Tax-Exempt Entities

Farewell, DOMA: Paving the Way for Equality in Employee Benefits

In the recent, landmark decision United States v. Windsor*, the US Supreme Court struck down Section 3 of DOMA as an unconstitutional violation of equal protection principles. Both the IRS and the DOL have issued guidance to assist same-sex spouses and employers with the transition to employee benefits equality.*

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Perhaps the Buddha was referring to the future US Congress when he said: "In the sky, there is no distinction of east and west; people create distinctions out of their own minds and then believe them to be true."

For many years, Section 3 of Defense of Marriage Act of 1996 (DOMA) provided that for all purposes under any federal law:

> The word "marriage" mean[t] only a legal union between one man and one woman as husband and wife, and the word "spouse" refer[red] only to a person of the opposite sex who is a husband or wife.

In *United States v. Windsor*, the US Supreme Court ruled this legally mandated distinction to be unconstitutional in violation of the Fifth Amendment's Due Process Clause, which prohibits denying equal protection of the laws to any person. [*United States v. Windsor,* 133 S. Ct. 2675 (2013)]

The *Windsor* case involved two New York residents, Edith Windsor and Thea Spyer, who were married in Ontario, Canada in 2007. When Spyer died, she left her entire estate to Windsor, but Windsor was barred from taking the federal estate tax exemption afforded to opposite-sex spouses. Windsor brought a refund suit against the US government, in which Section 3 of DOMA was declared unconstitutional in the District Court, a decision upheld by the Second Circuit, and now by the US Supreme Court. [For a detailed account of the facts and history of the *Windsor* case, *see* T. Ferrera, "ERISA Litigation Update: Supreme Court Decides DOMA and Prop. 8 Cases; Affirming Reasoning in Second Circuit Case Finding DOMA Unconstitutional," *Journal of Pension Benefits* (Summer 2013).]

In finding Section 3 of DOMA unconstitutional, the Court reasoned:

> The principal purpose and the necessary effect [of section 3 of DOMA] are to demean those persons who are in a lawful same-sex marriage … The class to which DOMA directs its restrictions and restraint are those persons who are joined in same-sex marriages made lawful by the State. DOMA singles out a class of persons deemed by a State entitled to recognition and protection to enhance their own liberty. It imposes a disability on the class by refusing to acknowledge a status the State finds to be dignified and proper. DOMA instructs all federal officials, and indeed all persons with whom same-sex couples interact, including their own children, that their marriage is less worthy than the marriage of others. The federal statute is invalid, for no legitimate purpose overcomes the purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect in personhood and dignity. By seeking to displace this protection and treating those persons as living in marriages less respected than others, the federal statute is in violation of the Fifth Amendment. [*Id.*]

Although this landmark case clearly has social implications well beyond the scope of employee benefits, *Windsor's* impact on achieving marriage equality in employee benefits is nonetheless significant, for the reasons discussed below.

Then: Unequal Treatment of Same-Sex Spouses Under DOMA

Currently, 16 states (Massachusetts, California, Connecticut, Iowa, Vermont, New Hampshire, New York, Washington, Maine, Maryland, Rhode Island, Delaware, Minnesota, New Jersey, Hawaii, and Illinois (effective June 1, 2014)) and the District of Columbia have legalized the issuance of marriage licenses to same-sex couples ("Marriage Equality States"). Under the DOMA regime, marriages validly performed in Marriage Equality States were not recognized under federal law. As stated in *Windsor,* "by creating two contradictory [marriage] regimes within the same State, DOMA force[d] same-sex couples to live as married for the purpose of state law, but unmarried for the purpose of federal law, thus diminishing the stability and predictability of basic personal relations the State has found it proper to acknowledge and protect." [*Windsor,* 133 S. Ct. at 2694]

In addition to the inequality issues addressed in the *Windsor* case, the dual status of same-sex spouses in Marriage Equality States has imposed unnecessary administrative burdens on employers that offer benefits to their employees' same-sex spouses (either voluntarily, or as required by state law). Because DOMA required that same-sex spouses be treated as unmarried for purposes of applicable federal law (*e.g.*, the Code, ERISA, FMLA, COBRA, etc.), employers had to keep track of the gender of each employee's spouse for purposes of administering benefit plans governed by the Code and ERISA.

For example, generally, an employee pays for his or her portion of the cost of employer-provided spousal health coverage on a pre-tax basis under an employer's Code Section 125, or "cafeteria," plan. However, because the term "spouse" only applied to opposite-sex spouses under DOMA, employees were required to pay the portion of the premium cost attributable to a same-sex spouse on an after-tax basis (*i.e.*, outside the cafeteria plan) unless the same-sex spouse qualified as a dependent for federal tax purposes. In addition, employers were required to impute income (reportable as wages on the employee's Form W-2) in the amount of the employer-funded portion of any premium cost attributable to an employee's same-sex spouse. Similarly, medical claims incurred by an employee's same-sex spouse could not be reimbursed from health flexible spending accounts or health savings accounts on a tax-favored basis, and could not be reimbursed at all under an employer's health reimbursement arrangement. To make up for these income tax disparities, many employers voluntarily provided affected employees with compensation "gross-up" amounts to cover the costs of the added federal tax liability.

