EXPERT UPDATE

IRS Provides Tax Guidance on Same-Sex Marriage Issues

Guidance on how certain tax rules are impacted by the U.S. Supreme Court's same-sex marriage decision from June 2015 was issued by the Internal Revenue Service (IRS).

It addresses how Code Section 125's mid-year election change rules apply when a health plan expands eligibility to include same-sex spouses. It also proposes updates to federal tax rules to reflect that same-sex couples can now marry in all states and that all states must recognize these marriages.

Changing a health plan's eligibility rules to include same-sex spouses qualifies as a significant improvement in coverage, which may allow employees to make election changes during a plan year.

Supreme Court Decisions

On June 26, 2013, the Supreme Court held in *United States v. Windsor* that Section 3 of the Defense of Marriage Act (DOMA)—which generally prohibited the federal government from recognizing the marriages of same-sex couples—was unconstitutional. However, it did not require states to allow same-sex marriage or recognize those performed in other states.

As a result, legally married same-sex couples became entitled to the same benefits and protections under federal law as opposite-sex married couples. The IRS issued tax guidance, such as Revenue Ruling 2013-17, in order to clarify the ruling's impact on tax code provisions that refer to marital status.

On June 26, 2015, the Supreme Court ruled in *Obergefell v. Hodges* that same-sex couples have the right to be married in their own states and to have their marriages recognized as valid in every other state.

The IRS issued Notice 2015-86 to clarify how the *Obergefell* decision applies to employee benefit plans, including a discretionary expansion of benefits that is not required under the federal tax rules.

Health Plan Rules

Federal tax laws do not require health plans to offer specific rights or benefits to an employee's spouse. However, legislation such as state insurance laws may include coverage requirements for spouses.

The IRS reminds employers that, to the extent that a health and welfare plan offers benefits to a same-sex spouse, the federal tax rules of Revenue Ruling 2013-17 and Notice 2014-1 apply.

Under this guidance:

- An employer should not impute additional income to an employee who covers his or her same-sex spouse as a dependent under the employer's health plan;
- An eligible employee may pay for a same-sex spouse's health coverage on a pre-tax basis through a cafeteria (or Section 125) plan in the same way that an employee with an opposite-sex spouse does; and
- An eligible employee may receive tax-free reimbursements for expenses of his or her same-sex spouse through a health flexible spending account (FSA), health reimbursement account (HRA) or health savings account (HSA).

The IRS also cautions that the *Obergefell* decision that a "spouse" must include both opposite-sex and same-sex spouses for purposes of federal and state laws could require changes to a health plan's operation.

If the terms of a health plan provide that eligible spouses are those who qualify as a spouse under state law, the terms of the plan would require coverage for same-sex spouses.

Cafeteria Plans – Mid-year Election Changes

Participant elections under a Code Section 125 cafeteria plan must be made before the first day of the plan year or the date taxable benefits would currently be available, whichever comes first.

Participant elections generally must be irrevocable until the beginning of the next plan year. This means that participants ordinarily cannot make changes to their cafeteria plan elections during a plan year.

Employers do not have to permit any exceptions to the election irrevocability rule for cafeteria plans. However, the IRS permits employers to design their cafeteria plans to allow employees to change their elections during the plan year if certain conditions are met. One of the IRS's permitted mid-year election change events is a significant improvement in coverage under an existing coverage option.

According to the IRS, if the eligibility criteria for a qualified benefit offered under a cafeteria plan changes during a plan year to add coverage for same-sex spouses, this change would constitute a significant improvement in coverage under an existing coverage option.

This eligibility change could occur, for example, as a result of a plan amendment, a change in applicable state law (if the plan's eligibility rules refer to state law) or a change in the interpretation of existing plan terms.

A cafeteria plan that allows participants to make a change in elections due to a significant improvement in coverage may permit a participant to revoke an existing election and submit a new election if same-sex spouses first become eligible for coverage under the terms of the plan during the period of coverage.

This new election may be an election by a participant to add coverage for a same-sex spouse to a benefit option in which the participant is already enrolled, or an election by a participant who had not previously elected coverage to add coverage for the participant and a same-sex spouse.

A cafeteria plan sponsor that recognizes one or more mid-year election change events should review its plan document to confirm that it addresses the permitted election changes. A cafeteria plan may be amended at any time to permit participants to change an election.

In the case of an amendment to allow employees to change their elections to cover same-sex spouses, the amendment must be adopted no later than the last day of the plan year that includes the later of:

- The date same-sex spouses first became eligible for coverage under the plan; or
- Dec. 9, 2015.

Proposed Regulations

The proposed regulations were issued to strengthen and clarify prior IRS guidance to reflect that same-sex couples can now marry in all states and that all states must recognize these marriages.

The proposed regulations would amend current IRS regulations to clarify that terms indicating sex, such as “husband” and “wife,” should be interpreted in a neutral way to include same-sex spouses as well as opposite-sex spouses.

The proposed regulations would apply to all federal tax provisions where marriage is a factor, including:

- Filing status;
- Claiming personal and dependency exemptions;
- Taking the standard deduction;
- Employee benefits;
- Contributing to an IRA; and
- Claiming the earned income tax credit or child tax credit.

In addition, the proposed regulations provide that a marriage of two individuals will be recognized for federal tax purposes if that marriage would be recognized by any state, possession or territory of the United States.

Under this rule, whether a marriage conducted in a foreign jurisdiction will be recognized for federal tax purposes depends on whether that marriage would be recognized in at least one state, possession or territory of the United States.

Domestic Partnerships and Civil Unions

For federal tax purposes, the term ‘‘marriage’’ does not include registered domestic partnerships, civil unions or other similar relationships recognized under state law that are not designated as a marriage under that state’s law. Similarly, the terms ‘‘spouse,’’ ‘‘husband and wife,’’ ‘‘husband’’ and ‘‘wife’’ do not include individuals who have entered into domestic partnerships, civil unions or other similar relationships.

The proposed regulations note that some couples have chosen to enter into civil unions or domestic partnerships to avoid certain consequences of marriage (such as increased taxes or the loss of Social Security benefits) and treating these couples as married would undermine their expectations regarding the scope of their relationships.