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employee benefits lawflash

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Guidance on Tax Treatment of Same-Sex Marriages Takes Effect

Plan sponsors will need to take prospective and, possibly, retroactive action in order to ensure compliance with the guidance.

On August 29, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) released guidance clarifying that same-sex couples who are legally married in jurisdictions or countries that recognize their marriages will be treated as married for all federal tax purposes, regardless of whether the same-sex couple resides in a state or jurisdiction that recognizes same-sex marriages.[1] This is commonly called a "state of celebration" approach to federal taxation issues. Note that the IRS guidance has no impact on the federal tax treatment of civil unions, domestic partnerships, or other employer-created variations of domestic partnerships, nor does it impact the state tax treatment for any same-sex relationships in states that do not recognize same-sex marriages, including same-sex marriages entered into in other jurisdictions.

Plan sponsors are required to comply prospectively with the guidance effective as of September 16, 2013 with respect to health and welfare plans and qualified plans and, possibly, to take retroactive action in order to ensure compliance with the guidance. This LawFlash provides additional details about the issues created by the IRS guidance.

What should employers do now with respect to health and welfare plans?

Stop imputing income and switch to pre-tax premiums for same-sex spouses.

As of September 16, 2013, employers must stop imputing income for health benefits for same-sex spouses. If applicable (assuming the existence of a cafeteria plan), employers must also switch from after-tax to pre-tax premiums for same-sex spouse health benefits.

If employers do not know whether employees receiving domestic partner benefits have same-sex spouses, employers may want to invite employees to disclose their marital statuses. For example, to the extent an employer requires married employees to provide copies of their marriage certificates in order to cover their spouses under the health plan, employers should ask same-sex married employees to provide marriage certificates in order to take corrective federal tax actions.

Determine tax treatment for 2013.

For health benefits where income was imputed and/or premiums paid on an after-tax basis during periods prior to September 16, 2013, employers may either

- leave the amounts paid prior to September 16, 2013 "as is" and let the employee request an income tax and payroll tax refund at the time the employee files his or her tax return, or

1. For more information on the guidance, see our September 3, 2013 LawFlash, "Same-Sex Marriages Recognized for Federal Tax Purposes," available at http://www.morganlewis.com/pubs/EB_LF_Same-SexMarriagesRecognizedTaxPurposes_03sep13.

- under-withhold for the rest of 2013 to put the employee in the same position that he or she would have been in if no income had been imputed and/or premiums were paid on a pre-tax basis. The IRS has indicated that if an employer elects this option, the employer must repay or reimburse the affected employees for the over-withheld income and payroll taxes before December 31, 2013.

Note that employers cannot initiate income tax refund claims on behalf of employees for 2010, 2011, and 2012. Employees will need to file for any refund of income tax overpaid for these prior years but may find that the increased income taxes associated with re-filing as a married couple more than offset the tax savings associated with the tax-free medical coverage.

The 2013 Form W-2 for an employee with a same-sex spouse should not include any imputed income for spousal healthcare coverage nor should it report any premiums paid for such coverage as taxable income if a pre-tax premium payment alternative was available to opposite-sex spouses.

Expand permissible health flexible spending account (FSA) and health reimbursement arrangement (HRA) dependents.

Now that same-sex spouses and their dependents are permissible recipients of tax-free health FSA and HRA reimbursements, employers should treat expenses incurred in 2013 by these individuals as eligible for reimbursement under such tax-favored accounts.

Inform employees about HSA maximum contribution changes.

Prior to the U.S. Supreme Court's *United States v. Windsor* decision and the recent IRS guidance, employees and their same-sex marriage partners who participated in high-deductible health plans could each take advantage of a full-family contribution to an HSA. However, now that these individuals are married for federal tax purposes, they must share a family HSA contribution limit, reducing the maximum amount of HSA contributions by nearly 50%. This new limitation will be particularly important if both individuals work for the same employer.

What should employers do now with respect to their retirement plans?

Treat same-sex spouses as "spouses" under the terms of the qualified plan.

As of September 16, 2013, employers should treat same-sex spouses as "spouses" under all qualified retirement plans. For example, because a participant's account balance under a qualified plan must be paid to the participant's spouse upon death unless the spouse consents to a different beneficiary, qualified plans must now pay the benefit to the same-sex surviving spouse of a deceased participant. Note that qualified retirement plans are not required to provide this death benefit to a surviving registered domestic partner or a civil union partner of a deceased participant. However, a plan could decide to make such an individual the default beneficiary by plan design.

The IRS has not yet provided guidance explaining how these rules apply to qualified plans for periods prior to September 16, 2013.

Communicate to employees the implications and request updated beneficiary designations.

Employers should communicate to employees the implications of the ruling and explain the need to update beneficiary designations. For example, an employee who is married to a same-sex spouse will need to obtain spousal consent in order to name someone other than his/her spouse the beneficiary under the plan—and, if they had taken this step in the past, such a beneficiary designation is effectively nullified as of September 16, 2013 if the employee did not previously receive consent from the same-sex spouse.

Anticipate additional IRS guidance related to plan amendments and retroactive corrections.
The IRS indicated that it will be releasing further guidance clarifying how qualified plans must comply. This guidance is expected to address, among other issues, (i) any plan amendment requirements, including the timing of such amendments, and (ii) how corrections should be handled for periods prior to the release of such future guidance.

Should employers consider filing for refunds of the employer portion of Social Security and Medicare taxes on the benefits?

Yes. Employers should consider filing for a refund of the employer portion of Social Security and Medicare taxes. Refunds may be requested for all open years available under the statute of limitations. The IRS indicated that it will be establishing a special administrative procedure that will provide guidance for filing these claims.

If employers decide to pursue a refund request, the employers are required, as a procedural matter, to ask the employees if they would like to join the claim. Employees are permitted to file on their own behalf without joining their employers' claims. The IRS clarified in its August 29 guidance that, if an employer makes reasonable attempts but cannot locate affected employees, the employer can proceed to request a refund of the employer portion of the taxes.

What issues have not yet been addressed?

Right for midyear enrollment for same-sex spouses.
The *Windsor* ruling did not clarify whether the invalidation of section 3 of the Defense of Marriage Act (DOMA) triggered the right for an employee who was already married at the time of the decision to enroll a same-sex spouse in a cafeteria plan midyear. Arguably, the invalidation of DOMA caused the economic cost of healthcare for same-sex spouses to decrease, which could create a midyear enrollment right. It also arguably changed employees' legal marital statuses, at least for federal tax purposes, which would appear to create a Health Insurance Portability and Accountability Act special enrollment right. While the recent IRS guidance did not address this issue, many employers are proceeding to offer a 30-day window, starting on September 16, 2013, permitting the addition of a previously acquired same-sex spouse or, alternatively, dropping employer coverage to begin coverage under the same-sex spouse's employer's health plan.

Timing of amendments and retroactive applicability.
As described above, the guidance did not address when qualified plan amendments need to be adopted and did not provide details regarding what must be included in those amendments. Additionally, the guidance did not address how the ruling should be applied for prior periods. More guidance on these issues should be forthcoming from the IRS.

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