

Client Alert

Latham & Watkins
Tax Department

The Recent California Decision Overruling the Ban on Same-Sex Marriages and its Effect on Employee Benefit Plans

On May 15, 2008, the California Supreme Court published its decision in the case *In re Marriages*, ruling that the state's ban on same-sex marriage was unconstitutional. In its 4-3 decision, the court held that Proposition 22, a voter-approved measure defining "marriage" as a union between a man and a woman, violated the California Constitution.

Although *In re Marriages* is a landmark decision, it should not have a major impact on most employee benefit plans because the decision affects state law, while most employee benefit plans are governed by US federal law that preempts state law in many instances. With respect to employee benefit plans that provide benefits through insurance subject to California law, employers generally are already required to provide an employee's domestic partner with benefits equivalent to those provided to an employee's opposite-sex spouse, so the decision may not significantly expand the coverage of such plans. Nonetheless, California employers should begin to review their plans and policies in light of the court's ruling.

Federal Law Aspects

Employee benefit plans governed by federal law generally include most

pension plans, 401(k) plans, medical, dental, life insurance and long-term disability benefit plans, as well as non-qualified deferred compensation plans, cafeteria plans and flexible spending account plans. Employers may choose to provide same-sex spouses with equivalent spousal benefits under such plans. However, employers should carefully review the applicable federal law because the extension of spousal benefits to same-sex spouses may result in taxation to the employee, as discussed below.

Employee benefit plans maintained by non-governmental employers generally are subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA). ERISA is a federal law that preempts state law, with certain important exceptions, such as state laws that regulate insurance. For instance, California's domestic partnership law generally requires that California insurance policies provide domestic partners with benefits equivalent to those offered to opposite-sex spouses. Plans that use California insurance policies incorporate such requirements.

In addition, ERISA and other federal laws are subject to the federal Defense of Marriage Act of 1996 (DOMA), which defines the terms "marriage" and "spouse" for federal law purposes. Under DOMA, "marriage" is defined

"Employers should begin to review their policies to determine whether to provide spousal benefits to employees' same-sex spouses on a voluntary basis, or whether they will be required to provide such benefits under California insurance law."

as a legal union between one man and one woman as husband and wife, while "spouse" is defined to mean a person of the opposite sex. Consequently, for purposes of the federal laws that govern employee benefit plans, such as ERISA and the Internal Revenue Code, the DOMA definitions of "marriage" and "spouse" would apply, precluding the recognition of same-sex spouses as "spouses" for federal law purposes.

Federal Tax Consequences

Some employee benefit plans may already extend benefits to an employee's domestic partner. These benefits may be taxable to the employee for federal income and employment tax purposes, and similar rules should apply for same-sex spouses. Thus, an employer providing benefits to an employee's same-sex spouse (or domestic partner) should consider the federal income and employment tax withholding and reporting consequences of providing such benefits. However, certain benefits may not be subject to federal taxation, if the same-sex spouse (or domestic partner) qualifies as the employee's "dependent" under federal tax law.

Under federal tax law, an employee's "dependent" generally may include an individual (1) who has the same principal abode as the employee and is a member of the employee's household, (2) who receives more than half of his or her support from the employee, and (3) whose gross income is less than the exemption amount (\$3,500 for 2008). Thus, an employee's same-sex spouse (or domestic partner) who earns less than the exemption amount in any taxable year may qualify as an employee's "dependent" for federal tax purposes.

California Insurance Law Aspects

In re Marriages will likely require the extension of spousal benefits to same-

sex spouses, if an employee benefit plan provides benefits through insurance policies subject to California insurance law. For example, medical, dental and vision insurance benefit plans are likely to provide spousal benefits to same-sex spouses because of California insurance law requirements.

The Decision's Effect on Specific Employee Benefit Plans

The effect of *In re Marriages* on various types of employee benefit plans raises a number of issues, some of which are outlined below. Future guidance will likely address these issues.

- **Retirement and 401(k) Plans:** Employers should not be required to provide same-sex spouses with the spousal benefits required by federal tax law, such as qualified joint and survivor annuities, qualified preretirement survivor annuities or other preretirement spousal death benefits. Rollovers by same-sex spouse beneficiaries should be subject to the rules applicable to rollovers by non-spouse beneficiaries.
- **QDROs:** Under a retirement or 401(k) plan, a plan participant's benefits may be assigned to a current or former spouse, child or other dependent of the participant pursuant to a qualified domestic relations order (QDRO). The DOMA definition of "spouse" generally should preclude a QDRO from treating a same-sex spouse as a "spouse," although a QDRO might assign benefits to a same-sex spouse who qualifies as a "dependent" under federal tax law. It is unclear, however, whether a same-sex spouse would qualify as a "dependent" under the ERISA rules governing QDROs. Also, a QDRO must relate to child support, alimony or marital property rights and, in light of DOMA, it is not clear whether an order assigning benefits to a same-sex spouse can satisfy this QDRO requirement.

- **COBRA:** Under federal law, COBRA generally requires an employer to offer continuing health plan coverage to an employee's spouse and dependent children in certain events, such as the employee's termination of employment or death. An employer should not be required to provide COBRA coverage to same-sex spouses because of the DOMA definition of "spouse."
- **Taxation of Health Benefits:** The extension of spousal benefits to same-sex spouses may result in a disparity in the taxation of medical, dental and vision benefits at the federal and state levels. Employer-provided medical, dental and vision benefits for employees, their opposite-sex spouses and "dependents" are not subject to federal income and employment taxes. In contrast, if an employer extends spousal medical, dental and vision benefits to an employee's same-sex spouse, the value of the spousal benefit generally should be taxable to the employee for federal income and employment tax purposes, unless the same-sex spouse qualifies as a "dependent" under federal tax law.¹ For California income tax purposes, an employee should not be taxed on the value of medical, dental and vision benefits for his or her same-sex spouse, although the California Franchise Tax Board has not yet provided specific guidance on the issue in light of *In re Marriages*.

will be required to provide such benefits under California insurance law.

Specifically, employers should review all plan documents to ensure that (1) the plan documents include a definition of "spouse," and (2) the definition clearly conveys the employers' intent with respect to spousal benefits. Employers should communicate all plan changes to employees and update employee communications, such as summary plan descriptions, to reflect such changes. Employers also should review the tax consequences of providing spousal benefits to same-sex spouses. In addition, certain plans are drafted to provide that domestic partner benefits will only be offered to employees who are unable to be married, and employers should review such plan provisions to determine whether domestic partner benefits would be cut off for same-sex domestic partners in light of *In re Marriages*.

Endnotes

¹ Under the federal tax rules, for purposes of medical, dental and vision benefits, an individual is determined to be a "dependent" without regard to whether the individual's gross income is less than the exemption amount.

² On June 8, 2008, the California Secretary of State determined that this proposition qualifies for the November General Election Ballot. Additionally, the court denied a request to stay its decision pending the outcome of the referendum.

Next Steps

The court's holding in *In re Marriages* is effective as of June 14, 2008. However, there will be a proposition on the ballot this November to amend California's Constitution to ban same-sex marriage.² Although the legal landscape with respect to same-sex marriages continues to develop, employers should begin to review their plans and policies to determine whether to provide spousal benefits to employees' same-sex spouses on a voluntary basis, or whether they

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