If the Supreme Court Rules Against DOMA: Ten Questions Employers Will Ask

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We expect the Supreme Court to issue its decisions on same-sex marriage next week. Whichever way the Court rules, employers will likely grapple with the implications for their benefit plans.

In *U.S. v. Windsor*, the Court will address the constitutionality of section 3 of the federal Defense of Marriage Act (DOMA), which defines spouse/marriage as a union between a man and a woman only, for purposes of interpreting federal law.

In *Hollingsworth v. Perry*, the Court will address whether the Equal Protection Clause of the Fourteenth Amendment prohibits the State of California from banning same-sex marriage (via a ballot initiative known as Proposition 8). Before reaching the merits, however, the Court first must determine whether the plaintiffs have standing.

If the Court strikes down part of DOMA, it is likely to leave two significant questions for employee benefit plans unanswered: **Is the change retroactive? And how will plans define "spouse" in light of a patchwork of same-sex marriage laws across the country?** These questions, and other employee benefit issues, are discussed below.

1. If DOMA is overturned, would it be retroactive?

If section 3 of DOMA is struck down as unconstitutional, it is anticipated that the change might be retroactive as if DOMA had never happened.

The prospect of retroactivity raises obvious concerns for employee benefit plans. Will same-sex spouses of deceased qualified plan participants seek survivor benefits, for past periods? Will a qualified plan face potential disqualification for *not* offering same-sex spouses a joint and survivor annuity, for retirements that occurred in the past?

A ruling with retroactive application is a possibility. A decision that DOMA is unconstitutional could invalidate the statute, retroactive to 1996, its date of enactment. Retroactivity is not a foregone conclusion, however, and the actual effective date will depend on the breadth of the Court's ruling. Historically, the Supreme Court's approach to retroactivity has varied, and practical considerations have been taken into account.[1]

We anticipate that the IRS will provide some transition guidance to protect plans from disqualification, for any periods prior to the ruling. Ideally, this guidance will provide a remedial amendment period in which plan sponsors can modify their plans retroactively to the date of the ruling, yet will not expect compliance for periods before that date.

We can assist you in reviewing plan documents and participant communications, for compliance with this changing landscape. Plan amendments will need to be drafted with great care, to minimize the risk of potential benefit claims under Title I of ERISA for periods before the ruling.

2. How do we define "spouse" in the plan, in light of a patchwork of state laws?

The answer will depend on the nuances of the Court's rulings.

Option #1: Sweeping Ruling: If the Court "goes big", it could decide the *Hollingsworth v. Perry* case by establishing a constitutional right to same-sex marriage in all states, under the Equal Protection Clause. This ruling would recognize a participant's right to same-sex marriage throughout the country. Such a ruling is considered unlikely, but if adopted, it would permit uniformity in benefit plan administration. A same-sex spouse would be considered a "spouse" for all purposes under the plan, regardless of the participant's state of residence or any jurisdictional rule stated in the plan document.

Option #2: Patchwork of State Laws: More likely, the Court's ruling in *Hollingsworth* will be modest, and the more significant changes will derive from the Court's decision in *Windsor*. Although it is impossible to predict with any certainty, the buzz is that the Court will strike down section 3 of DOMA as

unconstitutional, thus eliminating the federal barrier to same-sex marriage. This ruling would defer the issue to the states.

The downside of this approach is that it will leave a patchwork of state laws for employee benefit plans to muddle through. Only a dozen states have passed same-sex marriage laws, plus the District of Columbia. Under section 2 of DOMA – which is not challenged in *Windsor* –the remaining 38 states are not required to recognize these same-sex marriage vows.

The IRS looks at a couple's state of residence when determining marital status. Under this method, a same-sex couple that is legally married in New York may be considered "unmarried" if they move to a state that does not recognize same-sex unions, such as Illinois. In contrast, other federal agencies (such as the Department of Defense) look at the state in which the wedding took place when determining marital status. Under this method, the same-sex couple that is legally married in New York is considered married by DoD, no matter where the couple lives.

