

December 18, 2013

Internal Revenue Service Issues Guidance Regarding Same-Sex Marriage For Employer-Sponsored Welfare Plans

Background

In our June 26, 2013, Client Alert, we informed you that the United States Supreme Court ruled that Section 3 of the Defense of Marriage Act (“DOMA”) is unconstitutional.

In our August 30, 2013, Client Alert, we informed you that the Internal Revenue Service (“IRS”) issued guidance indicating that for federal tax purposes the IRS will recognize a marriage of same-sex individuals validly entered into in a state whose laws authorize the marriage of two individuals of the same sex – even if the state in which they are domiciled does not recognize the validity of same-sex marriages. The IRS specifically noted that this rule applies for purposes of employee benefit plans employers offer to employees.

In our September 20, 2013, Client Alert, we informed you that the U.S. Department of Labor (“DOL”), consistent with prior IRS guidance, adopted the “state of celebration” rule for employee benefit plan purposes. The DOL indicated that for purposes of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) and certain provisions of the Internal Revenue Code of 1986, as amended, over which the DOL has interpretive authority (such as the prohibited transaction rules), the term “spouse” includes individuals married to a person of the same sex who were legally married in a state¹ that recognizes such marriages, even if they are domiciled in a state that does not recognize such marriages.

Recent IRS Guidance

On December 16, 2013, in Notice 2014-1, the IRS issued a series of detailed and technical questions and answers pertaining to the application of same-sex spouses to employer sponsored welfare plans in specific situations.

1. Cafeteria Plan Mid-Year Election Changes

(a) What type of mid-year election change might apply?

A cafeteria plan (also known as a Section 125 plan) may permit an employee to revoke an election during a period of coverage and make a new election under certain circumstances (i.e. a mid-year election change). One circumstance under which a cafeteria plan may permit an employee to make a new election is a change in status event under IRS regulations, including a change in legal marital status. Another circumstance under which a cafeteria plan may permit an employee to make a new election is a significant change in the cost of coverage.

¹ The term “state” means any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island, the Northern Mariana Islands, any other territory or possession of the United States, and any foreign jurisdiction having the legal authority to sanction marriages.

The recent guidance provides that a cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the U.S. Supreme Court's decision (June 26, 2013) as if the participant experienced a change in legal marital status. Accordingly, a cafeteria plan may permit such a participant to revoke an existing election and make a new election in a manner consistent with the change in legal marital status². An election may be accepted by the cafeteria plan if the election is filed at any time during the cafeteria plan year that includes June 26, 2013, or the cafeteria plan year that includes December 16, 2013.

A cafeteria plan may also permit a participant 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.

The recent guidance provides that a cafeteria plan containing written terms permitting a change in election upon a change in legal marital status generally is not required to be amended to permit a change in status election with regard to a same-sex spouse in connection with the U.S. Supreme Court decision.

However, if the cafeteria plan document does not already permit a change in election upon a change in marital status, and to the extent that the cafeteria plan sponsor chooses to permit election changes with regard to a same-sex spouse, the cafeteria plan must be amended to permit such election changes on or before the last day of the first plan year beginning on or after December 16, 2013 (i.e. by December 31, 2014, for a calendar year plan). Such an amendment may be effective retroactively to the first day of the plan year including December 16, 2013, provided that the cafeteria plan operates in accordance with the IRS guidance.

(b) When must the mid-year election change take effect?

The IRS guidance addresses when the same-sex spouse election change takes effect. An election made under a cafeteria plan with respect to a same-sex spouse generally takes effect as of the date that any other change in coverage becomes effective for a benefit that is offered through the cafeteria plan.

More specifically, with respect to a change in status election that was made by a participant in connection with a same-sex spouse between June 26, 2013 and December 16, 2013, the cafeteria plan will comply with IRS rules to the extent that coverage under the cafeteria plan becomes effective no later than the later of (a) the date that coverage under the cafeteria plan would be added under the cafeteria plan's usual procedures for change in status elections, or (b) a reasonable period of time after December 16, 2013. The IRS provides examples to explain the application of this principle in concrete situations.

(c) What if an employee has been paying for same-sex spouse coverage on an after-tax basis?

The guidance addresses the complex situation of an employee who pays for the employee's cost of the employee's own health coverage on a pre-tax basis under the cafeteria plan but pays for the employee's portion of the cost of health coverage for a same-sex spouse under the employer's health plan on an after-tax basis.

