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IRS Clarifies Tax Treatment and Same-Sex Spouses

On August 29, the Internal Revenue Service ("IRS") issued much-awaited guidance, which applies for federal tax purposes only and which addresses:

- Whether a same-sex marriage will be recognized based on the state in which the marriage occurred (or was celebrated), or the state in which the same-sex couple resides;
- Whether domestic partners will be considered married; and
- Certain implications on benefit plans, related tax treatment, and some tax refunds.

Background. The IRS ruling comes on the heels of the recent Supreme Court decision holding provisions of the Defense of Marriage Act ("DOMA") unconstitutional. For more information on *United States v. Windsor* and general implications of the ruling for employee benefit plans, please see the June 27, 2012 *theHRBenefitsAuthority*, Supreme Court Strikes Down DOMA.

State of Celebration Approach. For purposes of the Internal Revenue Code (the "Code"), the IRS announced that it will use a *state of celebration* approach. This means a same-sex couple legally married in the state or foreign country in which their marriage was performed will be treated as married, even if the state in which the couple resides fails to recognize same-sex marriages.

- ***What this Means for Employee Benefit Plans.*** Under the IRS's rule, employers and plan administrators will not be required to monitor the state-to-state movements of employees or administer plans based on a patchwork of conflicting state laws. While this guidance is welcome, some uncertainty remains.

Domestic Partnerships and Civil Unions. Domestic partnerships and civil unions are not considered marriages for purposes of the Code.

Specific Employee Benefit Guidance. The IRS has issued the following specific guidance for employee benefit plans:

- ***Health and Welfare Plans***.
  - Pre-Tax Payments. If a group health plan offers coverage to an

employee's same-sex spouse, the employee previously was required to pay income tax on the value of the employer-provided benefit to the same-sex spouse. Additionally, these employees could not use pre-tax dollars under a cafeteria plan to pay for their same-sex spouses' premiums and instead could only pay on an after-tax basis. Now employees may pay premiums for their same-sex spouses on a pre-tax basis and employers are no longer required to impute taxable income, for federal tax purposes, on the employer portion. However, this treatment may be different for state tax purposes if the state does not recognize same-sex marriages.

- Income Tax Refunds. Affected employees may file an income tax refund claim for the amount of these taxes paid over the last 3 years. For the rest of 2013, employers may make withholding adjustments before the end of the year for any withholding done earlier in the year.

- FICA Tax Refunds. For the same reasons as above, both employers and employees were required to pay Social Security and Medicare taxes ("FICA") on the value of benefits provided to a same-sex spouse. The IRS expects to release additional guidance regarding refunds of FICA taxes paid in prior years and whether employers will be able to make adjustments in the current year.

- ***Retirement Plans***.

  - Prospective Application. Beginning September 16, 2013, retirement plans must treat same-sex spouses in the same manner as opposite-sex spouses for purposes of satisfying Code requirements, including qualified joint and survivor annuity and qualified pre-retirement survivor annuity benefits, consent to non-spousal beneficiaries, and payment of minimum required distributions.

  - Retroactive Application. In addition to other specific issues related to retirement plans, the IRS expects to release additional guidance regarding possible required plan amendments and retroactive spouse status.

Action Steps. Plan sponsors should take steps now to make appropriate adjustments to payroll withholding and update their participant communications and administrative processes to recognize the rights of same-sex spouses.

Other Considerations. The IRS guidance applies only for federal tax purposes. For other purposes different rules may apply, such as FMLA leave, for which the DOL has already indicated it will use a different approach based on the laws of the state in which the employee resides.

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