EMPLOYEE BENEFITS

DEPARTMENT OF TREASURY AND INTERNAL REVENUE SERVICE ANNOUNCE THEY WILL RECOGNIZE LEGAL SAME-SEX MARRIAGES FOR FEDERAL TAX PURPOSES REGARDLESS OF STATE OF DOMICILE

by Jordan Schreier

In June 2013, the US Supreme Court in *Windsor v. U.S.*, ruled as unconstitutional the portion of the federal Defense of Marriage Act ("DOMA") which provided that for federal law purposes, a marriage meant an opposite-sex marriage only. See Dickinson Wright's July 1, 2013 Client Alert on the *Windsor* decision and it implications. Ever since then, employers sponsoring employee benefit programs and employees in legal same-sex marriages have been waiting for the various federal agencies, and in particular, the Internal Revenue Service, to issue guidance on how they would treat same-sex marriages. This guidance is important since state laws vary greatly on recognition of same-sex marriages, with 13 states and the District of Columbia permitting same-sex marriages, some states (e.g., New Jersey) recognizing civil unions and domestic partnerships as substantially equal to marriage, some states granting some legal rights to same-sex couples (e.g., Wisconsin) and some states prohibiting same-sex marriages and refusing to grant them any marriage-like rights (e.g., Arizona, Michigan, Tennessee).

Department of Treasury and IRS Ruling

On August 29, 2013, in Revenue Ruling 2013-17, the Department of Treasury and Internal Revenue Service announced that for all federal tax purposes, same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married.[1] The ruling applies regardless of whether the couple resides in a jurisdiction that recognizes same-sex marriage or not. According to the Department, this ruling will provide certainty, clarity and coherence for same-sex couples nationwide, it will allow same-sex couples the ability to move throughout the country knowing their federal tax status will not change and it will promote uniformity, stability and efficiency in the application and administration of the tax code, including for employee benefit plan purposes. Among other things, the ruling applies to federal income and gift and estate tax and in particular, to employee benefit plans.

The ruling applies to any same-sex marriage legally entered into in any of the 50 states, District of Columbia, a U.S. territory or a foreign country, but does not apply to domestic partnerships, civil unions or other similar relationships.

The ruling is effectively prospectively as of September 16, 2013. However, the ruling is also retroactive for purposes of filing or amending tax returns or claiming credits or refunds for overpayment of income and employment taxes, as long as the statute of limitations is open. The ruling provides that individuals who were in same-sex marriages may, but are not required to, file amended federal tax returns for prior open years.

Implications for Employee Benefit Plans

While the ruling makes a clear statement of federal tax policy, it really only provides limited guidance for employee benefit plans, plan sponsors and plan participants but promises that additional guidance will be issued.

Benefit-Related Tax Refunds and Adjustments

The ruling provides that:

- An employee may file for a refund of federal income taxes the employee paid on the value of health coverage for the employee's same-sex spouse for tax years open under the statute of limitations.
- An employee may file for a refund of federal income taxes paid on premiums the employee paid on an after-tax basis for the health coverage for the employee's same-sex spouse for tax years open under the statute of limitations (if employees with opposite-sex spouses could pay premiums on a pre-tax basis).
- An employer may file a claim for a refund (or claim an adjustment) of social security taxes and Medicare taxes paid on the value of health coverage and after-tax premiums for same-sex spouses for tax years open under the statute of limitations. A special rule applies if the employer cannot locate the employee involved. The IRS said it would issue guidance on a special administrative procedure for employers for this purpose. However, an employer may not claim a refund or make an adjustment for income tax withholding withheld from employee pay for any of these tax years. An employer may make an income tax withholding adjustment in the current year, provided the employer has repaid or reimbursed the employee for the over-withheld income tax by the end of the calendar year.

Qualified Retirement Plans

As expected, under the ruling, beginning as of September 16, 2013, a qualified retirement plan must treat a same-sex spouse as a spouse for federal tax law purposes if the marriage was validly entered into in a jurisdiction whose laws authorize same-sex marriage, regardless of where the couple lives. However, the ruling states that the ability of taxpayers to file amended returns for prior periods does not apply to qualified retirement plans and notes that the IRS has not issued guidance on how the *Windsor* decision and Revenue Ruling 2013-17 apply to qualified retirement plans for periods prior to September 16, 2013.

Further Guidance

In addition to the special administrative procedure the IRS said it would provide employers for employment tax refund or adjustment purposes, the IRS also said it would issue further guidance on how the ruling impacts qualified retirement plans and other tax-favored arrangements as to plan amendment requirements, including when amendments would be required and any necessary corrections relating to plan operation for periods before future guidance is issued.

Next Steps

The most immediate implication of Revenue Ruling 2013-17 for employee benefit plan purposes is that employers have to be ready on September 16, 2013 to recognize same-sex spouses as spouses. For qualified retirement plans this means that as of September 16, 2013, same-sex spouses must be treated as spouses for purposes of:

- Qualified joint and survivor annuity rules (including notice and consent to waive)
- Qualified pre-retirement survivor annuity rules (including notice rules)
- Automatic survivorship rights under defined contribution plans (unless written consent to waive)
- Right to rollover death benefit proceeds to a spousal IRA
- The more favorable timing and interest rate terms for spouses under the required minimum distribution rules
- Hardship withdrawals under cash or deferred arrangements
- Qualified domestic relations orders

For welfare plan purposes this means that among other things, as of September 16, 2013, same-sex spouses must be treated as spouses for purposes of:

- COBRA (for plans that provide benefits to same-sex spouses)
- HIPAA special enrollment (for plans that provide benefits to same-sex spouses)
- Cafeteria plans (for plans that provide benefits to same-sex spouses)
- Dependent care flexible spending account maximum reimbursement rules
- Health savings account maximum contribution coordination rules

Employers will need to adjust their administrative process in cooperation with their plan's record keepers to account for this change. From a fiduciary perspective, it is likely that employers will need to send a notice to employees advising them of the change in plan operation so that participants are aware of the change in status of same-sex spouses and participants can take action to protect their own interests. For example, for a qualified retirement plan, they may need to obtain a written waiver and consent from their same-sex spouse to have a death benefit paid to someone other than the same-sex spouse. The IRS said that further guidance will address plan amendment and timing issues.

Employers that have provided welfare benefits to same-sex spouses (but not to domestic partners or partners in civil unions who are not spouses) should review whether they want to file for refunds of employment taxes they have paid on the taxable value of benefits provided and premiums paid and be prepared to seek refunds and adjustments when the IRS announces its streamlined administrative guidance for doing so. Employers that have not provided welfare benefits to same-sex spouses do not have this opportunity.

All employers will need to pay attention to further guidance from the IRS on other employee benefit plan issues such as whether the treatment of same-sex spouses as legal spouses for federal tax law is a change in status under a cafeteria plan. Importantly, the Department of Labor has not yet announced how it will approach same-sex marriage for purposes of ERISA compliance, though it is likely it will take an approach similar to the IRS.

The Dickinson Wright Employee Benefits Practice Group has already worked with a number of businesses as they address the many issues resulting from the *Windsor* decision. We will continue to monitor future developments and will issue further Alerts as additional significant information becomes available. In the meantime, please contact the author of this Alert, any member of the employee benefits practice team or your regular Dickinson Wright attorney for guidance and assistance on this or any other employee benefits matter.

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[1] The IRS also issued Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married Under State Law and Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions.

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