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Special Report

Compliance challenges arise after definition of marriage in DOMA falls

Highlights

- ✔ Federal benefits extended to married same-sex couples
- ✔ Some benefits implications unclear
- ✔ Tax refunds possible

Inside

When people get married, they might not consider the legal ramifications of becoming a spouse. And yet married status confers numerous legal rights and benefits on spouses. As such, it's necessary for the legal definitions of marriage and spouse to be established. State laws historically provided these definitions until 1996 when the federal government passed the Defense of Marriage Act (DOMA). That law limited the definition of marriage to "a legal union between one man and one woman as husband and wife" and the definition of spouse to "a person of the opposite sex who is a husband or a wife." DOMA regulated the meaning of marriage for more than 1,000 federal statutes, requiring states that allow same-sex marriages to deny federal benefits to same-sex couples.

On June 26, 2013, the U.S. Supreme Court ruled on the constitutionality of DOMA and a related case challenging California's ban on same-sex marriage. This briefing discusses the court's rulings in *United States v. Windsor* and *Hollingsworth v. Perry* and examines some of the employee benefits and tax issues that the rulings will affect. This briefing is a general discussion of just some of the possible implications of the rulings. For legal or tax advice based on your specific circumstances, consult an attorney or accountant.

Supreme Court ruling

In a greatly anticipated and deeply divided opinion, the Supreme Court ruled that lawfully married, same-sex couples are entitled to the equal protection of the laws pursuant to the Fifth and Fourteenth Amendments to the Constitution and, thus, Section 3 of the Defense of Marriage Act (DOMA) must fall (*United States v. Windsor*, June 26, 2013, Kennedy, A). "The federal statute is invalid, for no legitimate purpose overcomes [its] purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect in personhood and dignity," wrote the Court.

Justices Ginsburg, Breyer, Sotomayor and Kagan joined in the opinion. Chief Justice Roberts, and Justices Scalia and Alito filed dissenting opinions. Justice Thomas joined in the Scalia dissent; Justice Roberts joined it in part. Justice Thomas also joined the Alito dissent in part.

The High Court dismissed the companion same-sex marriage case, *Hollingsworth v. Perry*, holding that the proponents of California's "Proposition 8," which amended the state constitution to define marriage as a union between a man and a woman, lacked standing to appeal a federal district court's ruling that the ballot initiative was unconstitutional.

DOMA challenge. The surviving spouse of a same-sex couple was denied the benefit of the estate tax exemption under federal tax law solely because of Sec. 3 of DOMA, which defines the words "marriage" and "spouse" in federal law in a manner that prevents the IRS from recognizing her as a spouse, or

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the couple as married. Her claim for a refund turned on the constitutionality of DOMA. A district court found DOMA violated equal protection because there was no rational basis to support it.

The Bipartisan Legal Advisory Group of the U.S. House of Representatives (BLAG), which had intervened when the DOJ refused after three months to defend DOMA in the district court, appealed the decision. The United States also appealed as a nominal defendant. The Second Circuit ruled that Section 3 violates the Fifth Amendment's equal protection guarantee because its classification of same-sex spouses was not substantially related to an important government interest, and thus, affirmed summary judgment to the surviving spouse. The Supreme Court granted BLAG's petition for certiorari.

State vs. federal regulation of marriage. Although they longed to marry, the Supreme Court observed, the two women at the heart of the case were unable to do so in the United States. In 2007, they were married in Ontario, Canada. In time, "[t]he limitation of lawful marriage to heterosexual couples, which for centuries had been deemed both necessary and fundamental, came to be seen in New York and certain other States as an unjust exclusion," the Court observed. Presently New York, along with 11 other states and the District of Columbia have "decided that same-sex couples should have the right to marry and so live with pride in themselves and their union and in a status of equality with all other married persons."

It is against this background of lawful, same-sex marriage in some states, that the Court marked the design, purpose, and effect of DOMA as the beginning point in its consideration of the federal statute's constitutionality. While history and tradition have left the definition and regulation of marriage to the states, Congress in enacting statutes is also permitted to make determinations that bear on marital rights and privileges. One example cited by the Court was Congress' determination "that marriages 'entered into for the purpose of procuring an alien's admission [to the United States] as an immigrant' will not qualify the noncitizen for that status, even if the noncitizen's marriage is valid and proper for state-law purposes.'"

Though this and the other examples cited by the Court established the constitutionality of limited federal laws regulating the meaning of marriage with the goal of furthering federal policy, "DOMA has a far greater reach; for it enacts a directive applicable to over 1,000 federal statutes and the whole realm of federal regulations," wrote the Court. "And its operation is directed to a class of persons that the laws of New York, and of 11 other States, have sought to protect."

