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## Guidance on Taxes and Employee Benefits in the Year since the *U.S. v. Windsor*



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VIEWPOINT

In June 2013, Section 3 of the Defense of Marriage Act (DOMA) was ruled unconstitutional by the U.S. Supreme Court in *United States v. Windsor*. In particular, Section 3 of DOMA defined marriage for the purposes of federal law as being between one man and one woman, therefore, legally married same-sex couples were not considered married for purposes of federal law. As a result, legally married same-sex couples were denied a significant number of benefits that legally married opposite-sex couples enjoyed. However, after the Windsor decision and the repeal of Section 3 of DOMA, significant benefits are now available to legally married same-sex couples including in the areas of income tax and employee benefits.

### How has the repeal of Section 3 of DOMA affected income taxes?

As a result of the Windsor decision, the Internal Revenue Service (IRS) ruled that effective Sept. 16, 2013, all legally married same-sex couples must file their income-tax returns as either "married filing jointly" or "married filing separately." Note that civil unions or domestic partnerships are not considered legal marriages for this purpose. The IRS determines whether a marriage is legal based on whether the marriage was legally entered into in the "state of celebration." This means that a same-sex couple residing in Alabama but marries in New York in 2014, will be considered legally married by the IRS, even though their state of residency does not allow same-sex marriage and may not recognize

#### Scenario 1: Taxpayer earns \$100,000 in wages; spouse has no income

Total tax due on single returns	Total tax due on married filing joint return	Tax refund from amending
<b>\$18,964</b>	<b>\$12,512</b>	<b>\$6,452</b>

#### Scenario 2: Taxpayer and spouse each earn \$50,000 in wages

Total tax due on single returns	Total tax due on married filing joint return	Tax refund from amending
<b>\$12,512</b>	<b>\$12,512</b>	<b>No tax due or refund</b>

#### Scenario 3: Taxpayer earns \$300,000 in wages; spouse has no income

Total tax due on single returns	Total tax due on married filing joint return	Tax refund from amending
<b>\$80,762</b>	<b>\$70,185</b>	<b>\$10,577</b>

#### Scenario 4: Taxpayer and spouse each earn \$150,000 in wages

Total tax due on single returns	Total tax due on married filing joint return	Tax refund from amending
<b>\$65,914</b>	<b>\$70,185</b>	<b>(\$4,271) Penalty</b>

same-sex marriages entered into in another state for other purposes.

### The IRS may owe same-sex couples money

The IRS ruling also allows same-sex couples to file amended returns when the couple was legally married prior to the Windsor decision, but was forced to file as "single" because of DOMA. Generally, this is permitted for a period of three years from the date of filing the original return, including extensions.

Any legally married, same-sex couple that wants to take advantage of this opportunity should contact their accountant to determine if it is advantageous to amend prior year income-tax returns. There are many factors to consider before amending, such as the

date of marriage, the state the marriage was celebrated, anticipated refund or balance due, and income tax preparation fees. Amending one prior-year tax return does not require that you amend other years. The IRS allows taxpayers to choose which year(s) they will amend if any at all.

The scenarios in the chart above compare the tax implications of changing the filing status from single to married filing jointly in 2011:

*Note:* For all scenarios above, we assumed that wages were the only source of income subject to 2011 income-tax rates and that the taxpayers are claiming the standard deduction. In addition, the taxpayers do not have any dependents and do not qualify for any tax credits.

As illustrated in scenarios 1 and 3, in some cases when one spouse earns all of the income, the couple will pay less tax by filing jointly than they would if they filed as single taxpayers. On the other hand, when comparing scenarios 2 and 4, when each spouse has similar but higher incomes, they are often subject to a "marriage penalty." The marriage penalty takes effect when the taxes you pay jointly exceed what you would have paid if each of you had remained single and filed as single taxpayers.

## **Tax planning saves money; what should I do now?**

With 2014 quickly coming to a close, it is important to talk to your accountant about how this ruling may impact you. Depending upon your specific situation, many previously unavailable credits and deductions may be available. With this in mind, proper tax planning before year-end and implementing various strategies may minimize your joint income-tax liability and maximize your federal income-tax refund.

## **How did the Supreme Court's decision affect retirement plans?**

Most retirement plans sponsored by employers are subject to the Employee Retirement Income Security Act of 1974 (ERISA). These types of plans are referred to as "qualified plans." Because ERISA is a federal law, Section 3 of DOMA restricted spousal rights and benefits under such plans only to a spouse in an opposite-sex marriage.

