws related to banking, securities, *and insurance*. Thus, state insurance laws are generally saved from ERISA preemption. Certain states' insurance laws may have required issuers of group health plan coverage to offer opposite-sex coverage only, or more generally, may have required issuers to offer spousal coverage, with "spouse" for this purpose being defined by reference to the underlying state law definition. Prior to the Court's holding in *Obergefell*, this generally required issuers to offer spousal coverage as part of marketing group health plan coverage to employers, with such spousal coverage being defined by reference to applicable state law.

The Court's decision in *Obergefell* raises a host of complex issues for employers and issuers with respect to same-sex spousal coverage. It appears that with respect to policies issued in states that only required carriers to offer opposite-sex coverage (or to offer spousal coverage more generally), issuers will now be required to offer same-sex as well as opposite-sex spousal coverage. In states that do not specifically require an issuer to offer any spousal coverage, it is unclear whether an issuer could choose to only offer opposite-sex spousal coverage. While certainly unclear at present, it seems an argument could be made that if the applicable state administrative agency (*e.g.*, a department of insurance) approves such policies, doing so nevertheless could be unconstitutional along the lines set forth by the Court in *Obergefell*.

For employers who sponsor insured plans and make available only opposite-sex spousal benefits, it is unclear the extent to which an employer could adopt plan terms to exclude same-sex spouses from coverage, even if the issuer with respect to such coverage is required by state law to make such coverage available. Notably, in a CMS set of Frequently Asked Questions ("FAQs") issued on March 14, 2014 related to a marketing requirement for carriers with respect to the Affordable Care Act, CMS appeared to indicate that an employer may be able to continue to prohibit access to insured same-sex spousal benefits via the employer's plan terms related to eligibility, even if the issuer is required to make such benefits available to the employer. This FAQ, however, was issued for a limited purpose and may or may not represent the position of other federal agencies and/or a reviewing court on the issue.

Issuers could find themselves in some difficult situations to the extent an employer with an insured plan seeks to use plan terms to limit spousal benefits to only opposite-sex spouses. This is because issuers could be put in the difficult position of having to take on business or legal risks to the extent they permit employers to limit access to spousal benefits to only opposite-sex spouses. While we suspect the permissibility of this practice will be resolved by the courts in the future, in the interim, issuers and employers will need to proceed carefully in light of the changing legal landscape.

- ***Claims for retroactive benefits may emerge or increase as a result of the Court's holdings in* Windsor *and* Obergefell.**

It is possible that the Court's decisions in *Windsor* and *Obergefell* could result in new or increased litigation for benefits owed based upon past discrimination or exclusion of same-sex spouses by an employer or issuer. For employers with self-funded plans, the Court's prior holding in *Windsor* appears most relevant for purposes of determining litigation risk in this regard. However, for employers with insured plans, as well as the issuers underwriting such coverage, the Court's decision in *Obergefell* could result in new or increased litigation by enrollees with same-sex spouses. The merits of such litigation seem dependent upon numerous factors, including the employer's plan terms as well as the specific language of the state insurance law at issue (including whether it required the offering of opposite-sex coverage by express terms or operation of state law).

- ***Employers may now be considering the extent to which they can phase out domestic partner benefits following the Court's ruling in Obergefell.***

Many employers currently offer domestic partner benefits to an employee's qualifying domestic partner (perhaps in reference to a legally recognized domestic partnership or civil union, or a functional domestic partnership based upon shared domicile and financial interdependence). For many employers, the offering of these benefits was driven by a desire to provide parity in benefits for their gay, lesbian, bisexual and transgender ("GLBT") employees who could not get married for purposes of state and/or federal law. In recent years, some employers may have even extended domestic partner benefits to opposite-sex domestic partners.

The Court's decision in *Obergefell* will likely cause some employers to eliminate, or consider eliminating, domestic partner benefits altogether now that their GLBT employees should be able to get married in their states of domicile. For those employers considering eliminating domestic partner benefits, there are a host of considerations, including (i) whether to eliminate all domestic partner benefits, including, if offered, opposite-sex domestic partner benefits, (ii) how to notice such change, (iii) when to make such change applicable (*e.g.*, whether to make it applicable immediately, or whether to give existing employees with domestic partners some period of time to get married prior to the change in benefit policy so as to be able to maintain benefit eligibility), and (iv) whether to grandfather existing employee domestic partnerships. Given the importance of health care benefits to employees, employers generally would be wise to provide ample notice of any changes to domestic partner benefit policies and may want to consider giving existing employees in qualifying domestic partnerships sufficient time to get married in order to preserve benefit eligibility.

Puerto Rico Plans

Shortly after *Obergefell*, Puerto Rico Governor Padilla signed an executive order requiring governmental agencies in Puerto Rico to become compliant with the Court ruling within 15 days. In addition, on July 8, 2015, and after the Puerto Rican government dropped its opposition to same-sex marriages, the U.S. Court of Appeals for the 1st Circuit ruled that the same-sex marriage ban in Puerto Rico's "mini-DOMA" law is unconstitutional. Finally, on July 15, 2015, the Puerto Rico Supreme Court ruled in a non-binding decision that "[I]t is unquestionable that rulings [of the U.S. Supreme Court] such as *Obergefell* are applicable in the Commonwealth of Puerto Rico." (Translation ours.)

Based on the foregoing, any outstanding concerns with respect to operating and amending Puerto Rico tax-qualified retirement plans to include same-sex marriages should be put to rest. Further, although the Puerto Rico Treasury Department has not yet issued guidance regarding same-sex spouses, it would appear that the fair market value of health, welfare and fringe benefits provided to same-sex spouses domiciled in Puerto Rico would be excluded from the employee's wages for purposes of Puerto Rico income taxes and any applicable Puerto Rico payroll taxes (similar to the situation under the U.S. Code for income tax and payroll tax purposes).

Observations

In two short years, the Court has brought about a sea change in the marital rights of same-sex couples impacting virtually all areas of federal and state law. The Court's rulings provide major tax relief and benefit rights to same-sex couples – and in the short term, require plan sponsors and administrators to modify their tax compliance and plan administration practices in a variety of areas.