Employee benefits after the Supreme Court decision upholding same-sex marriage

June 29, 2015

In brief

The Supreme Court held last week that same-sex couples have the legal right to marry in all US jurisdictions and that states must recognize same-sex marriages performed in other jurisdictions. While perhaps a monumental social decision, the Court’s decision in Obergefell v. Hodges does not raise significant employee benefits issues on the federal level; same-sex married couples have been treated the same way as opposite-sex married couples under federal law since the Court’s 2013 decision in United States v. Windsor. Obergefell will require all states to provide same-sex married couples with the same rights and tax treatment under state law as opposite-sex married couples.

In detail

Background

Since the Supreme Court’s 2013 Windsor decision, employers are required to recognize same-sex marriages as the equivalent of opposite-sex marriages for all federal rules relating to employee benefits, including qualified retirement plans, health insurance and fringe benefits. Federal government agencies, including the IRS and DOL, adopted a ‘state of celebration’ rule so that a same-sex marriage performed under the laws of any state or foreign country must be recognized for purposes of federal taxes and ERISA-governed plan rights in all states regardless of where the couple resides. Because federal law recognizes same sex-spouses for these purposes, all qualified retirement plans should already be amended and participant communications updated to remove any distinctions between same-sex and opposite-sex spouses that result in different benefits, rights or features. Therefore, from an employee benefits perspective, the new Supreme Court decision likely will have only limited impact.

In the aftermath of Windsor, most employers reviewed their plan provisions around spousal benefits and made changes to comply with the federal requirements. In addition, following the reasoning of the Windsor holding many more states began to recognize same-sex couples’ right to marry, so that ultimately at the time Obergefell was decided there were only 13 states that continued to prohibit same-sex marriages. Employers have become increasingly sensitized to the issue over the past several years having to continually adapt state tax withholding and reporting procedures, and improving on procedures to document or validate employees’ enrollment of spouses.
Obergefell v. Hodges
The Obergefell decision answers the significant questions left open by the Windsor decision — or to be more precise: same-sex couples have a constitutional right to marry and states must recognize other states’ marriage decrees in the case of same-sex couples.

State taxes
The Obergefell holding will require employers to address state issues for employees in same-sex marriages who work or reside in a state that didn’t previously recognize the employee’s spouse. Changes include adjusting state wage reporting and income tax withholding for benefits provided to spouses on a tax-free basis, such as employer-provided health insurance and cafeteria plan elections, allowing for consistent reporting and administration.

Obergefell makes it easier for same-sex couples to marry because they no longer have to travel to states that perform same-sex marriages to achieve that legal status. So, employers that didn’t previously have an employee with a same-sex spouse may be confronted with the issue for the first time. While plan sponsors were already required to amend qualified plans (e.g., 401(k) plans and pension plans) to eliminate any unequal treatment of same-sex spouses, employers may be confronted anew with reviewing tax-withholding, wage reporting, and enrollment procedures for health and other fringe benefits to treat spouses the same regardless of gender — particularly if those employers have large employee populations in states that haven’t previously recognized same-sex marriage.

Corrective action may be necessary, including making plan amendments and revising plan administrative procedures and payroll and income tax processes, for employees with a same-sex spouse, if these changes haven’t already been made. Because federal law already recognizes same-sex spouses, little additional employee benefit plan guidance from the IRS or DOL is expected. This Insight summarizes some key issues relating to spousal benefits.

Revisiting domestic partner benefits
Neither the Windsor decision nor the Obergefell decision change any laws affecting domestic partnerships, civil unions, or other formal relationships that aren’t ‘marriages’ under state law. These relationships are not recognized as marriages; and individuals (whether of the same or opposite gender) who have entered into these relationships are not treated as married under federal law. Employers may continue to provide benefits to unmarried domestic partners, but the benefits are not eligible for the tax exclusion that applies to benefits provided to employees’ spouses.

Because same-sex couples will now have the freedom to marry in any state and have their marriages recognized in all states, some employers who currently offer domestic partner benefits may reconsider their employee benefit plan designs to eliminate domestic partner health coverage. The reasons for adding such benefits in the first place may no longer be present since same-sex marriage is now allowed and the Affordable Care Act’s market reforms guarantee that individuals will be able to purchase comprehensive affordable health insurance in the marketplace.