Tracing the history and tradition of state power and authority over marriage in order to assess the validity of DOMA's intervention, the Court also noted the federal government's historical deference to state law policy decisions with respect to domestic relations. Moreover, state marriage laws vary to some extent, for example, with regard to minimum age requirements and degree of consanguinity.

DOMA rejects the long-standing precept "that the incidents, benefits, and obligations of marriage are uniform for all married couples within each State, though they may vary, subject to constitutional guarantees, from one State to the next," the Court said. The state's power in defining the marital relation was of primary relevance in this case apart from federalism principles. Here, the state's decision "to give this class of persons the right to marry conferred upon them a dignity and status of immense import," continued the Court. "When the State used its historic and essential authority to define the marital relation in this way, its role and its power in making the decision enhanced the recognition, dignity, and protection of the class in their own community." In contrast, DOMA, due to its reach and extent, departs from this history and tradition of reliance on state law to define marriage.

"The Federal Government uses this state-defined class for the opposite purpose—to impose restrictions and disabilities," wrote the Court, moving next to the question of whether "the resulting injury and indignity" amounts to a deprivation under the Fifth Amendment. "What the State of New York treats as alike the federal law deems unlike by a law designed to injure the same class the State seeks to protect."

Sovereign exercise of authority. There was no doubt that New York, in first recognizing and then permitting same-sex marriage, was engaging in a proper exercise of its sovereign authority under our system of federalism. "The States' interest in defining and regulating the marital relation, subject to constitutional guarantees, stems from the understanding that marriage is more than a routine classification for purposes of certain statutory benefits," noted the Court. Private, consensual sexual intimacy between two same-sex adults cannot be punished by the state and it can be an element to a more enduring personal bond. "By its recognition of the validity of same-sex marriages performed in other jurisdictions and then by authorizing same-sex unions and same-sex marriages, New York sought to give further protection and dignity to that bond." New York gave

the lawful conduct of same-sex couples who wished to be married a lawful status. "This status is a far-reaching legal acknowledgment of the intimate relationship between two people, a relationship deemed by the State worthy of dignity in the community equal with all other marriages," wrote the Court. "It reflects both the community's considered perspective on the historical roots of the institution of marriage and its evolving understanding of the meaning of equality."

DOMA's intent to injure. "DOMA seeks to injure the very class New York seeks to protect," and in so doing "violates basic due process and equal protection principles applicable to the Federal Government," wrote the Court. "The Constitution's guarantee of equality 'must at the very least mean that a bare congressional desire to harm a politically unpopular group cannot' justify disparate treatment of that group."

To determine whether the "law is motived by an improper animus or purpose," the court applied the standard articulated in its *Rumer v. Evans* opinion—"'[d]iscriminations of an unusual character' especially require careful consideration"—and found DOMA could not survive. The states' responsibility for the regulation of domestic relations is an important indication of the substantial societal impact that states' classifications have in its peoples' daily lives and customs. "DOMA's unusual deviation from the usual tradition of recognizing and accepting state definitions of marriage here operates to deprive same-sex couples of the benefits and responsibilities that come with the federal recognition of their marriages," wrote the Court. "This is strong evidence of a law having the purpose and effect of disapproval of that class." Here, the avowed purpose and practical effect of DOMA are to "impose a disadvantage, a separate status, and so a stigma upon all who enter into same-sex marriages made lawful by the unquestioned authority of the States."

Current state laws

As of July 1, the following recognize same-sex marriage:

- Connecticut
- Delaware
- Iowa
- Maine
- Maryland
- Massachusetts
- Minnesota (effective August 1, 2013)
- New Hampshire
- New York
- Rhode Island (effective August 1, 2013)
- Vermont
- Washington
- District of Columbia

The following states recognize same-sex unions/domestic partnerships:

- California
- Colorado
- Hawaii
- Illinois
- Nevada
- New Jersey
- Oregon
- Wisconsin

Benefits issues

The Supreme Court's ruling significantly affects employee benefits, which are governed by several federal laws, including the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code). Because of DOMA's definition of "spouse," federal benefits under these laws were available to an employee's opposite-sex spouse only. Now that the Court has struck down that definition, state laws presumably will define marriage and spouse. As such, if a state allows same-sex couples to marry, an employee's same-sex spouse would be entitled to the same federal benefits as an employee's opposite-sex spouse.

