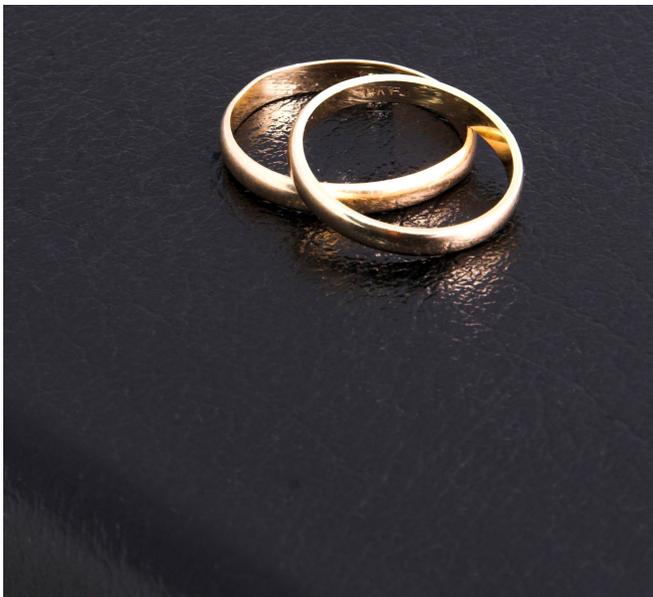


DOMA IS DEAD – NOW WHAT?



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On June 26, the Supreme Court in *U.S. v. Windsor* held that section 3 of the Defense of Marriage Act was unconstitutional. DOMA's proclamation that marriage is between a man and a woman is dead. No longer can the federal government distinguish in any of its laws or regulations between same sex and opposite sex marriage.¹

This decision has substantial and immediate practical effects for participants in and administrators of retirement and welfare benefit plans. This memo summarizes the issues, suggests actions, and sets out the significant uncertainties that still exist. In all cases, if benefit payments have not yet begun, plan administrators now should make appropriate good faith reasonable efforts to ensure that each same sex spouse is treated as every other spouse.

The most important unanswered questions involve transition from the current situation. It is not clear whether the decision in *Windsor* is retroactive or prospective; the Court did not address this issue. In a number of instances, it is unclear whether an employer or benefit plan administrator must (or may) take action to undo or redo existing situations where benefits are already in pay status and the participant has a same sex spouse. Even though there are open issues, employees will inevitably have questions and employers may want to provide some communication in the immediate future explaining the situation, particularly where it is clear that changes have occurred in how benefits will be treated under various plans.

An additional issue raised by *Windsor* concerns the different state law definition of "spouses" for plans and the taxation of benefits. How will individuals be treated who married in, e.g., California, and have moved to another state where same sex marriage is not recognized? Historically for tax purposes, where the individual resides – "domicile" – determines tax treatment. Will that be the case for benefits for same sex

¹ Under applicable rules, the judgment in *Windsor* is expected to become "final" on or about July 22, 2013. Section 2 of DOMA was not overturned, but it was not an issue in *Windsor*. Section 2 provides that one state does not have to recognize a same sex marriage from another state.

spouses? President Obama has stated that he hopes the government agencies involved will look to the state where the marriage celebration occurred. We do not know if this will be the case. If the IRS interprets *Windsor* as applying to the state of domicile, then plan administrators will have to keep constant track of domicile and adjust benefits based on where people live in order to avoid potential severe tax issues.

Even though there is uncertainty, in a number of situations – particularly for California residents – the law is clear. In these cases, there seems to be no reason to delay taking action. Moreover, if action is not taken quickly employers and plan administrators could be at risk for later litigation if delays caused loss to a same sex spouse. Where the rules are not clear, employers may have some leeway and might wish to delay action (and plan amendments) and wait for guidance from the IRS.

Note that under *Windsor* the change applies to “spouses” as defined by state law. It does not apply to domestic partners. For Californians, the companion case to *Windsor*, *Hollingsworth v. Perry* does not invalidate or change any of the California Family Code related to registered domestic partners. The California Secretary of State plans to continue processing Declarations of Domestic Partnership, and other filings related to California domestic partners who meet the criteria specified by California Family Code section 297. While domestic partners have the same rights as spouses under California law, they may not be treated as spouses under federal tax law; the IRS may issue guidance on this issue.

The chart below summarizes the major areas involving benefit plans that are affected by *Windsor*.