Further, same-sex spouses were precluded from the spousal rights enjoyed by opposite-sex spouses under qualified retirement plans governed by ERISA, including: rights to survivor benefits, pre-retirement death benefits, the right to defer death benefit distributions, and the right to deny consent to changes to an employee's beneficiary designation. Additionally under the DOMA regime, same-sex spouses could not bring claims for future rights to plan benefits in the event of divorce under an ERISA plan's qualified domestic relations order provisions.

Now: IRS and DOL Response to *Windsor*

Now that Section 3 of DOMA is unconstitutional, there is no longer a distinction between same-sex and opposite-sex marriages or same-sex and opposite-sex spouses for purposes of federal law. What does this mean? In Marriage Equality States, same-sex spouses may now be afforded the same rights and protections that were previously applicable only to opposite-sex spouses under employer-provided health and qualified retirement plans governed by federal law.

Shortly after the *Windsor* decision was issued, the IRS and DOL both issued guidance regarding the application of the *Windsor* holding with respect to provisions of the Code and ERISA, respectively, as well as the treatment of same-sex spouses domiciled in non-Marriage Equality States, as described below.

IRS Revenue Ruling 2013-17

In Revenue Ruling 2013-17 ("Ruling"), the IRS addressed three issues: (1) the interpretation of the terms "spouse," "marriage," "husband," and "wife"; (2) determination of the validity of a same-sex marriage; and (3) the application of *Windsor* to relationships formally recognized by a state that do not amount to marriage.

First, the IRS ruled that the term "spouse" includes an individual who is legally married to a person of the same sex, and the term "marriage" includes a same-sex couple legally married under state law. In addition, the terms "husband" and "wife" as used in the Code must be given a gender-neutral interpretation. In the Ruling, the IRS explained that this, most natural reading, is consistent with the holding in *Windsor,* and "avoids the serious constitutional questions that an alternate reading would create" (*i.e.*, an interpretation that would "confer marriage benefits and burdens only on opposite-sex married couples"). The Ruling further provides that in addition to being consistent with other provisions of the Code and the legislative history

of applicable Code provisions, a gender-neutral reading of the Code promotes fairness, through the equal treatment of same-sex and opposite-sex couples, and administrative efficiency.

Conversely, the Ruling states that such terms do *not* include individuals in formal relationships recognized under state law (*e.g.*, registered domestic partnerships, civil unions, etc.) that are not legally valid marriages.

As with opposite-sex marriages, the Ruling provides that the validity of a same-sex marriage is determined based on the state in which the couple was legally married (otherwise known as the "state of celebration"), regardless of where the same-sex spouses are currently domiciled. The IRS explained that for federal income tax purposes, the Service has recognized marriages based on the state of celebration for over half a century—"to achieve uniformity, stability, and efficiency in the application and administration of the Code"; and that such policy considerations "apply with equal force in the context of same-sex marriages."

Effective as of September 16, 2013, the Ruling is applicable on a prospective basis. Additionally, the holdings set forth in the Ruling may be applied retroactively for purposes of amending prior tax returns or claiming refunds of overpayments (provided the period of limitations for filing such claim is still open).

The Ruling specifically provides that taxpayers may amend returns or claim refunds (within the period of limitations) with respect to any overpayment of income tax made in connection with the receipt of employer-provided health coverage or fringe benefits (*e.g.*, remitted tuition, housing and meals, dependent care assistance plans, etc.) that was not previously excludable under the DOMA regime. For this purpose, an employee who paid for employer-provided spousal coverage on an after-tax basis will be treated as if he or she made pre-tax salary reduction contributions under the employer's cafeteria plan.

Similarly, employers (including sole proprietors) may amend returns and/or claim refunds for any overpayment of employment taxes made in connection with the same. To facilitate this process, the IRS recently issued Notice 2013-16, which contains streamlined procedures that employers can use in recouping overpayments of FICA taxes (within the period of limitations).

To assist same-sex spouses in understanding the implications of *Windsor* and the Ruling, the IRS also issued *FAQs for Individuals of the Same Sex Who are Married Under State Law* ("FAQs"). ["IRS FAQs for Individuals of the Same Sex Who are Married Under State Law," available at *http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples* (last visited Sept. 27, 2013)] Q&A 18 provides that the Ruling applies to qualified retirement plans as of September 16, 2013, but the Ruling does not address the retroactive application of its holdings to qualified retirement plans. The IRS stated that it expects to issue future guidance regarding: (1) plan amendments; and (2) corrections relating to plan operations before future guidance is issued.

