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Employee Benefits & Executive Compensation ADVISORY ■

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Agencies Provide Follow-Up Guidance for Health Benefits on Supreme Court Same-Sex Marriage Ruling

This advisory discusses the impact of the Supreme Court's *Windsor* decision and recent Internal Revenue Service (IRS) and Department of Labor (DOL) guidance for health and welfare benefit plans. While there are still some unanswered questions, the recent agency guidance has given plan administrators guidelines about how to proceed. Some action must be taken quickly to take advantage of recent transition relief, so employers whose plans cover same-sex spouses (or who wish to amend their plans to do so) should take note of the relevant deadlines below.

On June 26, 2013, the Supreme Court held in *Windsor v. United States* that Section 3 of the Defense of Marriage Act (DOMA) was unconstitutional. As a result, the definition of "spouse" under federal law now includes a spouse of the same sex. Since the Supreme Court handed down its decision, it has been unclear how employee benefit plans would be affected—especially welfare benefit plans such as cafeteria plans, FSAs, HRAs and HSAs. Although *Windsor* established that "spouse" would be defined by reference to state law, one of the key questions for plan administrators was whether the federal agencies would define spouse by reference to the laws of the state of ceremony or the laws of the state of domicile. This question is significant, since the majority of states do not recognize same-sex marriages.

Agency guidance is beginning to bring some clarity to the issues left unresolved by the *Windsor* decision itself:

- On August 29, 2013, the IRS issued Revenue Ruling 2013-17 and two FAQs on how the IRS intends to apply the Court's decision in *Windsor* for federal tax purposes.[1]

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[1] *See* Internal Revenue Service, "Treasury and IRS Announce That All Legal Same-Sex Marriages Will Be Recognized For Federal Tax Purposes; Ruling Provides Certainty, Benefits and Protections Under Federal Tax Law for Same-Sex Married Couples," August 29, 2013, *available at* http://www.irs.gov/uac/Newsroom/Treasury-and-IRS-Announce-That-All-Legal-Same-Sex-Marriages-Will-Be-Recognized-For-Federal-Tax-Purposes;-Ruling-Provides-Certainty,-Benefits-and-Protections-Under-Federal-Tax-Law-for-Same-Sex-Married-Couples; Internal Revenue Service, Revenue Ruling 2013-17, August 29, 2013, *available at* http://www.irs.gov/pub/irs-drop/rr-13-17.pdf; Internal Revenue Service, "Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married Under State Law," August 29, 2013, *available at* http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples; and Internal Revenue Service, "Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions," August 29, 2013, *available at* http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions.

- On September 18, 2013, the DOL issued guidance that matched the definition of "spouse" adopted in the IRS guidance.[2]
- On September 23, 2013, the IRS issued Notice 2013-61, which provides special administrative procedures for employers to make adjustments to FICA and income tax withholding for benefits previously provided to same-sex spouses.[3]
- On November 20, 2013, the IRS updated its prior FAQ guidance with respect to refunds of employment tax amounts.
- Most recently, on December 16, 2013, the IRS released Notice 2014-01, which relates to cafeteria plans, health and dependent care FSAs and HSAs.[4]

Post-*Windsor* Guidance

IRS Revenue Ruling and FAQs

The August IRS guidance, which is generally prospectively effective on September 16, 2013, answers some, but not all, of the questions facing plan sponsors of health and welfare plans. Important takeaways include:

- The terms "spouse" and "husband and wife" include individuals who entered into a legal marriage in any jurisdiction that recognizes same-sex marriage, regardless of where they currently live.
- Employers and employees can request refunds of taxes for all open years on amounts for health coverage provided by the employer to a same-sex spouse that was previously included in income. The process for employers is detailed in Notice 2013-61.[5]

Practice Pointer: The September 16, 2013, prospective effective date for the August IRS guidance appears to establish a date after which taxpayers MUST take certain action. However, the guidance does not seem to limit actions taken before that date.

DOL Technical Release

The DOL has also issued guidance on the impact of Windsor on benefit plans. In Technical Release 2013-04, the DOL reached the same conclusion as the IRS on the definition of "spouse." According to the DOL, for purposes of its jurisdiction, "marriage" includes a same-sex marriage that is legally recognized as a marriage under any state, territory or foreign jurisdiction.

IRS Notice 2014-01

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[2] Department of Labor, Technical Release 2013-04, September 18, 2013, *available at* http://www.dol.gov/ebsa/pdf/tr13-04.pdf.

[3] Internal Revenue Service, Notice 2013-61, September 23, 2013, *available at* http://www.irs.gov/pub/irs-drop/n-13-61.pdf.

