



## After *Windsor* decision same-sex marriage laws continue to present challenges for retirement plan sponsors

### Who's affected

These developments directly affect sponsors of and participants in all qualified defined benefit and defined contribution plans, section 403(b) plans, and governmental section 457(b) plans, whether or not they are subject to ERISA.

### Background and summary

As of June 25, 2013, 13 states and the District of Columbia had legalized same-sex marriages. In contrast to these state laws, the federal "Defense of Marriage Act" (DOMA), which was enacted in 1996, defined "marriage" as "a legal union between one man and one woman," for purposes of determining the meaning of any federal law or regulation (such as the Internal Revenue Code and ERISA). This disjoint was eliminated on June 26, 2013, but a new disjoint was created, when the U.S. Supreme ruled in *Windsor v. United States* that Section 3 of DOMA, containing this definition of marriage, was unconstitutional.

Since the *Windsor* decision did not strike down Section 2 of DOMA, which allows states to prohibit same-sex marriages and refuse recognition to same-sex marriages validly created elsewhere, those states with their own DOMA laws or constitutional amendments prohibiting same-sex marriage are now in conflict with federal law. Currently, 35 states are in this situation.

This conflict between federal law and some state and local laws creates concerns for sponsors of retirement plans that are generally subject to federal law. Even sponsors of plans that are not subject to ERISA and are therefore subject to state law face conflicts with Internal Revenue Code requirements.

In late August and early September 2013, the IRS and Department of Labor (DOL) issued preliminary guidance regarding changes to the interpretations of both Internal Revenue Code and ERISA provisions as a result of the *Windsor* decision. Both agencies adopted a "state of celebration" rule for determining the marital status of same-sex couples but acknowledged that additional guidance will be required to enable qualified plans to come into complete compliance with this decision.

### Action and next steps

Plan sponsors need to understand the impact of the *Windsor* decision on their plans, as well as the state of celebration rule. In addition, plan sponsors that have employees working in states that do not recognize same-sex marriages need to be aware of the disjoints and potential pitfalls they will encounter when administering their plans that must now recognize same-sex marriages at the federal level.

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## **Marriage vs. civil union vs. domestic partnership**

As of October 21, 2013, 14 states (Massachusetts, California, Connecticut, Iowa, Vermont, New Hampshire, New York, Maine, Maryland, Washington, Delaware, Rhode Island, Minnesota and New Jersey), the District of Columbia, and six Native American tribal governments issue marriage licenses to same-sex couples. In addition, several counties in New Mexico issue same-sex marriage licenses. In these jurisdictions, same-sex and different-sex married couples have the same state-level legal rights and obligations.

At the next level are civil unions. The civil union concept originated in Vermont as a legal status that was identical to marriage, but was not a true marriage. This concept was later adopted by several other states, prior to those states recognizing same-sex marriages. Currently, same-sex civil unions are offered in New Jersey, Illinois, Hawaii, and Colorado.

Finally, a number of states and localities offer domestic partnership status to same-sex couples. The domestic partnership concept was originally created by the state of Hawaii in 1997. The rights and responsibilities of domestic partners vary from state to state (and locality to locality). Currently, Oregon and Nevada offer domestic partnerships that are nearly equivalent to marriage with respect to the rights that they provide to same-sex partners.

A [chart](#) illustrating the status of these state laws is provided as a “related document” to this publication.

## **Federal Defense of Marriage Act (DOMA)**

For purposes of applying federal laws and regulations, the federal DOMA enacted in 1996 defined “marriage” as “a legal union between one man and one woman.” It also allowed states to prohibit same-sex marriages and refuse recognition to same-sex marriages validly created elsewhere. Currently, 35 states have enacted DOMA laws or have constitutional amendments prohibiting same-sex marriage.

On June 26, 2013, the U. S. Supreme Court ruled in *U.S. v. Windsor* that Section 3 of DOMA, which denied federal benefits and recognition to same-sex marriages, was unconstitutional. However, this ruling did not strike down Section 2 of DOMA, which allows states to prohibit same-sex marriages and refuse recognition to same-sex marriages validly created elsewhere.