DOL Technical Release 2013-04

On September 18, 2013, the DOL issued guidance that largely parallels the holdings in the IRS Ruling. [DOL Technical Release 2013-04 ("DOL Guidance")] Similar to the Ruling, the DOL Guidance provides that the term "spouse" will be read to include any individual validly married under state law, and the term "marriage" includes a same-sex marriage that is legally valid under state law (but will not apply to domestic partnerships, civil unions, or other relationships formally recognized under state law). Also similar to the Ruling, the DOL Guidance states that the validity of any same-sex marriage will be determined based on the state of celebration. The DOL explained that this approach gels with "the core intent underlying ERISA of promoting uniform requirements for employee benefit plans," and it satisfies the requirement that the DOL and IRS end up on the same page when carrying out statutory provisions related to ERISA-covered plans (and also the Department of Health and Human Services when carrying out HIPAA).

Effects on Plan Administration

Although legally valid same-sex marriages must be recognized in all jurisdictions for purposes of federal law, same-sex spouses that are domiciled in non-Marriage Equality States may be forced to deal with a reverse-DOMA regime. Although the *Windsor* case found Section 3 of DOMA to be unconstitutional, Section 2 of DOMA, which provides:

> No State, territory, or possession of the United States, or Indian tribe, shall be required to give effect to any public act, record, or judicial proceeding of any other State, territory, possession, or tribe respecting a relationship between persons of the same sex that is treated as a marriage under the laws of such other State, territory, possession, or tribe, or a right or claim arising from such relationship.

. . . is still valid law.

In other words, in non-Marriage Equality States, although same-sex spouses will be treated as married under federal law, they may not be treated as married under state law, and the administrative burden of dual recordkeeping now largely falls on employers in non-Marriage Equality States.

Additionally, employers in non-Marriage Equality States that currently provide benefits to employees' same-sex domestic partners or partners in civil unions will have to continue maintaining dual recordkeeping systems for purposes of complying with federal tax law and ERISA.

It should be noted that there is some uncertainty as to whether a self-funded health plan is required to offer health benefits to an employee's same-sex spouse, especially in Marriage Equality States, as there is no statutory duty to do so under ERISA (*i.e.*, unlike statutory spousal rights required for qualified retirement plans), and ERISA generally preempts any state insurance law or anti-discrimination law that would require otherwise. However, in order to operate an ERISA-covered self-funded health plan to exclude same-sex spouses, the plan document would be required to define "spouse" to specifically exclude same-sex spouses. In administering the plan, an employer would increase its administrative burdens by, among other things, having to determine the sex of each employee who enrolls in spousal coverage (yet still provide spousal rights to the employee's same-sex spouse under any ERISA-covered retirement plan maintained by the employer). As DOMA no longer provides a statutory basis for excluding same-sex spouses from health plan coverage, such differential treatment would be damaging to the morale of employees with same-sex spouses and promote hostile employer-employee relations.

Further, although not addressed in a benefits context, the EEOC held that a US Post Office employee "alleged a plausible sex stereotyping case which would entitle him to relief under Title VII if he were to prevail." [*Veretto v. United States Postal Service*, EEOC Appeal No. 0120110873 (July 1, 2011)] In the *Veretto* case, the claimant alleged that he was subject to a hostile work environment due to coworker harassment following the publication of the claimant's wedding announcement in his local newspaper. The claimant alleged that the coworker's harassment was motivated by the sexual stereotype that "marrying a woman was an essential part of being a man." In other words, the coworker's actions were "motivated by his attitudes about stereotypical gender roles in marriage." [*Id.*] The EEOC's ruling definitely lays the groundwork for a federal sex discrimination claim in the employee benefits context. Thus, if the DOL does not first issue guidance that closes the statutory loophole for self-funded health plans (*i.e.*, to be consistent with the DOL's interpretation of the definition of "spouse" under ERISA, as well as respective agency interpretations of the Code, Social Security, COBRA, HIPAA, etc.), it seems that amending a health plan to provide for such an exclusionary definition would be an open invitation for affected employees to bring federal sex discrimination claims under Title VII—especially in Marriage Equality States.

Self-funded health plans aside, for employers that offer same-sex spousal benefits in Marriage Equality States, the *Windsor* decision and related agency guidance generally makes plan administration much simpler, because everyone who is legally married is now a spouse for purposes of employee benefit plans.

Afterthoughts

In addition to achieving equality in employee benefits (*i.e.*, without having to provide gross-ups or maintain dual recordkeeping), employee benefits practitioners in Marriage Equality States are generally no longer required to use excessively wordy adjectival phrases like "same-sex" and "opposite-sex" when describing spouses or marriages. This will likely result in less legal fees, shorter policies and plan documents, and less wasted paper, leaving us with more trees to enjoy. More trees will serve to slow the rate of climate change, as well as increase the amount of beauty in nature—exposure to which makes people happier (as studies have shown). Happier people are generally kinder people, who will spread more kindness and love throughout their communities and ultimately the universe. Perhaps, then, this is not just about the conceptual distinction between same-sex and opposite-sex spouses, but a small example of how everything affects everything else, and the terms of a plan document are much more significant than we realize … ■