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# *What does the DOMA decision mean for employer-sponsored benefit plans?*

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## *In brief*

Following the Supreme Court's holding that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional, employers should review their retirement and health and welfare benefit plans to identify all provisions applicable to spouses of employees. Employers should prepare to modify plan design, communications, day-to-day operation and administration to comply with the decision and any additional guidance published by applicable regulatory agencies. Under Section 3 of DOMA, same-sex marriages were not recognized for federal purposes even if recognized under state law. The Supreme Court's decision leaves the definition of marriage to the states, and leaves intact Section 2 of DOMA which allows states to refuse to recognize same-sex marriages performed in another state. The Supreme Court noted that the law's definition of marriage or spousal status affects over 1,000 federal laws and regulations; and these include those governing retirement and health and welfare benefits. Unfortunately, the decision does not give employers and plan sponsors a uniform approach to same-sex married couples – instead it will still require a state-by-state evaluation of marital status. And the decision leaves many unanswered questions, including what happens when an employee with a same-sex spouse moves from a state that recognizes same-sex marriages to a state that does not, as well as its retroactive impact. We will have to wait for guidance from the regulators to answer these questions. This *Insight* highlights some of the implications for employer-sponsored plans.

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## *In detail*

Because DOMA did not allow same-sex marriages to be recognized for federal purposes, employees with same-sex spouses residing in states that recognized their marriages were treated as single for federal income tax withholding, payroll taxes and benefits, even though they were considered married for state law purposes. The

Supreme Court's decision in *United States v. Windsor*, No. 12-307 (June 26, 2013), means that employees who are married pursuant to state law are to be treated as married for federal purposes as well.

Employers will want to review their policies and processes surrounding same-sex married employees, and may want to perform a larger review of their

policies and processes for domestic partners now that DOMA has been set aside. Corrective action may be necessary, including making plan amendments and revising plan administrative procedures and payroll and income tax processes, for married employees with a same-sex spouse. In addition, employers will need to await further guidance from regulators on

numerous questions that remain unanswered in the wake of the Supreme Court's decision.

### **Retirement plans**

The DOMA decision will affect tax-favored retirement plans in a variety of ways. In addition, nonqualified plans, particularly those that are designed to be coordinated with the employer's tax-qualified plans may also be affected. Retirement plans will likely have to extend the federal benefits and protections to same-sex spouses at least in states that recognize those marriages. Following are some of the retirement provisions that may be affected.

#### *Surviving spouse benefits*

Certain tax-favored retirement plans — such as defined benefit pension plans and money purchase plans — are generally required to provide automatic survivor benefits to a spouse in the form of a qualified preretirement survivor annuity (QPSA) if a participant dies before normal retirement age unless the participant waives the benefit and certain spousal notice and consent requirements are satisfied. These plans must also provide that the regular form of payment for married participants upon retirement is a qualified joint and survivor annuity (QJSA) with the spouse as the survivor unless the participant elects otherwise with the spouse's consent. Profit-sharing and stock bonus plans — including 401(k) plans — are not generally required to offer an annuity payment form, but those that do must offer a QJSA to married participants. Those that do not offer annuities usually satisfy the spousal protection rules by paying a participant's vested account balance upon death to the surviving spouse (unless the spouse consents to a different beneficiary). Many profit-sharing plans also require spousal consent for participant loans.

#### *Observation*

*We will need guidance from Treasury and the IRS as to whether pension plans will be required to retroactively offer a joint and survivor annuity option to retired participants with a legally recognized same-sex spouse.*

#### *415 limits*

The value of a spouse's survivor benefit under a subsidized QJSA is not generally taken into account when adjusting a benefit for purposes of determining the maximum amount that can be paid from a defined benefit plan.