Qualified Retirement Plans

PRE-DOMA RULE	NEW RULE	COMMENT
<p>1. <u>Beneficiary Designation</u></p> <p>Plan document may not have required consent from same sex spouse to name someone else as a beneficiary.</p> <p>Under the plan document, the same sex spouse may not be default beneficiary if no other is named.</p> <p>Plan may not provide survivor benefits other than to a spouse.</p>	<p>Same sex spousal consent required to name other as beneficiary for both DB and DC plans. (Not required for 403(b) or 457(b) plans).</p> <p>Same sex spouse may become default beneficiary depending on terms of the plan.</p> <p>Plan would now provide survivor benefits to same sex spouse. Required survivor benefits under pension plans (unless waived by spouse) include qualified preretirement survivor annuities (QPSAs).</p>	<p>Plan may need to get new beneficiary designations with same sex spouse consent to non-spouse beneficiary. Communications and forms will need to be revised. Participants need to know that current beneficiary designations may be automatically voided by plan terms. Plan administrator may have fiduciary obligation to inform participants of this issue.</p> <p>New beneficiary designations may be appropriate because same sex spouse is now the default beneficiary. Here, also, there may be a fiduciary obligation to inform participants.</p> <p>Cost to plan may increase with newly provided survivor benefits (though cost increase may not be significant). If <i>Windsor</i> is retroactive, then surviving spouse benefits may be due to surviving same sex spouses.</p>

PRE-DOMA RULE	NEW RULE	COMMENT
<p>2. <u>Required minimum distributions – time benefits begin</u></p> <p>Distributions after the participant’s death to a non-spouse must begin within one year after participant’s death.</p>	<p>Distributions to same sex spouse may be deferred until participant would reach age 70 ½.</p>	<p>If benefits are in pay status, administrators should decide whether to allow changes that fit with the new rules. For example, it may be possible to allow a same sex spouse an election to stop a current payout and delay payout to a later time</p> <p>FYI - The federal government (Office of Personnel Management (“OPM”)) will give existing retirees with same sex spouses two years from the date that <i>Windsor</i> was decided to request changes in their form of retirement benefit.</p>
<p>3. <u>Required minimum distributions – life expectancy</u></p> <p>Generally, under defined contribution plans, benefits may be distributed based on the life expectancy of the participant and non-spouse beneficiary. However, the life expectancy is determined once when benefits start and then is reduced by one each year.</p>	<p>The life expectancy of a participant and spouse may be re-determined each year, spreading the required payments over a longer period.</p>	<p>Administrators should decide if they wish to allow recalculation of life expectancies for participants in pay status. (See #2 above for OPM’s decision re retirees.)</p>

PRE-DOMA RULE	NEW RULE	COMMENT
<p>4. <u>Minimum Distribution Incidental Benefit</u></p> <p>Expected payments to a non-spouse beneficiary more than 10 years younger than the participant cannot exceed a specified percent of the expected payments to the participant, in accord with a complex table published by the IRS.</p>	<p>Payments to a same sex spouse may equal as much as 100% of the annuity payable to the participant regardless of the age of the spouse.</p>	<p>It is not clear whether the administrators will be allowed by the IRS to apply the MDIB rules to beneficiaries already in pay status.</p>
<p>5. <u>Rollovers of Distributions</u></p> <p>Non-spouse beneficiary can only have a limited rollover to an inherited IRA.</p>	<p>Same sex spouse may rollover to the spouse's own IRA, or another employer's plan that accepts the rollover.</p>	<p>By definition an inherited IRA cannot be owned by a surviving spouse. It is not clear whether pre-<i>Windsor</i> inherited IRAs automatically lost that status. However, employers are not responsible for inherited IRAs.</p>
<p>6. <u>Hardship Withdrawals</u></p> <p>Hardship withdrawal on account of medical, tuition and funeral expenses of non-spouse not available unless is "dependent."</p>	<p>These hardship withdrawals are now available to same sex spouses without the additional restrictions.</p>	
<p>7. <u>10% Early Withdrawal tax</u></p> <p>10% penalty tax may apply to withdrawal for the benefit of a non-spouse beneficiary.</p>	<p>10% penalty tax does not apply to certain withdrawals for medical expenses, tuition expenses and first time homebuyer expenses for spouses.</p>	