The ongoing existence of DOMA Section 2 sets up potential problems for both same-sex spouses and the federal government with respect to the determination of marital status for same-sex couples legitimately married in one state but living or working in a state that does not recognize their marriages. For opposite sex couples, this is not an issue since all states abide by the “full faith and credit” provision of the U.S. Constitution and recognize marriages that are legal in other states even if not allowed under their law. For example, currently common-law marriage can be contracted in only nine states (Alabama, Colorado, Kansas, Rhode Island, South Carolina, Iowa, Montana, Utah and Texas) and the District of Columbia. However, all other 41 states recognize common-law marriages lawfully contracted in those jurisdictions. As a result, once married, always married, until divorced or widowed.

As a result, it was left to the regulatory agencies to decide how the marital status of same-sex spouses would be determined for federal purposes. On August 29, 2013, the IRS released preliminary guidance providing that for all federal tax purposes, the IRS will look to the jurisdiction (state, District of Columbia, territory or country) in which the marriage was celebrated to determine the legality of a same-sex marriage. This “state of celebration rule” was effective September 16, 2013 for qualified retirement plan purposes.

Following the IRS's lead, the Department of Labor (DOL) published guidance on September 18, 2013, adopting the “state of celebration rule” for purposes of ERISA Title I. As a result, there will be a measure of consistency between the IRS and DOL when interpreting and issuing guidance with respect to Title I and Title II provisions involving marital status.

## **Impact of conflicting laws on retirement programs**

Whether or not a retirement plan is subject to ERISA, it must now recognize same-sex marriages for federal tax purposes. However, plan sponsors also need to be aware of conflicting state laws that play a role in plan administration, as individuals

who are considered married for federal tax purposes may not be considered married for state tax purposes. Plan sponsors must also be prepared to properly address situations involving participants who were previously treated as unmarried because they had same-sex spouses, but must now be recognized as married. In addition, it is important to understand that civil union partners and domestic partners are not considered spouses under federal law, even though some states that permit same-sex marriages treat such relationships entered into in other states or jurisdictions as marriages (Connecticut, New Hampshire, Washington, Delaware, Rhode Island).

## Why marriage matters

Spousal status affects all plans, whether or not they are subject to ERISA, with respect to:

- **Payment of Required Minimum Distributions (RMDs).** Generally, a plan must begin distributing benefits to a participant no later than April 1st of the year following the later of the year the participant reaches age 70½, or terminates employment with the employer. Payments made from defined contribution plans and 403(b) plans are based on special factors if the participant's designated beneficiary is his or her spouse. In addition, special rules apply to the timing and calculation of payments to be made to a surviving spouse.
- **Tax withholding and reporting of distributions to spouse.** Plans must comply with federal and state income tax withholding and information reporting requirements (e.g., Form 1099-R). Prudential Retirement will comply with applicable federal and state withholding requirements. Impacted participants may wish to consult with a tax advisor to understand differences in federal and state tax rules.

In addition, plans that are subject to ERISA may need to provide some or all of the following special spousal benefits or rights, which must now be extended to same-sex spouses:

- **Default beneficiary provisions.** Most plans contain default rules for identifying a participant's beneficiary if he or she has not designated specific beneficiaries. The participant's surviving spouse is typically the first default beneficiary in these hierarchies.
- **QPSA payments.** Qualified defined benefit plans and some qualified defined contribution plans must pay Qualified Preretirement Survivor Annuities (QPSAs) to a participant's surviving spouse, unless the coverage has been waived and the spouse has consented to the waiver. Under many defined benefit plans, if the participant dies before his Annuity Starting Date (ASD) and does not have a surviving spouse, no death benefit is payable at all.
- **Death benefits under certain defined contribution plans.** If a participant dies before his ASD, qualified defined contribution plans that do not provide a Qualified Joint and Survivor Annuity (QJSA) as the normal form of payment must pay the participant's entire vested account balance to the participant's surviving spouse, unless the spouse has consented to the designation of an alternative beneficiary.
- **QJSA payments.** When a qualified plan's normal form of payment is a QJSA (all defined benefit plans and some defined contribution plans), the annuity payable to a participant must include a survivor annuity payable to the surviving spouse, unless the participant elects a different form of payment and the spouse has consented to that election. If the participant is not married, the QJSA is simply a single life annuity, with no survivor annuity payable, unless the participant selects a different form of payment.
- **QOSA coverage.** Plans that are required to provide QJSAs must also provide Qualified Optional Survivor Annuities (QOSAs), which provide a different level of survivor annuity to a participant's surviving spouse.
- **In-service withdrawals and plan loans.** Participants in qualified defined contribution plans that are subject to the spousal consent rules must obtain spousal consent to take in-service withdrawals (including hardship withdrawals) or loans. For participants in some plans, hardship withdrawals are automatically available to pay expenses incurred by a spouse.
- **Qualified Domestic Relations Orders (QDROs).** A QDRO may require the division of a participant's accrued benefit or account balance between the participant and a former spouse.

- **Optional plan provisions.** Some plans contain provisions that are not required by law but reflect optional choices by the plan sponsor. For example, some plans that are not subject to spousal consent requirement still require spousal consent to participant loans.

## Response to the *Windsor* decision

In light of the *Windsor* decision, Prudential Retirement has evaluated our processes and procedures relative to the administration of the provisions noted above. In all situations, we have determined that no changes are required at this time. However, we encourage plan sponsors to pay special attention to the following items:

- **Payment of RMDs.** A participant who has been receiving payments based on an unmarried status due to the application of DOMA may request that payments be recalculated based on a married status by providing the spouse's date of birth.
- **QPSA and QJSA payments and death benefits under certain defined contribution plans.** Prudential will continue to use its current process to confirm the participant's marital status. Plan sponsors will want to ensure that files passed to service providers, including Prudential Retirement, contain the correct marital status for participants. In the case of defined contribution plan death benefits, Prudential may also use other information, such as a death certificate, to determine marital status.
- **In-service withdrawals and loans.** Prudential will continue to use its current process to confirm the participant's marital status. Plan sponsors will want to ensure that files passed to service providers, including Prudential Retirement, contain the correct marital status for participants. If validation of marital status is required to obtain a benefit (e.g., hardship expenses for a spouse), Prudential will continue to request a marriage certificate.
- **QDROs.** Prudential will continue to segregate accounts based upon the direction provided in a QDRO.

## Questions remain

Despite the welcome initial guidance provided by the IRS and DOL, important questions remain, including:

- What is the deadline for adopting plan amendments, if needed, to reflect changes related to the *Windsor* decision?
- The effective date of the initial IRS guidance was September 16, 2013. How does this effective date apply to situations where:
  - A participant with a same-sex spouse died before that date, but the claim for the death benefit is not made until after that date; or
  - A participant with a same-sex spouse elected a non-QJSA form of payment before that date, but the actual Annuity Starting Date is after that date; or
  - A participant who had a same-sex spouse on his RMD required beginning date that occurred before September 16, 2013 is receiving payments calculated based on an unmarried status.

Prudential Retirement suggests that affected plan sponsors discuss the treatment of same-sex marriage with their own legal counsel to determine what their next steps should be given their own specific situations. For additional information regarding the impact of the *Windsor* decision and the initial IRS guidance, plan sponsors may want to refer to Prudential Retirement's publications, "[DOMA decision answers one question but raises many more](#)" and "[IRS guidance on recognition of same-sex marriages may require quick action](#)".

### Pension Analyst by Prudential Retirement

The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current legislation and regulatory developments affecting qualified retirement plans. This publication is distributed with the understanding that Prudential Retirement is not rendering legal advice. Plan sponsors should consult their attorneys about the application of any law to their retirement plans.

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