[4] Internal Revenue Service, Notice 2014-01, December 16, 2013, *available at* www.irs.gov/pub/irs-drop/n-14-01.pdf.

[5] The August IRS guidance also clarifies how the decision in *Windsor* impacts qualified retirement plans. For more information, *see* Alston & Bird, "Employee Benefits & Executive Compensation Advisory: Same-Sex Marriages and Retirement Plans – Old Questions, New Answers," September 12, 2013, *available at* http://www.alston.com/advisories/ebec-same-sex-marriages-questions-answers.

This Notice provided guidance about cafeteria plans, as well as health and dependent care FSAs and HSAs. These rules are discussed in more detail below. Highlights include:

- Plans that cover same-sex spouses may treat the same-sex marriage as a change in legal status for purposes of the IRC § 125 cafeteria plan rules. Elections to cover same-sex spouses are prospectively effective no later than i) the regular date of a change in status or ii) a reasonable period after December 16, 2013.
- Employers who currently cover same-sex spouses on an after-tax basis must treat after-tax payroll deductions as pre-tax salary reductions if the employee provides notice of the same-sex marriage and certain criteria (discussed below) are met.
- Reimbursements are permitted for eligible medical and dependent care expenses incurred by or for a same-sex spouse at any time after the later of i) the start of the plan year that includes June 26, 2013, or ii) the date of the marriage. If a same-sex couple is treated as married, the married couple limitation on dependent care FSA contributions applies.
- If a same-sex couple is treated as married in 2013 and each has an HSA, the aggregate contributions by both spouses are limited to the statutory maximum for family coverage if one or both has other than self-only high-deductible health plan coverage.

Q&As for Health and Welfare Plans

The following Q&As will cover what we know—and what we don't yet know—about the effect of the *Windsor* decision and the recent guidance on health and welfare plans. We anticipate that the IRS and DOL will issue further guidance in the future.

Issues Specifically Addressed by the Agencies

- *How are "spouse" and "husband and wife" defined for federal tax purposes?* The IRS and DOL clarified that the terms "spouse" and "husband and wife" in the Internal Revenue Code (the "Code"), ERISA and related laws under the agencies' jurisdiction include same-sex individuals who are validly married in accordance with the laws of *any jurisdiction* that recognizes same-sex marriages, even if the couple resides in a state that does not recognize same-sex marriages. This is the "state of ceremony" test.[6] Note that it does not include registered same-sex domestic partners or civil union partners.

Practice Pointer: This outcome provides the most administrative simplicity for employers. If the agencies adopted an approach that looked to the laws of the state of domicile instead of the state of ceremony, the status of employer-provided accident and health insurance for same-sex spouses would vary depending on where the same-sex couple lived. It would be even more complicated administratively if a same-sex couple moved from a state that recognized same-sex marriages to another state that didn't (or vice versa).

[6] Although we refer to a "state of ceremony," a marriage in any jurisdiction, including another country, would be recognized. For instance, the marriage at issue in the *Windsor* case took place in Canada.

- *Is the cost of employer-provided health coverage for same-sex spouse coverage excluded from federal income and employment tax?* Yes, employer-provided health coverage for an employee's federally recognized same-sex spouse is now excluded from income and employment tax. If a plan is already providing health insurance coverage to same-sex spouses, the August IRS guidance seems to indicate that the cost of such coverage paid by the employer *must* be tax free *for federal tax purposes* after September 16, 2013.[7]
- *How may/must adjustments be made if the employer-provided health coverage to same-sex spouses treated the coverage as taxable?* For those employers that did provide health coverage to same-sex spouses, the September IRS guidance clarifies the following:
  - Employers may request refunds or make adjustments for employment taxes and FICA taxes paid with respect to certain benefits and remuneration for same-sex spouses for 2013 and some prior years. These are optional, and employers that prefer to use the regular procedures for correcting employment tax overpayments may do so.
  - For the third quarter of 2013, if an employer calculates and reimburses an employee for the amount of employment taxes withheld for the same-sex spouse before the filing of the Form 941 for that quarter, the employer won't report the wages and withholding on the third-quarter Form 941. If the employer does not reimburse the employee before filing the third-quarter Form 941, it must report the amount of the over-collection and can use one of the special administrative procedures discussed in the Notice.
  - There are two administrative procedures that employers may choose for corrections in the fourth quarter of 2013 (with respect to benefits provided in the first three quarters of 2013).
    - Under the first option, the employer must repay or reimburse affected employees for the amount of over-collected FICA and income tax for the first three quarters of 2013 on or before December 31, 2013. On the fourth-quarter 2013 Form 941, the employer will reduce the wages reported and income tax withheld, corresponding to the benefits for same-sex spouses that were treated as wages for the first three quarters of 2013. The benefit of this option is that the employer does not have to file separate Forms 941-X for the first three quarters of 2013. The employer may only correct the employer share of FICA tax that corresponds to the employee share of FICA tax that has been repaid or reimbursed on or before December 31, 2013.
    - Under the second option, an employer that does not repay or reimburse employees for the amount of withheld FICA and income taxes with respect to same-sex spouse benefits provided in 2013 on or before December 31, 2013 (and thus files the fourth-quarter 2013 Form 941 without making the adjustment), may correct overpayments of FICA taxes for 2013 using Form 941-X. In this situation, the employer files one Form 941-X for the fourth quarter of 2013 to correct for all quarters of 2013, provided that the employer has satisfied the usual requirements for filing a Form 941-X. The employer should write "WINDSOR" in dark, bold letters across the top margin of page one of Form 941-X. If an employer uses this method, it can only show corrections made under this procedure on the Form 941-X.
      - Keep in mind that employers cannot make an adjustment for overpayment of income tax for a prior calendar year, except in cases of administrative error. Because the employer can use the second method only if it didn't repay or reimburse the employee on or before December 31, 2013, the second approach *cannot be used* with regard to income tax withheld in 2013. Instead, affected employees will receive credit when they file their Forms 1040.
  - For years before 2013, employers may make a claim or adjustment for FICA taxes for all four quarters on one Form