#### *Required minimum distributions*

All tax-favored retirement plans (including qualified pension and profit-sharing plans, 403(b) plans, 457(b) eligible deferred compensation plans and individual retirement arrangements (IRAs)) are subject to minimum distribution rules concerning when distributions must begin and how much must be distributed. Distributions generally must begin by the later of April 1 following the year in which the employee turns 70-1/2 or the year in which the employee retires (except for IRA owners and 5% owners, who must commence payments by April 1 of the year following attainment of age 70-1/2, regardless of whether the owner actually retires).

There are some special rules for surviving spouses. Lifetime distributions generally are determined using the 'Uniform Lifetime Table' based on the age of the employee. However, where the employee's spouse is the sole beneficiary and the spouse is more than 10 years younger than the employee, a longer distribution period measured by the joint life and last survivor expectancy of the employee and spouse may be used. In addition, where an employee

dies before distributions have begun, the entire account generally must be distributed within five years or must be paid over the life expectancy of the beneficiary beginning by the end of the year following the year of the employee's death. However, a surviving spouse may defer commencement of payments until the end of the year in which the employee would have attained age 70-1/2.

#### *Rollovers*

The surviving spouse of a deceased participant has broader rollover rights than does a non-spouse beneficiary, including the right to roll over an eligible distribution to another qualified plan, 403(b) plan, governmental 457(b) plan, or an IRA. The surviving spouse who is the beneficiary of a decedent's IRA may treat it as their own and may make rollovers to and from the IRA. While a non-spouse beneficiary may currently roll over a distribution from a qualified plan to an IRA, unlike a spousal beneficiary, they may not make any subsequent rollovers from that IRA. The IRA of a non-spouse beneficiary is subject to stricter required minimum distribution rules.

#### *Qualified domestic relations orders*

A limited exception to the Code and ERISA's anti-alienation provisions — which generally prohibit plan benefits from being assigned, alienated, or subject to garnishment or execution — is provided for qualified domestic relations orders (QDROs). A QDRO may require the plan to distribute or segregate a benefit in favor of a participant's spouse, former spouse or dependents provided the domestic relations order meets certain requirements. As a result of the DOMA decision, plans will likely need to amend their QDRO provisions and administrative procedures to provide for the recognition of QDROs issued

upon the dissolution of a legally recognized same-sex marriage.

### **Hardship withdrawals**

Under the safe harbor standards for determining whether a participant has experienced an immediate and heavy financial need, 401(k) and 403(b) plans may allow hardship withdrawals for medical, tuition and funeral expenses incurred by an employee's spouse. Prior to the Supreme Court's decision, plans that allowed hardship withdrawals in accordance with the safe harbor rules were permitted, but not required, to allow hardship withdrawals for medical, tuition and funeral expenses for a same-sex spouse only if such spouse was the participant's primary beneficiary under the plan.

### **Observation**

*Employers will certainly need to amend their plans' definition of 'spouse' where the definition is based on federal law under DOMA. We do not yet know whether a single definition of spouse will be permitted or required, or whether the definition will depend on the employee's state of residence, or on the state in which the marriage was performed, or some other standard. In addition, plan procedures for the issues highlighted above will need to be changed to incorporate the relevant provisions for same-sex spouses in the case of a state-recognized marriage. We understand that IRS and Treasury are analyzing the Supreme Court's decision and will provide guidance as soon as possible.*

### **Health and welfare plans and other fringe benefits**

The Supreme Court's decision will also impact employer-sponsored group health plans as well as the taxation of employees with same-sex spouses who take advantage of such programs. Although employers are not required to provide coverage for

spouses, those that do are subject to additional administrative requirements and spousal protections that will likely apply to same-sex spouses, at least in states that recognize same-sex marriage. Following are some of the ways this decision affects employer-provided health and welfare and other fringe benefits.