However, before beginning a wholesale elimination of domestic partner benefits in any plan, employers should consider whether such benefits were added to address other state or local requirements (for example, where state or municipal contractor rules require that domestic partners be granted rights similar to spouses). Many state and local laws with protections for domestic partners may take some time to reconcile to the now equal treatment of same-sex and opposite-sex marriages at the federal level.

In addition, once domestic partner benefits have been offered, employers should consider the employee relations impact of eliminating such benefits. Elimination of domestic partner benefits can affect employees in opposite-sex relationships as well as same-sex relationships. Employers eliminating such benefits should consider such factors as the number of employees affected (i.e., those enrolled in domestic partner benefits), the costs of continuing to maintain such benefits (including administrative costs), a strategy for communicating the change to their employees, and a timeline for implementing the change.

FMLA
The Family and Medical Leave Act allows otherwise eligible employees to take unpaid leave to care for a family member (including the employee’s spouse) with a serious health condition. After Windsor the FMLA regulations continued to define ‘spouse’ by reference to the employee’s state of residence.

Earlier in 2015, the DOL issued final rules defining spouse consistent with IRS and other employee benefit plan rules to look to whether the marriage was valid in the state in which it was performed. While this final rule went into effect for FMLA purposes in most states, a federal case in Texas resulted in the final rule being delayed in a few states that continued to refuse to recognize same-sex marriages. Presumably following the Obergefell decision, that final rule will be allowed
to go into effect in all states, and employers must now recognize same-sex spouses for purposes of FMLA leave regardless of where the couple was married or resides.

How does same-sex marriage recognition affect employee benefit plans?

The remainder of this Insight summarizes the common ways recognizing an employee’s same-sex spouse impacts employee benefit plans. Many of these results became effective with the Windsor decision, and subsequent guidance issued by the IRS — particularly Revenue Ruling 2013-17 that required marriages that were valid where they were performed to be recognized for all federal tax purposes, including income taxes, estate and gift taxes, and qualified plan purposes. Where the Obergefell decision may have further impact, additional considerations are noted.

Retirement plans

IRS Notice 2014-19 addressed the retroactive impact of the Windsor decision on qualified plans and provided examples of various qualification requirements affected by a participant’s marital status. The IRS recognized that each plan’s existing terms would dictate whether amendments were technically required, and specified that the deadline for adopting required plan amendments (for example, because the plan defined ‘marriage’ or ‘spouse’ to include only opposite-sex marriages/spouses) was generally December 31, 2014 (or if later, the due date for the employer’s federal income tax return for the period that included June 26, 2013). Notice 2014-19 required all qualified plans to be operated consistent with Windsor effective June 26, 2013, so employers gained some comfort in knowing the change would have limited retroactive effect.

Spousal Annuities

Some qualified retirement plans (e.g., defined benefit pension plans and money purchase plans) generally must provide automatic survivor benefits to a spouse in the form of a qualified preretirement survivor annuity (QPSA) if a participant dies before normal retirement age (unless the participant waives the benefit and certain spousal notice and consent requirements are satisfied). These plans must also provide that the regular form of payment for married participants upon retirement is a qualified joint and survivor annuity (QJSA) with the spouse as the survivor unless the participant elects otherwise with the spouse’s consent. The value of the spouse’s survivor benefit under a subsidized QJSA isn’t generally taken into account for purposes of determining the maximum amount that can be paid under a defined benefit plan under Code section 415(b) limits.

Profit-sharing and stock bonus plans — including 401(k) plans — are not generally required to offer an annuity payment form, but those that do must offer a QJSA to married participants. Those plans that do not offer annuities usually satisfy the spousal protection rules by paying a participant’s vested account balance upon death to the surviving spouse (unless the spouse consents to a different beneficiary). Many profit-sharing plans also require spousal consent for participant loans.

Hardship withdrawals

Safe-harbor standards for determining if a participant has experienced an immediate and heavy financial need for purposes of hardship withdrawals from 401(k) and 403(b) plans were also affected since a spouse’s medical, tuition and funeral expenses incurred by the participant could be considered. In addition, a spouse’s resources must be considered for purposes of determining whether the immediate and heavy financial need could be satisfied from other available resources.