² On a *prospective* basis, the IRS will not allow a mid-year election change on the basis that the change in tax treatment of health coverage for a same-sex spouse resulted in a significant change in the cost of coverage. However, if a cafeteria plan between June 26, 2013 and December 31, 2013 allowed a participant to make a mid-year election change for a same-sex spouse due to a significant change in the cost of health coverage, the IRS will not disallow the change or disqualify the cafeteria plan.

More specifically, the IRS explains when the employee's payment of health coverage of the same-sex spouse must be treated as a pre-tax salary reduction – rather than as payment on an after-tax basis. An employer that, before the end of the cafeteria plan year including December 16, 2013, receives notice that such a participant is married to the individual receiving health coverage must begin treating the amount that the employee pays for the spousal coverage as a pre-tax salary reduction under the plan no later than the later of (a) the date that a change in legal marital status would be required to be reflected for income tax withholding purposes, or (b) a reasonable period of time after December 16, 2013.

How can the participant provide notice to the employer? A participant may provide notice of the participant's marriage to the same-sex spouse receiving health coverage by making an election under the employer's cafeteria plan to pay for the employee cost of spousal coverage through salary reduction or by filing a revised IRS Form W-4 representing that the participant is married.

The IRS further addresses the tax treatment for an employee who had been paying for the cost of same-sex spouse coverage on an after-tax basis.

The IRS states that the participant's salary reduction election under the cafeteria plan is deemed to include the employee cost of spousal coverage, even if the employer reports the amounts as taxable income and wages to the participant. Accordingly, the amount that the participant pays for spousal coverage is excluded from the gross income of the participant and is not subject to federal income or federal employment taxes. This rule applies to the cafeteria plan year including December 16, 2013 and any prior years for which the applicable limitations period has not expired.

In essence, the IRS provides that a cafeteria plan participant may choose to pay for the employee cost of same-sex spouse coverage on a pre-tax basis through the remaining pay periods in the current cafeteria plan year by providing notice of the participant's marital status to the employer or the cafeteria plan, or to continue paying for these benefits on an after-tax basis. In either case, the participant may seek a refund of federal income or federal employment taxes paid on any amounts representing the employee cost of spousal health coverage that were treated as after-tax and may exclude these amounts from gross income when filing an income tax return for the year.

2. Flexible Spending Arrangements (“FSAs”)

The IRS guidance states that a FSA (such as a health FSA or dependent care FSA) may reimburse covered expenses of the participant's same-sex spouse or the same-sex spouse's dependent that were incurred during a period beginning on a date that is no earlier than (a) the beginning of the cafeteria plan year that includes the date of the U.S. Supreme Court decision (June 26, 2013) or (b) the date of marriage, if later. The same-sex spouse may be treated as covered by the FSA (even if the participant had initially elected coverage under a self-only FSA) during that period. For example, a cafeteria plan with a calendar year plan year may permit a participant's FSA to reimburse covered expenses of the participant's same-sex spouse or the same-sex spouse's dependent that were incurred during a period beginning on any date that is on or after January 1, 2013 (or the participant's date of marriage if later).

3. Contribution Limits for Health Savings Accounts (“HSAs”) and Dependent Care Assistance Programs

The maximum annual deductible contribution to one or more HSAs for a married couple either of whom elects family coverage under a high-deductible health plan is \$6,450 for the 2013 taxable year (as adjusted for cost of living increases). This deduction limit applies to same-sex married couples who are treated as married for federal tax purposes with respect to a taxable year (that is, couples who remain married as of the last day of the taxable year), including the 2013 taxable year.

If each of the spouses in a same-sex married couple elected to make contributions to separate HSAs that, when combined, exceed the applicable HSA contribution limit for a married couple, the excess contribution must be corrected. The IRS explains in the guidance how the correction can occur.

The maximum annual contribution to one or more dependent care FSAs for a married couple is \$5,000. This limit applies to same-sex married couples who are treated as married for federal tax purposes with respect to a taxable year (that is, couples who remain married as of the last day of the taxable year), including the 2013 taxable year.

If each of the spouses in a same-sex married couple elected to make dependent care FSA contributions that, when combined, exceed the applicable exclusion limit for a married couple, the excess contribution must be corrected. The IRS explains in the guidance how the correction can occur.

If you have any questions regarding the IRS guidance, please contact the author of this Client Alert or a member of the Butzel Long Employee Benefits Group.

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