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[7] It appears that employers who previously imputed the value of such coverage in the employee's income could stop doing so even before September 16, 2013.

941-X for the fourth quarter of that year, as long as the period of limitations has not expired and will not expire within 90 days of filing the adjusted return. This is subject to the usual requirements for prior-year corrections, including the issuance of Forms W-2c. The employer should write "WINDSOR" in dark, bold letters across the top margin of page one of Form 941-X. If an employer uses this method, it can only show corrections made under this procedure on the Form 941-X. Like the second method for 2013, this method *cannot be used* with regard to income tax, and affected employees will need to file a Form 1040X.

- *How can employees request refunds?* The August IRS guidance provides procedures for employees to request refunds.
  - Employees may request refunds of income taxes paid on employer-provided health insurance coverage that was imputed in income for all "open" years (three years from the date of the return or two years from the date the tax was paid, whichever is later). Such refunds would be requested via an amended Form 1040.
  - If the coverage was otherwise provided through a cafeteria plan, the employee may also request a refund for income taxes paid on all after-tax employee contributions made for the accident and health insurance coverage of the same-sex spouse for all open years.

Practice Pointer: The tax status of benefits for same-sex partners under state law remains unclear in states that prohibit recognition of same-sex marriages. States will likely provide more guidance on this issue.

- *Can an employee with a same-sex spouse change his or her cafeteria plan election?* Plans may treat a same-sex marriage as a change in legal status for purposes of the cafeteria plan rules under Code Section 125. If the same-sex couple was married (as defined in Notice 2013-17) on June 26, 2013, the cafeteria plan may treat the *Windsor* decision as a change in legal marital status.
  - This allows an employee to make the following changes (to the extent they are otherwise allowed under the cafeteria plan): enroll the employee; enroll the employee and same-sex spouse; enroll the same-sex spouse if the employee is already enrolled; and drop the employee from coverage if the employee becomes covered under the same-sex spouse's coverage. With respect to a health FSA, the employee may enroll in coverage or increase the amount elected—if the employee becomes covered under the same-sex spouse's plan, he or she may decrease the amount elected. For a dependent care FSA, an election to drop coverage or increase coverage is also presumably permitted to account for the marriage (and potential addition of dependents).
  - The relevant election change may be made at any time during the plan year that includes June 26, 2013, or December 16, 2013. This would also include an election that was previously made during the plan year that includes June 26, 2013, or December 16, 2013, but was denied or suspended by an employer awaiting federal guidance. The election is prospectively effective no later than the regular date of a change in status or a reasonable period after December 16, 2013.
  - Plans may also allow an employee who marries a same-sex spouse after June 26, 2013, to make a mid-year election change due to a change in legal marital status.
  - A plan amendment is required by the last day of the first plan year beginning on or after December 16, 2013, if the plan does not otherwise allow the election changes permitted by the guidance. The amendment may be retroactive to the first day of the plan year, including December 16, 2013.