Note, however, that Section 2 of DOMA, which allows states to refuse to recognize same-sex marriages performed under the laws of other states, was not challenged in *Windsor*. As such, benefit plans in states that do not allow same-sex marriage or do not recognize such out-of-state marriages might have to continue to look to their own state law to determine entitlement to some federal benefits. (See **chart** below for some possible results of the interaction of an employee's same-sex relationship status with state and federal laws.)

"The big open question is what happens to same-sex spouses who live in Florida or Texas, for example. No one can answer the question until additional guidance is issued. It is possible that the answer can vary for different purposes (for example, state of residence will likely carry the day for tax filing and imputed income purposes, but it is possible the IRS could say that "state of celebration" governs for pension plan purposes). In the meantime, it appears that employers can choose either approach, but it will be imperative to amend plans to add clear plan language to document the employer's approach," according to Todd Solomon, Employee Benefits partner at McDermott Will & Emery.

Health insurance. The Court's ruling will affect some aspects of health insurance benefits, but not others. Because federal law does not require employers to provide health insurance coverage to spouses, the ruling does not require employers to extend such coverage to same-sex spouses. Insured health plans will need to follow state laws, however.

"Employers with self-insured welfare plans (meaning benefits are paid out of the company's general assets) will not necessarily be required to extend spousal benefit coverage to same-sex spouses, because federal law does not require spousal welfare benefit coverage in any way and because state insurance law mandates would not apply to a self-insured plan. However, employers that continue to provide benefit coverage only to opposite-sex spouses are almost certain to face risk legal challenges under federal discrimination law," according to Solomon.

COBRA. Some employers will be required to extend COBRA coverage to same-sex spouses. Lacking a federal requirement to cover spouses, a plan's definition of spouse (or state law) will determine whether an employee's same-sex spouse is covered. If the same-sex spouse is covered and the employer is subject to COBRA, the employer would have to offer COBRA coverage to the same-sex spouse.

The application of COBRA for a same-sex couple who are legally married in one state then move to a state that does not recognize same-sex marriages is less clear, according to Scott Macey, president of the ERISA Industry Committee (ERIC). Would they then lose federal recognition of that marriage for COBRA purposes, since insured health benefits are covered under state insurance law, and COBRA looks to state law to determine coverage issues? One would think, said Macey, that the federal government will come up with a rule stating that, once a same-sex couple is validly married in a state that recognizes such marriages, the federal government, for COBRA or other purposes, would continue to recognize the marriage, regardless of the state the couple resides in.

Cafeteria plans, HSAs. An employee's same-sex spouse also would be entitled to the same benefits as an employee's opposite-sex spouse under heath savings accounts and flexible spending arrangements, which the Code governs. Likewise, because federal law (Code Sec. 125) governs cafeteria plans, the change-in-status rules would apply to an employee's same-sex spouse. For example, a cafeteria plan participant whose same-sex spouse lost his or her job would be allowed to change his or her benefits elections, such as adding health insurance coverage for the spouse.

Tax treatment. The ruling also will affect the tax treatment of health insurance coverage for same-sex spouses.

"Employees will no longer have to pay federal income taxes on the income imputed for an employer's contribution to a same-sex spouse's medical, dental or vision coverage. And the employee can pay for the same-sex spouse's coverage on a pre-tax basis under a Section 125 plan and the same-sex spouse will be eligible for tax-free reimbursements from a FSA, HSA, and HRA," Solomon notes.

FMLA and HIPAA. The Family and Medical Leave Act (FMLA) and the Health Insurance Portability and Accountability Act (HIPAA) are two other federal laws that confer employment-related benefits on spouses. FMLA coverage and special enrollment rights under HIPAA will be applicable to same-sex spouses where the other requirements of those laws are met.

FMLA regulations generally defer to state law with regard to what constitutes "spouse." Before the court's decision, even employers in states that recognized same-sex marriage could, because of DOMA's definition of spouse, deny FMLA leave to a same-sex couple lawfully married in that state, unless the state had adopted broader leave policies. Now, the FMLA's 12 weeks of job-protected leave presumably apply, but only for employees who reside in states that recognize same-sex marriage.

Retirement plans. The DOMA ruling also impacts spousal benefits pursuant to qualified retirement plans. As mentioned above, because federal laws govern such plans, employers will have to treat same-sex spouses the same as opposite-sex spouses with respect to retirement plan benefits, such as survivorship annuities or death benefits.

"Same-sex spouses must also consent to payment of the employee's pension benefits in a form other than a 50% joint and survivor annuity with the same-sex spouse as the beneficiary," Solomon notes.

