

DOMA rejection triggers changes and opportunity for employers

July 2, 2013

In brief

On June 26, 2013, the US Supreme Court held in *US v. Windsor* that Section 3 of the US Defense of Marriage Act (DOMA) is unconstitutional. Section 3 defined marriage as a legal union between one man and one woman for purposes of federal law. Under DOMA, married same-sex couples and their families were not eligible for certain tax benefits and protections (collectively, qualified benefits) that were available to married couples of the opposite sex. For example, same-sex couples could not exclude the value of employer-paid health care coverage, certain tuition benefits or group-term life insurance premiums from their gross income and wages, yet amounts were excludible from the wages of married couples of the opposite sex. As a result, the imputed value of these and other qualified benefits were subject to social security and Medicare taxes (FICA) and income taxes. However, in light of the Supreme Court's landmark decision, these qualified benefits provided to same-sex spouses may now be excluded from taxable wages and no longer subject to federal income and FICA taxes if the marriage is legally recognized under state law. As a result, employers, for themselves and the affected employees, should now be able to seek tax refunds for amounts previously withheld on qualified benefits provided to same-sex spouses.

In detail

Background

The specific issue before the Court was whether Section 3 violated the right to equal protection of the laws under the Fifth Amendment of the US Constitution for same-sex couples who are legally married under state law. In a 5-4 decision, the US Supreme Court held that Section 3 of DOMA is unconstitutional, a judgment that could affect over 1,000 federal benefits and tax provisions. While the full ramifications of *Windsor* are still to be determined in many areas, employers should be aware of the implications and

the actions that may be required in the coming months as a result of the Supreme Court's decision.

What does this mean for employers?

Prospectively

First, employers may begin treating qualified benefits provided to same-sex spouses whose marriage is recognized under state law (eligible same-sex spouses) as excludible fringe benefits after the 25-day period to petition the Court for rehearing under Rule 44 expires on July 21, 2013. As of July 1, 2013, the states that recognize same-sex marriage, in addition to Washington, DC, include

Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont, and Washington.

Prior years

Employers should conduct in-depth reviews of their plans to determine which plans are affected and to what extent. Many questions remain including whether qualified benefits paid in a prior year to lawfully married same-sex couples who currently live in states that do not recognize same-sex marriages are

excluded from income. However, it is clear that employers and employees entitled to tax refunds need to move quickly to secure them.

Employers that originally included the value of qualified benefits for eligible same-sex spouses in gross income and wages and withheld the applicable federal income and employment taxes should now be entitled to claim refunds or credits, for themselves and their affected employees, despite remaining questions. For these purposes, this information is already available and in the payroll system. Because qualified benefits have already been excluded from wages in states that recognize same-sex marriage, most payroll systems include specific coding for those benefits. Therefore, identification of affected employees and refund amounts should not be difficult relative to the more complex analysis required on other benefit matters. The claim for refund, made on Form 941-X, *Adjusted Employer's Quarterly Tax Return or Claim for Refund*, is for FICA taxes paid on qualified benefits provided during any years that are still open under the statute of limitations. For most employers, claims can be filed for periods beginning in 2010. Those employers that took steps to protect the statute on prior periods by filing protective claims may now perfect those claims as part of this process. Income tax withholding refunds, by contrast, are limited to withholding made during the current calendar year.

The process for filing FICA refund claims can be exacting and requires administrative oversight. While the IRS may issue guidance for employers seeking refunds resulting from the Decision, there are certain procedural

requirements that will not change and can be undertaken immediately. Because an employer assumes a fiduciary role acting on behalf of its affected employees, and FICA tax includes an employee component, an employer must provide employees an opportunity to participate in the FICA refund claims. This requirement applies to employers perfecting previously filed protective claims or those filing original claims.

To provide employees an opportunity to participate, an employer must secure the employee's written statement confirming that the employee has not made any previous claims and will not make any future claims for refund or credit of the amount of the over collected FICA tax. The employer is required to wait a reasonable period of time (typically 45 days) for the employee's response. If an affirmative response is received, the employee's FICA refund claim should be included with the employer's claim. If no response is received or the employee denies inclusion, then the employer may generally exclude the employee from the claim and only request the employer's portion of FICA taxes.

In addition, employers will need to prepare and file Forms W-2C, *Corrected Wage and Tax Statement*, for all employees who provided their consent in a timely manner.

Prior periods in 2013

The IRS may provide simplified procedures for correcting overpayments made in 2013 and employers will likely have options relative to the method of recovery. Unlike prior years, both FICA and income tax amounts withheld from eligible payments in 2013 may be

credited or refunded. Employers seeking adjustments are required to repay or refund the overpayments to employees, as appropriate.

The takeaway

While some questions remain unresolved, a significant opportunity should exist for employers and employees to obtain refunds or credits for employment taxes, and in some cases, income taxes associated with eligible benefits provided to same-sex spouses.

Additional resources

For details about how DOMA affects:

- income, estate, and gift taxes, please see our PFS Tax Insight, *DOMA overturned: impact on income, estate, and gift taxes* (dated July 2) or
- benefit plans, please see our HRS Insight, *What does the DOMA decision mean for employer-sponsored benefit plans* (dated June 28, 2013).

Let's talk

For more information, contact your PwC team or the following authors:

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