It is unclear whether employee benefit plans would be required to define marital status based on a participant's state of residence (i.e., the IRS approach). If so, it would place a tremendous burden on plan administrators to track the participant's residence over time, and to confirm the state of residence before any benefits are paid. To the extent the IRS permits any leeway, we would seek to draft around this residency requirement in order to ease plan administration. This is an area where we would welcome IRS guidance.

Option #3: It is also possible that the Court will not strike down DOMA, and/or will dismiss the cases on jurisdictional grounds. In this case, the status quo might remain in place, for now. Moreover, a dismissal for lack of standing might create a greater patchwork system until the Court does decide the issues, with the law varying by Circuit.

3. Which states allow same-sex marriage?

Twelve states (CT, DE, IA, ME, MD, MA, MN, NH, NY, RI, VT, WA) plus the District of Columbia issue marriage licenses to same-sex couples.[2]

Eight other states recognize same-sex civil unions or domestic partnerships (CA, CO, HI, IL, NV, NJ, OR, WI). In the state of Massachusetts, this status is recognized as a legal marriage.

4. What are the minimum benefits that we need to offer to same-sex spouses?

If section 3 of DOMA is struck down, employee benefit plans would be required to recognize a same-sex spouse in 12 states and in D.C. as a "spouse" for all purposes under ERISA and the Internal Revenue Code. (If the Court makes a sweeping decision, this treatment would be required in all 50 states.)

Pension & Savings Benefits

- QJSA & Spousal Consent: In a pension or money purchase plan, a spouse is entitled to receive a qualified joint and survivor annuity if the participant dies after retirement. The participant may not elect any other benefit form at retirement, and may not designate any other beneficiary, unless the spouse consents to the election.
- QPSA: In a pension plan, a spouse is entitled to receive a qualified pre-retirement survivor annuity if the participant dies before retirement.
- Beneficiary Status: In a savings plan and contributory pension plan, the spouse is the default beneficiary for the participant's account.
- Hardship Withdrawals: In a 401(k) plan, the spouse's medical or educational needs can give rise to a participant's hardship withdrawal.
- Age 70½ Required Minimum Distributions: In some cases, a surviving spouse is entitled to defer distributions for a longer period, following the death of the participant.
- QDROs: A former spouse may be entitled to a portion of a participant's pension and savings benefits, under a domestic relations order issued by a state court.
- 415(b) Limits: The value of a subsidized QJSA is not taken into account if the survivor benefit is paid to the participant's spouse.

Health & Welfare Benefits

- Health Plan Coverage: A same-sex spouse would be entitled to health plan coverage, if such coverage is offered to opposite-sex spouses. For companies that already offer health plan coverage to same-sex spouses, the employer contribution to coverage would become tax-free and the employee contribution could be paid with pre-tax dollars.
- COBRA: A spouse is entitled to COBRA continuation coverage following a qualifying event (such as divorce or job loss).
- HIPAA: A spouse is entitled to special enrollment rights under HIPAA, for the 180-day period following a marriage or new baby.
- Health Reimbursement Plans: A spouse's expenses can be reimbursed under an FSA, HSA or HRA, if the plan so permits.
- Cafeteria Plans: A spouse is recognized under the change-in-status election rules.
- FMLA: A participant is entitled to take an unpaid leave of absence under the FMLA to care for a spouse.

5. What about collectively bargained plans?

Any changes needed would apply to collectively bargained plans at the same time as all other plans. Unlike a legislative change – which typically includes a delayed implementation date for collectively bargained plans – a Supreme Court ruling that a statute is unconstitutional would take effect immediately.

6. We offer same-sex domestic partner benefits. Is that coverage still necessary if DOMA is struck down?

This is a design decision. Now that same-sex couples have the ability to marry in a dozen states plus D.C., companies that currently offer same-sex domestic partner benefits will need to decide whether to continue offering same-sex *domestic partner* benefits in those places as well, if section 3 of DOMA is struck down.