PRE-DOMA RULE	NEW RULE	COMMENT
<p>8. <u>Spouse consent to plan loan</u></p> <p>Plan document need not require consent from same sex spouse to a plan loan to a participant.</p>	<p>Spouse consent required for plan loan.</p>	<p>Consent is required in the 90 day period before the date the loan is secured. Before <i>Windsor</i>, federal law provided that consent was not required. So there is a reasonable basis to conclude that retroactive consent will not be required post-<i>Windsor</i>. However, if a loan application is still in process and funds not disbursed, it would be better to obtain same sex spouse consent.</p>
<p>9. <u>Spouse consent to benefit form other than qualified joint and survivor annuity</u></p> <p>Plan document need not require consent from same sex spouse to a benefit form that is not a qualified joint and survivor annuity.</p>	<p>Spousal consent required for benefit form other than QJSA.</p>	<p>If the participant was not married before the time benefits began, no more action should be needed. It is unclear whether the plan must attempt to obtain spouse consent to benefits that are currently in pay status where the participant was married before benefits began.</p> <p>FYI – see item #2 about the decision by OPM and change in benefit form for existing retirees.</p>
<p>10. <u>“One year marriage” rule</u></p> <p>Some plans require at least one year of marriage before a spouse survivor annuity is paid, to avoid “deathbed marriages.”</p>	<p>The same rule will apply to same sex marriages.</p>	<p>There is a reasonable basis for concluding that a pre-<i>Windsor</i> marriage was in existence before the Supreme Court’s decision. DOMA did not say that there was no marriage; it only said that the federal government would not recognize it. Under this argument, a same sex marriage at least one year old meets the one year requirement.</p>
<p>11. <u>QDROs</u></p> <p>QDROs do not apply to same sex spouses.</p>	<p>QDROs will apply to same sex (former) spouses.</p>	<p>Administrators may receive new QDROs from former spouses.</p>

PRE-DOMA RULE	NEW RULE	COMMENT
<p>12. <u>Section 415(b) limit</u></p> <p>Section 415(b) requires an actuarial reduction to the dollar limit in determining the limit for survivor annuities for a non-spouse.</p>	<p>No actuarial reduction to the dollar limit is required for qualified joint and survivor annuities for same sex spouses.</p>	<p>It is not clear whether administrators will be allowed by the IRS to apply these section 415 rules to participants in pay status</p>

NON-QUALIFIED RETIREMENT PLANS

PRE-DOMA RULE	NEW RULE	COMMENT
<p><u>Nonqualified Plans</u></p> <p>Distributions may be made on unforeseeable emergency of a beneficiary as well as to a spouse. Therefore, there was no restriction on making this distribution to a same sex spouse as long as he/she was a beneficiary.</p>	<p>Unforeseeable emergency distributions to a spouse makes this rule a bit less constraining.</p>	<p>Employers should review non-qualified plan provisions to determine what the effect will be on benefits under those plans and determine if any amendments are needed.</p>

HEALTH AND WELFARE PLANS

PRE-DOMA RULE	NEW RULE	COMMENT
<p>1. <u>Participation in health plans – tax status of plan</u></p> <p>Under IRS rules, a person who is not a spouse or tax dependent cannot participate in a tax free health plan. If someone who is not a spouse or dependent does participate, the tax free nature of the plan is lost for every person who participates (but see item 2 below).</p>	<p>A same sex spouse may participate in a tax free health plan.</p>	

PRE-DOMA RULE	NEW RULE	COMMENT
<p>2. <u>Participation in health plans – imputed income</u></p> <p>To avoid losing the tax free status of a health plan, employers commonly impute as income to the employee the fair market value of coverage for the same sex spouse.</p>	<p>Income imputation is not needed for same sex spouse.</p>	<p>If <i>Windsor</i> is retroactive, then same sex spouses may wish to file for a tax refund because the income imputed may be incorrect – health coverage would not have been taxable. A refund may be appropriate for income tax and perhaps for FICA tax.¹</p> <p>Employers should stop imputing income to the employed spouse and should stop withholding taxes for that imputed income where the benefit is clearly now non-taxable. This action should occur as soon as reasonably possible.</p> <p>FYI – OPM will immediately allow same sex spouses and their children to participate in federal government plans. Enrollment must be in the 60 day period after <i>Windsor</i> was decided.</p> <p>----- 1 Same sex married couples may also consider whether they wish to file for income tax refunds that may be due because joint returns are now available to them.</p>
<p>3. <u>FSA's, HRA's, HSA's</u></p> <p>Same sex spouse could not receive benefits if not a tax dependent.</p>	<p>Reimbursement of expenses may be made for same sex spouse.</p>	<p>Again, it is unclear whether expenses incurred before <i>Windsor</i> was decided can be reimbursed.</p> <p>FYI - OPM has not made a distinction based on when expenses were incurred.</p>
<p>4. <u>COBRA</u></p> <p>COBRA coverage is not available to same sex spouses</p>	<p>COBRA coverage is available to same sex spouses.</p>	<p>It is not clear whether plan administrators should now offer COBRA coverage to same sex spouses when the statutory period for offering coverage has already run.</p>