Another retirement plan feature at issue is hardship distributions from 401(k) plans. Hardship withdrawals from a Code Sec. 401(k) plan are permitted if an employee has an immediate and heavy financial need, such as medical expenses previously incurred by the employee's spouse. Thus, if an employer's plan allows such distributions, the employer must treat same-sex spouses equally to opposite sex-spouses regarding such distributions.

Plan administrators also should consider spousal issues relating to a qualified domestic relations order (QDRO). ERISA states that pension plans must provide for the payment of benefits in accordance with the applicable requirements of any QDRO.

Other benefits. Employers should review the definition of "spouse" in not only their health insurance and pension plans, but also other employee benefit plans and policies that are not governed by federal laws, such as funeral leave, discounts or memberships.

Macey said it would be a good idea for employers to talk to their legal counsel to identify what changes to their plans seem to be required in light of the decision, when those changes need to be made, whether or not there are questions employers currently have no answer to, and how they might obtain those answers. The assortment of issues is still murky, he said.

Tax issues

The Supreme Court decision opens the door for same-sex married couples to enjoy many federal tax-related benefits previously available only to opposite-sex married couples. These include income tax benefits, taxpayer-friendly employee benefits and more. Same-sex couples must now also deal with circumstances under the tax law that may create a so-called "marriage penalty." Employers must prepare for extensive changes in the treatment of same-sex couples.

Filing status. The same tax benefits and disadvantages faced by just-married, opposite-sex couples – in changing from filing as separate, unmarried individuals to filing as married filing jointly (or married filing separately) – are now shared by same-sex married couples. Likewise, however, those same-sex couples not married under state law continue to be subject to the same disadvantages and benefits, and face may of the same strategic decisions, as unmarried heterosexual couples under the federal tax law.

Same-sex couples who currently are married under state law are presumably now also barred for federal tax purposes from filing separate returns as unmarried (or as head of household, in most cases); they must file either jointly or married filing separately for 2013 (unless they are divorced or have a final separation agreement

Possible benefit rights for same-sex couples

The interaction of an employee's same-sex relationship status and state and federal laws is complex. This chart shows generally how an employer might need to treat an employee's same-sex spouse or partner. Employers should review state laws and specific benefit plan terms to analyze a specific employee's situation.

Status of same-sex couple	State where employee lives	Federal benefits rights (such as FMLA, COBRA)	Tax treatment of employee's partner's health insurance (not including self-insured plans)	Pension plans
Married	Allows same-sex marriage	Yes	Employer portion not taxed (state and federal taxes)	Must treat as spouse for purposes such as survivorship benefits, etc.
Married	Does not allow same-sex marriage	Maybe	Employer portion not taxed for federal purposes, but state treatment depends on state law	Probably have to treat as spouse under federal law
Domestic partnership or civil union (not married)	Allows marriage and domestic partnerships or civil unions	No	Must impute income for federal tax purposes, but state treatment depends on state law	No treatment as spouse under federal laws*
Domestic partnership or civil union (not married)	Does not allow marriage or domestic partnerships or civil unions	No	Must impute income for both state and federal taxes	No treatment as spouse under federal laws*

**A plan's definition of "spouse" would determine whether an employee's partner is treated as a spouse in these situations. A plan's definition could be broader than state law.*

in place by the end of 2013). The general rule that has always applied to filing status now presumably applies to same-sex married status as well: an individual's filing status is determined for the entire year based upon marital status on December 31st of that year. The IRS is expected to issue guidance in this area.

Dependency exemptions. In 2012, the IRS explained on its website that if a child is a qualifying child under Code Sec. 152(c) and both parents are same-sex partners, either parent, but not both, may claim a dependency deduction for the qualifying child if separate returns are filed. If both parents can otherwise claim a dependency deduction for the child on their income tax returns, the IRS will treat the child as the qualifying child of the parent with whom the child resides for the longer period of time. If the child resides with each parent for the same amount of time during the tax year, the IRS will treat the child as the qualifying child of the parent with the higher adjusted gross income.

Health insurance. Because of DOMA, employers that allow an employee to add his or her same-sex spouse to their health plan had to impute income to the employee for federal income tax purposes equal to the fair market value of health coverage provided to the same-sex spouse. As mentioned above, employees will no longer have to pay federal income taxes on the income imputed for an employer's contribution to a same-sex spouse's health coverage.

The Supreme Court's decision may open the window to refunds of taxes paid by employees on income imputed to employees for same-sex married spouses and refunds of payroll taxes paid by employers on that income. FICA tax refund claims by employers and employees for prior, open years may also be possible. ■