Required minimum distributions

All tax-favored retirement plans (including qualified pension and profit-sharing plans, 403(b) plans, 457(b) eligible deferred compensation plans and individual retirement arrangements (IRAs)) are subject to minimum distribution rules concerning when distributions must begin and how much must be distributed. Distributions generally must begin by the later of April 1 following the year in which the employee turns 70½ or the year in which the employee retires (except for IRA owners and 5% owners, who must commence payments by April 1 of the year following attainment of age 70½, regardless of whether the owner actually retires). There are some special rules for surviving spouses that allow a surviving spouse to delay payments for a longer time than other beneficiaries.

Rollovers

The surviving spouse of a deceased participant has broader rollover rights than does a non-spouse beneficiary, including the right to roll over an eligible distribution to another qualified plan, 403(b) plan, governmental 457(b) plan, or an IRA. The surviving spouse who is the beneficiary of a decedent’s IRA may treat it as their own and may make rollovers to and from the IRA. While a non-spouse beneficiary may currently roll over a distribution from a qualified plan to an IRA, unlike a spousal beneficiary, they may not make any subsequent rollovers from that IRA. The IRA of a non-spouse beneficiary is subject to stricter required minimum distribution rules.
Qualified domestic relations orders

A limited exception to the Code and ERISA’s anti-alienation provisions—which generally prohibit plan benefits from being assigned, alienated, or subject to garnishment or execution—is provided for qualified domestic relations orders (QDROs). A QDRO may require the plan to distribute or segregate a benefit in favor of a participant’s spouse, former spouse or dependents provided the domestic relations order meets certain requirements. Plans must adopt procedures for reviewing QDROs and spousal rights are entitled to certain notice and disclosures. QDROs issued upon the dissolution of a legally recognized same-sex marriage must be enforced by plans.

Health and welfare plans and other fringe benefits

Employer-sponsored health plans

Employer-paid health benefits, including amounts provided through a cafeteria plan, are generally excludable from an employee’s income. The exclusion also applies to benefits provided to an employee’s spouse and dependents, as defined in Code section 152. Under Windsor, the cost of employer-provided health insurance for an employee’s same-sex spouse is not taxable income to the employee; however, states that did not recognize same-sex marriages could continue to require employers to impute income for state tax purposes. As mentioned above, after Obergefell, the value of health coverage provided to a same-sex spouse should not be taxed if the same coverage is tax-free when provided to an opposite-sex spouse. For most employers, this will reduce the burden of applying inconsistent tax treatment between federal and state income inclusion and among employees in different states.

COBRA continuation coverage

Group health plans must provide COBRA continuation coverage when coverage would otherwise be lost due to certain qualifying events. The spouse of a covered participant can elect COBRA coverage in the event of the employee’s termination of employment, and upon the participant’s death, divorce or legal separation.

Cafeteria plans

A participant’s election under a cafeteria plan may not be changed during the plan year unless there has been a change in status event, such as marriage, death of a spouse, legal separation or annulment.

FSAs, HRAs and HSAs

The tax rules related to flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs) provide for tax-free reimbursement of qualifying medical expenses of spouses and section 152 dependents. While the expenses of a same-sex spouse can be reimbursed from these accounts, the maximum family contribution will limit the amount the two same-sex spouses can contribute to an HSA.

HIPAA special enrollment rights

Group health plans must provide special enrollment rights that allow participants to enroll a new spouse mid-year, or to change their coverage elections in the case of a marital status change, such as marriage, divorce or legal separation, and when the employee loses coverage under a spouse’s plan or adds a dependent child.

Other employee fringe benefits

Other fringe benefits that may be provided by employers to spouses of their employees on a tax-free basis—such as no additional cost services, employee discounts, retirement planning services, and the use of on-site workout facilities—are provided to same-sex spouses without causing imputed income for federal purposes. Employers that are located in states that had not permitted same-sex marriages will now have to adjust state income tax withholding for these benefits if the state does not tax these benefits for an opposite-sex spouse.

The takeaway

Although employers are already required to recognize same-sex spouses for federal purposes, this is a good opportunity for employers to review plans, communications and systems, including payroll systems, to ensure that the requirements of the law are being met now for both federal and state purposes. Employers may require additional information from employees to determine if the employees are married or are domestic partners.
**Let’s talk**

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