PRE-DOMA RULE	NEW RULE	COMMENT
<p>5. <u>HIPAA</u></p> <p>No special enrollment rights are available on marriage or when same sex spouse loses eligibility for coverage under another plan.</p>	<p>The same special enrollment rights must be made available to same sex spouses, as other spouses.</p>	<p>It is not clear whether plan administrators should now offer coverage to same sex spouses when the statutory period for offering it has already run.</p>
<p>6. <u>Cafeteria plans including dependent care plans</u></p> <p>Mid-year election changes are not available because of changes in marital status for same sex spouses.</p>	<p>Mid-year election changes are available under standard rules for spouses.</p>	<p>It is not clear whether plan administrators should offer elections to change when the standard time has run before <i>Windsor</i>.</p>
<p>7. <u>Family and Medical Leave Act</u></p> <p>FMLA leave not required with respect to same sex spouse, including extensions of certain health care coverage rights during FMLA leave.</p>	<p>FMLA is now required as well as extension of health coverage.</p>	

WHAT STEPS TO TAKE NOW

1. Inventory

Review all of your benefit plans to determine exactly how same sex spouses are affected. Also consider the implications for any domestic partner provisions. If domestic partners marry, will you want to consider date of original domestic partnership as date for determining spousal benefits (i.e. one year marriage requirement)?

2. Vendors

Immediately contact your vendors to determine how soon they will be changing administrative practices to comply with new requirements.

Vendors should change processes in any case where benefits have not begun and *Windsor* has changed the rules.

Vendors should also post on any website used by your participants and beneficiaries a notice that summarizes the changes required by *Windsor* and, as appropriate, contact and other relevant information.

3. In-house plan administration

To the extent all or some portion of benefit administration is done in-house, immediately make any website changes needed similar to those in item 2 above and provide a quick summary of the changes required by *Windsor*, as well as perhaps indicating any questions left to be resolved by regulatory guidance (such as retroactivity issues).

4. Notice to employees

Plan administrators may have an obligation to tell participants and retirees of the changes in the rules (including the uncertainties) quickly. Best practice is to decide on your policy to the extent that you can at this time, communicate it, and let participants and former employees know the uncertainties.

5. Payroll

If you are imputing income for health plan coverage, immediately stop that imputation in cases clearly covered by *Windsor* and send a notice to employees about this. Offer employees the opportunity to adjust withholding.

In appropriate circumstances, consider seeking refund of FICA tax pay for same sex spousal benefits. File protective claims as necessary or appropriate.

6. Communications and plan documents

Amend all forms and communications as necessary (e.g. application forms, notices to employees, tax notices, enrollment forms, and beneficiary designation forms). Prepare to amend plan documents and SPDs. The *Windsor* changes likely represent a “material modification” under ERISA requiring distribution of a summary of material modifications. You will want to provide communications in a manner that will satisfy these requirements so no additional disclosure will be required later.

However, caution should be observed in making immediate changes to plan documents. If plans are amended immediately, the IRS and DOL guidance, when issued, may require additional amendments to the plans and the anti-cutback rules may limit such amendments.

7. Authority to make plan changes

If the delegation from your governing board to amend benefit plans or your authority for plan amendments under collective bargaining agreement provisions allow changes “required” to comply with changes in the law, consider carefully to what extent this delegation applies. Delegations may only cover changes where there is no discretion or few options as to how to comply with the law change. Each employer will need to review its particular situations.

8. Watch for guidance

Keep careful watch for guidance from the IRS and other agencies, especially regarding retroactivity and domestic partner provisions in state law.

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