

## IRS Comes Out with Same-Sex Guidance

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**Supreme Court Ruling.** In *United States v. Windsor* (June 2013), the US Supreme Court upheld a lower court decision declaring Section 3 of the federal Defense of Marriage Act (DOMA) unconstitutional. Section 3's definition of "marriage" as "a legal union between one man and one woman as husband and wife" was determined to violate constitutionally required due process and equal protection principles. With this decision, same-sex couples in states that recognize marriages between persons of the same sex clearly obtained marriage-based federal rights and benefits under the tax laws, including rights relating to 401(k) plans governed by the Internal Revenue Code.

The *Windsor* decision did not address the validity of Section 2 of DOMA, which gives individual states the right to recognize, or not recognize, same-sex marriages of other states. The effect of the decision on same-sex spouses who reside in states that do not recognize same-sex marriage was not clear, and awaited regulatory guidance. On August 29, 2013, the IRS issued the first installment of such guidance in the form of Revenue Ruling 2013-17 and two sets of frequently asked questions and answers.

**IRS Ruling.** The IRS guidance resolves the debate over the territorial scope of the *Windsor* decision by adopting a general rule respecting a marriage of same-sex individuals for federal tax purposes. This rule holds that if such a marriage was validly entered into in a state whose laws authorize same-sex marriages, it will be recognized under the tax laws even if the married couple resides in a state that does not recognize the validity of same-sex marriages. The IRS cited historical precedent as well as practical considerations for this decision. With regard to employee benefit plans, it noted the need for

nationwide uniformity and pointed to the difficulty that employers would have in applying rules, such as spousal elections, consent, and notices, if the rules changed every time a same-sex couple moved to a state with different marriage recognition rules. The IRS ruling eliminates the need for plans to continually track the state of domicile of same-sex couples.

While the uniformity rule may make sense for many, it may lead to legal challenges under Section 2 of DOMA. It should also be noted that the uniformity rule applies to same-sex marriages contracted outside the United States in foreign jurisdictions having the legal authority to sanction marriages. Since Revenue Ruling 2013-17 does not purport to address the treatment of same-sex couples in domestic partnerships or civil unions, the uniformity rule has no application to these relationships.

**Effective Date.** The uniformity holding of Revenue Ruling 2013-17 is to be applied prospectively as of September 16, 2013. For example, in the case of a defined contribution plan providing for default distributions to a participant's spouse upon the participant's death, the plan must presumably pay the death benefit to a same-sex surviving spouse if the participant's death occurs on or after the effective date. The ruling does not, however, provide guidance with regard to the *Windsor* decision's application to employee benefit plans with respect to periods before September 16, 2013, although the IRS promises to do so in a manner that considers the potential consequences to all involved, including the plan sponsor, the plan, and affected employees and beneficiaries. Nonetheless, even if the IRS is true to its word, any rule it promulgates will not have the power to prevent certain parties, such as the surviving same-sex spouse of a deceased

participant, from pursuing claims against a benefit plan or its sponsor.

**Specific 401(k) Issues.** Most plans subject to ERISA and tax-qualified retirement plans, other than government plans and non-electing church plans, must contain a number of provisions that hinge upon the marital status of the plan participant. With respect to 401(k) plans, these provisions may raise the following issues:

- **Spousal Death Benefit.** A retirement plan may not pay a death benefit to a beneficiary other than the participant's surviving spouse unless the spouse consents to the designation of a non-spouse beneficiary, and the participant's spouse is generally the default beneficiary if there is no beneficiary designation. A plan provision that automatically designates a surviving spouse as the plan beneficiary enables a 401(k) plan not only to avoid the need to pay benefits in the form of an annuity, as described below, but also eliminates the requirement to obtain spousal consent as a condition of granting a plan loan. As noted above, the *Windsor* decision and Revenue Ruling 2013-17 require a participant who has designated a beneficiary other than his or her same-sex spouse, or wishes to designate such an individual as his or her beneficiary, to obtain the consent of the same-sex spouse to the designation.
- **Spousal Annuity.** For those plans subject to the joint and survivor annuity rules, lifetime benefits in a qualifying joint annuity form will need to be offered to participants with same-sex spouses, and same-sex spousal consent will now be required for non-annuity benefit payments or annuity payments that do not provide for a survivor annuity to the spouse.

continued on page 9 ►

► **Legal Update**

*continued from page 3*

- **Plan Loans.** Many tax-qualified retirement plans that permit participant loans require spousal consent to any such loan. A same-sex spouse's consent will now be required unless the plan provides that the spouse is the participant's designated beneficiary.
- **Qualified Domestic Relations Order (DRO).** DROs requiring the payment of a participant's benefit to his or her same-sex spouse or their children will now be enforceable against the plan.
- **Hardship Distributions.** Under the hardship distribution rules applicable to 401(k) plans, the rules allowing such distributions for certain medical, tuition, or funeral expenses of spouses will now apply to same-sex spouses.
- **Required Minimum Distributions.** Under the minimum distribution requirements applicable to tax-qualified retirement plans, including 401(k) plans, spouses of deceased

plan participants may delay the commencement of benefits for a longer period after the participant's death than non-spouse beneficiaries. Same-sex spouses will now be able to take advantage of this opportunity to defer payment of death benefits.

- **Rollovers.** A same-sex spouse entitled to receive a death benefit distribution from a tax-qualified retirement plan will now be able to roll over the distribution to an employer plan, as well as to certain other retirement vehicles, and will no longer be limited to making a rollover to an inherited Individual Retirement Account (IRA).

*Summary.* Many uncertainties remain as to the impact of the Supreme Court's decision, even after the IRS's recent guidance. Additional guidance addressing open questions has been promised, but may face resistance and/or challenge from employers, same-sex spouses, or relatives of

the parties to a same-sex marriage based on Section 2 of DOMA or how the IRS resolves the issue of retroactivity. While this guidance is being developed, 401(k) sponsors and their advisors should now be considering the following actions:

- Communicating the Supreme Court's decision to employees;
- Identifying all past and present employees who are in a same-sex marriage;
- Identifying those plan provisions that may be affected by a changed definition of the terms "spouse," "marriage," and "husband and wife"; and
- Preparing plan amendments removing any requirement that the foregoing relationships be limited to members of the opposite sex. ❖

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