Federal Tax Guidance for Same-Sex Couples and Employee Benefit Plans

September 6, 2013

On August 29, 2013, the IRS and Department of Treasury issued the much anticipated, federal tax guidance adopting a rule that the marital status of a same-sex couple will be based on the state or foreign law where the marriage is validly performed, even when the couple resides in a state or foreign jurisdiction that does not recognize same-sex marriages. This federal tax guidance was issued through Revenue Ruling 2013-17, and IRS Answers to Frequently Asked Questions for same-sex married couples and registered domestic partners and individuals in civil unions.

The federal tax guidance specifically states that, *for federal tax purposes*, the terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same sex, if the individuals are lawfully married under the laws of the state or foreign jurisdiction in which their marriage was performed. Moreover, the valid marriage of such same-sex individuals shall be recognized for federal tax purpose even if the couple is domiciled in a state that does not recognize the validity of same-sex marriages. This federal tax guidance applies prospectively as of September 16, 2013, with certain retroactive applicability.

The federal tax guidance was necessary to implement the federal tax aspects of the Supreme Court's decision in *U.S. v. Windsor*, holding that Section 3 of the Defense of Marriage Act ("DOMA") (which defined marriage as a "union between one man and one woman") was unconstitutional. Although this federal tax guidance impacts many different provisions of the Code, the purpose of this alert is to highlight items dealing specifically with employee benefit plans.

Health Care Coverage

In a nutshell, the federal tax guidance relieves an employer from imputing federal income tax to an employee for the value of same-sex spousal coverage under the employer's group health plan. Historically, an employer was required to impute federal income and other employment-related taxes to an employee for the value of the cost of same-sex spousal coverage under the employer's group health plans (unless the same-sex spouse otherwise qualified as the employee's dependent under Code Section 152). Likewise, an employee was not permitted to pay, with pre-tax dollars, his or her share of the premium costs for such same-sex spousal health coverage through the employer's Code Section 125-cafeteria plan. While the *Windsor* decision constitutionally struck down the federal ban against same-sex marriages, it left unclear whether the treatment of same-sex marriages could be impacted by the couple's choice of domicile, which would make administering health plans with multi-jurisdiction operations very complicated. Thankfully, the federal tax guidance provides uniformity that any employer offering group health coverage to employees' same-sex spouses will not need to impute *federal* income taxes to the employee for such coverage.

The federal tax guidance allows individuals to claim a refund from the IRS for open tax years (generally the last three tax-years from the date on which the return was filed) if the individual previously had imputed federal taxes for same-sex spousal coverage under an employer-sponsored health plan and also provides guidance for the employer to claim a refund for its share of FICA taxes under these circumstances or to correct other over-withholding of income taxes during a current tax year. The IRS has indicated that a special administrative procedure for employers to file claims for refunds or make adjustments for excess social security taxes and Medicare taxes paid on same-sex spouse benefits will be provided in future guidance.

Unfortunately, a number of uncertainties still exist regarding the impact of this federal tax guidance on employer's group health plans, including:

- The state income tax consequences of same-sex spousal coverage under the employer's group health plan in states that do not permit or recognize same-sex marriages. For example, some states could require an employer to impute state income taxes to its employees for same-sex spousal coverage.

- Whether employer-sponsored group health plans would be legally required to offer same-sex spousal coverage whenever opposite-sex spousal coverage is offered, or will ERISA's pre-emptive provisions permit the employer to make that plan design decision.
- Whether the employer would be obligated to notify employees of the opportunity to claim a refund of federal taxes for open tax year or take any other retroactive remedial action for income taxes that have already been imputed to an employee for the current tax year.

Tax-Qualified Retirement Plans

The federal tax guidance also clarifies that a same-sex spouse must be treated as the spouse for purposes of satisfying the federal tax laws relating to tax-qualified retirement plans. After the *Windsor* decision, many commentators believed that same-sex marriages would be recognized only if a plan participant's state of residency permits same-sex marriages or recognizes those validly performed in other jurisdictions. However, the federal tax guidance makes it clear that the validity of the marriage is determined under the laws of the state or foreign jurisdiction where the marriage is validly performed and not based on whether the participant's current state of domicile permits or recognizes same-sex marriages.

Examples of the type of federal tax laws relating to tax-qualified retirement plans that impact spouses, now including same-sex spouses, are:

- Requirement to provide qualified joint and survivor annuity or pre-retirement survivor annuity to the surviving spouse of a participant under a defined benefit pension plan or other tax-qualified plans;
- Requirement to provide survivor benefits (including account balances under a defined contribution plan) automatically to the participant's surviving spouse, unless the spouse has consented in writing to the designation of another beneficiary;
- Requirement to comply with the terms of a Qualified Domestic Relations Order which assigns a portion of a participant's benefits to a former spouse; and
- Requirements relating to minimum required distribution, eligible rollover and other rules and rights impacting spouses under tax-qualified retirement plans.

Employers should begin granting these federal tax rights to same-sex spouses under their tax-qualified retirement plans beginning on **September 16, 2013**. The IRS intends to issue additional guidance in the near future addressing plan amendment requirements (including the timing of any required amendments), any necessary corrections relating to plan operations for periods before any future guidance is issued and to what extent, if any, this federal tax guidance will apply retroactively for periods prior to September 16, 2013 (e.g. grant retroactive rights to a surviving same-sex spouse to claim spousal rights under a tax-qualified plans relating to the participant's death occurring prior to September 16, 2013).

Domestic Partners, Civil Unions or Other Formal Relationships

A notable clarification under the federal tax guidance involves individuals who have entered into a registered domestic partnership, civil union or other similar formal relationship pursuant to the laws of a state or foreign jurisdiction. Specifically, the term "marriage" for federal tax purposes will not include registered domestic partnership, civil union or other similar formal relationship, unless such relationship is specifically denominated as a legal marriage under the laws of such state or foreign jurisdiction. In other words, an employee's same-sex domestic or civil partner will not be afforded the federal tax rights that now are available to same-sex spouses who are legally married under the laws of the state or foreign jurisdiction where performed. For employers, this means that the employer should continue to impute federal income tax for the value of a domestic or civil partner's health coverage and not permit pre-tax premium payments by the employee for such coverage. Additionally, the employer would not be required to grant any spousal-like rights under its tax-qualified retirement plan to domestic or civil partners.

Conclusion

This federal tax guidance provides welcome uniformity and certainty for employers in administering their benefit programs. Same-sex spouses will receive the same federal tax treatment as other spouses, regardless of the couple's choice of domicile. We eagerly await the additional IRS guidance and will provide an updated client alert as soon as it is released.

In the meantime, please contact us to begin discussing the changes necessary for your employee benefit plans, or to learn more about the federal tax guidance in other tax areas. Please contact Margaret A. Hunter (mhunter@dykema.com or 313-568-6788), Amy M. Christen (achristen@dykema.com or 248-203-0760) or Gabe Marinaro (gmarinaro@dykema.comor 313-568-6874), or any of the Employee Benefits attorneys listed to the left.

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