### **Employer-sponsored health plans**

Employer-paid health benefits, including amounts provided through a cafeteria plan, are generally excludable from an employee's income. The exclusion also applies to benefits provided to an employee's spouse and dependents, as defined in Code Section 152. Under DOMA, a same-sex spouse could not qualify as a spouse for this purpose, and most did not qualify as tax dependents under Section 152. As a result, the value of health coverage provided to a same-sex spouse has been imputed as federal taxable income to the employee, with both the employee and his employer subject to payroll taxes with respect to this imputed amount.

### **Observation**

*In states that recognize same-sex marriages, imputed income for federal tax purposes will no longer be required where same-sex spouses are covered under an employer-sponsored health plan. States that do not recognize same-sex marriages may continue to require employers to impute income for state tax purposes. We await guidance on whether consistent federal tax treatment for same-sex spouses will be permitted or required. Thus, prior to the decision, employers had inconsistencies between federal and state income inclusion in the states that recognize same-sex marriages. This administrative burden may continue in the future for employers in states that do not.*

### **COBRA continuation coverage**

Group health plans must provide COBRA continuation coverage when coverage would otherwise be lost due to certain qualifying events. The spouse of a covered participant can elect COBRA coverage in the event of the employee's termination of employment, and upon the participant's death, divorce or legal separation.

### **Cafeteria plans**

A participant's election under a cafeteria plan may not be changed during the plan year unless there has been a change in status event, such as marriage, death of a spouse, legal separation or annulment.

### **FSAs, HRAs and HSAs**

The tax rules related to flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs) provide for tax-free reimbursement of qualifying medical expenses of spouses and Section 152 dependents. Thus, under DOMA, the expenses of a same-sex spouse could not be reimbursed from these accounts.

While the ruling will generally result in favorable tax treatment for same-sex spouses in states that recognize same-sex marriages, it may require inconsistent administration depending on the employee's state of residence. In addition, under DOMA each same-sex spouse with family tier health coverage was able to contribute the maximum family contribution to an HSA. With the decision, the maximum family contribution will limit the amount the two same-sex spouses can contribute, in states recognizing same-sex marriages.

### **HIPAA special enrollment rights**

Group health plans must provide special enrollment rights that allow

participants to enroll a new spouse mid-year, or to change their coverage elections in the case of a marital status change, such as marriage, divorce or legal separation, and when the employee loses coverage under a spouse's plan or adds a dependent child. Special enrollment rights were not required for domestic partners.

#### *Other employee fringe benefits*

Other fringe benefits that may be provided by employers to spouses of their employees on a tax-free basis — such as no additional cost services, employee discounts, retirement planning services, and the use of on-site workout facilities — may now be provided to same-sex spouses without causing imputed income for federal purposes.

#### *FMLA*

The Family and Medical Leave Act allows otherwise eligible employees to

take unpaid leave to care for a family member with a serious health condition. Family member includes the employee's spouse, which under the FMLA regulations is defined as a husband and wife as defined or recognized under state law for purposes of marriage in the state in which the employee resides, including common law marriage in states where it is recognized. However, because the FMLA was bound by DOMA's definition of marriage, FMLA leave has not generally been made available to employees to care for same-sex spouses. Following the Supreme Court's decision, employers may be required to revise their FMLA policies and procedures at least in states where same-sex marriage is recognized to allow employees up to twelve weeks of unpaid leave to care for a same-sex spouse.

#### *The takeaway*

The Supreme Court's ruling in overturning Section 3 of DOMA will have a significant impact on the way employee benefit plans are designed, drafted and administered. Employers with workers in multiple states will have to deal with the challenges presented by the differences in state law regarding same-sex couples and will want to carefully evaluate their plans in light of this decision. Hopefully, regulatory guidance will be provided shortly to address whether an employees' marital status will be affected if they move from a state that recognizes same-sex marriage to a state that does not, whether the ruling has any retroactive effect, and whether a plan may voluntarily define a spouse as a same sex spouse for benefit purposes, even if the employee resides in a state that doesn't recognize same-sex marriages.

**Let's talk**

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