Business Reasons to Offer Same-Sex Domestic Partner Coverage: Not all same-sex couples who have the right to marry would elect to do so. Some may view marriage as unnecessary, particularly individuals who have invested resources in estate planning or other arrangements.

Business Reasons to Revoke Same-Sex Domestic Partner Coverage: On the other hand, some employees may consider it inequitable to provide benefits to same-sex domestic partners but not opposite-sex domestic partners, in states where both have the option to marry.

A compromise between these two positions might involve grandfathering employees who have already established same-sex domestic partnerships and limiting any changes to new hires.

7. Is it possible to have both a spouse and a domestic partner?

No. Plan documents should be amended to preclude this possibility. A spouse has legal rights under ERISA and the Internal Revenue Code, and a domestic partner does not.

8. What are the cost implications for H&W plans?

If an employer offers health plan coverage to same-sex partners already, this change likely would save the company (and its employees) money in the long run. Presently, employer contributions toward health plan coverage are considered taxable income to a participant with a same-sex spouse; these amounts are subject to employment and income taxes. If DOMA is struck down, the employer would no longer have to pay FICA taxes on this amount, and the employer may be able to obtain refunds of FICA payments made in the past, to the extent the limitations period has not expired. Employers also would be spared the associated reporting obligations. In the short-run, however, plan sponsors would likely incur some programming and communications costs.

Employees who have a same-sex domestic partner – not a spouse – would continue to be taxed on the value of employer contributions toward same-sex domestic partner coverage. Also, employee contributions toward same-sex domestic partner coverage would have to be made from after-tax dollars, rather than pre-tax dollars.

If an employer does not offer health plan coverage to same-sex spouses, a decision overturning DOMA would require you to do so (assuming that coverage to opposite-sex spouses is already provided), which would increase the employer's costs.

9. What are the cost and administrative implications for pension and 401(k) plans?

We expect that the administrative changes for qualified plans would be considerable if DOMA were struck down, and the cost less so.

Administrative Changes: The first step in providing pension and savings benefits to same-sex spouses is *identifying who these spouses are*. Plan administrators may want to canvas participants who are listed as "unmarried" to determine whether a same-sex spouse exists. If so, the spouse would be entitled to certain rights under ERISA, such as the right to receive notice of a joint and survivor annuity benefit from a pension plan upon the participant's retirement. The spouse also would be the participant's default beneficiary under a 401(k) plan, and for any employee contributions under a contributory pension plan.

The plan administrator would want to avoid the potential liability of overlooking a same-sex spouse of which the plan was unaware. To this end, we recommend proactive communications with participants on this issue. Plans also may need to revise their beneficiary designation forms.

Financial Costs: The biggest cost would be adding a pre-retirement survivor benefit for same-sex spouses to pension plans. This would presumably increase the actuarial cost of a pension plan because it requires the payment of a survivor benefit where, previously, none had been required by law. (Under ERISA, the benefit of an unmarried participant can be forfeited if the participant dies before retirement.) The entitlement to a survivor benefit is good news for the same-sex spouse, but it does cost money. Your actuaries should be able to estimate the cost of this change, if any, and whether it would impact your funding obligations. In our experience, this cost is usually relatively modest, but it depends on the demographics of your workforce.

10. Does this affect nonqualified plans?

It might. Nonqualified plans are governed by contract law rather than by ERISA. Many nonqualified plans already offer benefits to same-sex spouses and partners. Some nonqualified plans piggyback on the terms of the qualified plans. Check plan terms to determine whether existing plan provisions are consistent with the company's intent.

[1] *See, e.g.,* Linkletter v. Walker, 381 U.S. 618 (1965) (holding that "the Constitution neither prohibits nor requires retrospective effect"). *See also* Los Angeles v. Manhart, 435 U.S. 702, 723 (1978) (striking down gender-based actuarial tables on a prospective basis, in recognition that "[r]etroactive liability could be devastating for a pension fund"), *cited in* Arizona v. Norris, 463 U.S. 1073 (1983).

[2] In three of these states, the law has been adopted and will take effect in mid-2013 (DE – July; MN, RI – August).