For example, in defined-contribution plans (i.e., 401(k) plans), ERISA requires that if a plan participant names anyone other than his or her spouse as the primary beneficiary of the participant's account, the participant must obtain the spouse's consent to such designation. However, because Section 3 of DOMA required plans to treat a same-sex spouse as a non-spouse beneficiary, there was no requirement for the participant to obtain the same-sex spouse's consent.

Similarly, in defined-benefit plans (i.e., pension plans), there was no requirement for a same-sex spouse to consent to a distribution option that would eliminate the possibility of a lifetime benefit for the spouse after the participant's death.

Same-sex spouses also had fewer options for rolling over the participant spouse's interest in a plan after the participant's death and were barred from obtaining a share of the participant spouse's interest in a plan when assets were divided in the course of a divorce.

Because of the Supreme Court decision overturning Section 3 of DOMA, the limitations on the rights of a same-sex spouse of a participant in a qualified plan have been eliminated. Same-sex spouses now enjoy all of the rights and privileges enjoyed by oppo-

site-sex spouses under ERISA. In addition, the IRS decision to use "state of celebration" for determining whether a marriage is valid for purposes of federal tax law includes the sections of the tax law that apply to qualified plans. The Department of Labor issued concurrent guidance requiring that "state of celebration" apply for all other purposes under ERISA. Therefore, for all retirement plans governed under federal law, the determination of whether the marriage of a plan participant is valid is based on whether the marriage was valid in the place it was established.

## **How has this change affected other employer-sponsored benefit plans?**

In addition to governing most retirement plans, ERISA also governs most group health and other employee-welfare benefit plans sponsored by an employer (or employee organization, such as a union). As a result, prior to the Supreme Court's decision, same-sex married couples were not afforded all of the rights and benefits of opposite-sex married couples in one spouse's health or welfare benefit plan. Even in states that recognized same-sex marriage and in plans that were open to covering same-sex spouses, couples faced a number of issues that did not affect opposite-sex married couples.

One of the most significant issues that same-sex married couples faced in the area of employer health coverage was the taxation of the cost of coverage. If an employer paid any portion of a non-employee spouse's premium, the amount of the employer contribution was treated as income for the employee spouse (for purposes of calculating the employee's taxes and the employer's share of Medicare and Social Security taxes). Furthermore, the amount that the employee spouse contributed toward the cost of coverage for the non-employee spouse had to be paid on an after-tax basis (unless the non-employee spouse could be considered a "dependent" of the employee spouse within the meaning of the Internal Revenue Code, which was often difficult).

Same-sex married couples faced other issues related to health and welfare benefits. For example, a spouse who lost coverage mid-year could not enroll in the other spouse's plan until open enrollment at the end of the year. In addition, same-sex married couples could not use one spouse's health flexible-spending account (FSA) or health-savings account (HSA) for health-related expenses of the other spouse. Furthermore, a same-sex spouse would not have any right to spousal continuation coverage under the Consolidated Omnibus Reconciliation Act (COBRA).

As with retirement plans, the restrictions

that same-sex couples faced in health and welfare benefit plans changed after the Windsor decision. The IRS issued guidance applying "place of celebration" to health plans as well. Employees who had been affected by the rule imputing income for the cost of a same-sex spouse's coverage may have the ability to file an amended tax return and claim a refund for income taxes paid on such imputed income. The IRS has also issued guidance on how an employer may claim a refund of the employer's share of taxes paid on such imputed income.

## **What should an employer do to comply?**

Employer-sponsored plans should be reviewed to ensure that language related to spousal rights and benefits are gender-neutral and compliant with the Supreme Court's determination, as well as subsequent guidance issued by the IRS and the Department of Labor.

Regarding health and welfare benefit plans, plan sponsors should keep in mind that there is no requirement that a plan provide coverage for spouses. However, if an employer chooses to provide coverage to opposite-sex spouses, the Affordable Care Act requires that coverage must be provided to same-sex spouses on the same terms and conditions. This requirement applies in all states, including states that prohibit same-sex marriage.

It should be noted that the Supreme Court's decision has afforded same-sex married couples with the same rights as opposite-sex married couples. However, unmarried couples and domestic partners, whether same-sex or opposite-sex, do not have any of the same rights as married couples in retirement or health and welfare benefit plans.

## **Conclusion**

In the year since the Windsor decision, the landscape has changed dramatically for same-sex married couples and their employers. Same-sex married couples do not face all of the hurdles that they once did. With the abundance of recent cases relating to marriage equality, changes will undoubtedly continue. We encourage individuals and employers to stay informed and consider how those changes may affect them. □

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