- *Can an employee with a same-sex spouse change the tax status of his or her contributions for coverage?* Where an

employee already covers a same-sex spouse, but pays the employee's portion of such coverage with after-tax dollars, the employer **must** treat the after-tax payroll deductions as pre-tax salary reductions when certain criteria are satisfied.

- In order for this to apply, the **employer must receive notice before the end of the plan year that includes December 16, 2013**. The employee may provide notice through i) an election to pay for such coverage with pre-tax dollars or ii) by filing a revised W-4. If the employer receives timely notice of the employee's marital status, it must treat the contributions as pre-tax salary reductions no later than i) the date that a change in legal marital status would be required to be reflected for income tax withholding under IRC § 3402 or ii) a reasonable period of time after December 16, 2013.
- The employee may request a refund for taxes withheld in 2013 on such coverage prior to providing notice, as well as prior years that are still open for tax purposes.

- *How does* Windsor *affect Health and Dependent Care FSAs?* Reimbursements are permitted for eligible medical or dependent care expenses incurred by or for a same-sex spouse at any time after the later of the i) start of the plan year that includes June 26, 2013, or ii) the date of the marriage. The same-sex spouse is treated as covered under the FSA, even if the employee had elected self-only coverage. However, the December 16 IRS guidance does not address the treatment of expenses incurred before the employee increases his or her election in accordance with this guidance.
  - The tax-free benefit for dependent care FSA expenses under Code Section 129 will be affected both by the manner in which the couple files its federal tax return and the same-sex spouse's earned income. The August IRS guidance indicates that same-sex couples filing after September 16, 2013, must use a married filing status (jointly or married and filing separately). Under Code Section 129, married couples filing jointly may not receive more than $5,000 in benefits and couples that are married and filing separately may not receive more than $2,500 each.
  - Election changes to decrease an employee's contribution to the dependent care FSA may be made before the end of the year. However, if the combined dependent care FSA contributions exceed the (married) limitation for the year, the excess will be included in income.
- *How does* Windsor *affect HSAs?* Qualifying medical expenses incurred by a same-sex spouse would be eligible for a tax-free reimbursement through an HSA. If a same-sex couple is treated as married in 2013 and each spouse has an HSA, the aggregate contributions by both are limited to the statutory maximum for family coverage if one or both has other than self-only HDHP coverage.
  - Contributions for one or both of the spouses may be reduced for the remaining portion of the tax year in order to avoid exceeding the contribution limit. However, if the combined contributions for the same-sex couple exceed the statutory limit in 2013 and the excess contributions remain undistributed by the tax return due date for the spouses, there would be an excess contribution (which would be subject to an excise tax).

Practice Pointer: Keep in mind that this applies to plans that cover same-sex spouses. If same-sex spouses are specifically excluded, presumably no election changes would be permitted (although the plan may be amended, if the employer wishes to cover same-sex spouses).

Issues Not Specifically Addressed by the Agencies

- *Do I have to offer welfare benefits to same-sex spouses?* Nothing in the *Windsor* decision or federal law requires plans to offer coverage to same-sex spouses. In many cases, a plan amendment would be required to add coverage for a same-sex spouse if the plan doesn't currently offer such coverage.

  However, employers should keep in mind that same-sex spouses may become automatically eligible as a result of the *Windsor* decision, even if the plan doesn't intend to offer coverage to same-sex spouses. Whether same-sex spouses are automatically eligible will depend on how the plan defines an eligible spouse. For example, a plan provision that defines an eligible spouse in accordance with "federal law" and does not specifically exclude same-sex spouses would appear to automatically include a same-sex spouse without further amendment or modification to the plan.

- *Are medical expenses for a same-sex spouse eligible for reimbursement from an HRA?* Whether expenses incurred by a same-sex spouse would be eligible for reimbursement from an HRA depends on how the plan defines "spouse." It is our view that that medical expenses incurred by same-sex spouses became automatically eligible for reimbursement by virtue of the *Windsor* decision if the HRA defines spouse by reference to federal law and does not specifically exclude same-sex spouses. Otherwise, a plan amendment is required for plans that restrict coverage to opposite-sex spouses that wish to allow employees to submit expenses for expenses incurred by a same-sex spouse.

- *How does* Windsor *impact COBRA?* As a result of *Windsor*, a same-sex spouse covered by a group health plan is now a qualified beneficiary entitled to COBRA. If group health coverage is currently offered to same-sex spouses, but COBRA continuation coverage is not, or continuation coverage that does not otherwise comply with COBRA is not offered, plan changes will be required. However, it is not clear whether all qualifying events after *Windsor* must be recognized or whether plans can recognize only qualifying events that occurred after September 16, 2013. We expect future guidance on this subject.

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