

CLIENT ALERT

TO: Employee Benefits Clients of Williams Parker
FROM: Carol L. Myers & Edward Kim
RE: IRS Notice 2014-1: Guidance on Same-Sex Marriage Issues for Cafeteria Plans, Flexible Spending Arrangements and Health Savings Accounts

On December 16, 2013, the IRS issued Notice 2014-1, which provides guidance for cafeteria plans (including components of cafeteria plans that provide for pre-tax payment of insurance costs as well as health and dependent care flexible spending arrangements) and health savings accounts in connection with same-sex spouse participation following the landmark U.S. Supreme Court decision *United States v. Windsor* and subsequent IRS guidance (Revenue Ruling 2013-17). The IRS, in the Revenue Ruling, adopted the "state of celebration" rule (lawfully married under state law or law of any U.S. territory or possession or any foreign jurisdiction with legal authority to sanction marriages at the time and location where the marriage ceremony was performed) to determine a legal spouse. This client alert is intended to provide you with a summary of the Notice and action items that you can take to comply with the Notice.

Midyear Election Changes to Cafeteria Plans

1. When can an employee make a coverage change based on having a same-sex spouse: A cafeteria plan may permit an employee who was legally married on June 26, 2013 (the date of the *Windsor* decision) to a same-sex spouse (as determined by the state of celebration rule) to change an existing cafeteria plan election if the election is made at any time during a cafeteria plan year that includes June 26, 2013 or December 16, 2013. A participant who marries a same-sex spouse after June 26, 2013, can also make a midyear election change due to the change in the participant's marital status if filed at any time during the cafeteria plan year that includes June 26, 2013, or the cafeteria plan year that includes December 16, 2013.

Action Item: It is now permitted for plan sponsors to honor any participant with a legally valid same-sex spouse to make the mid-year election change.

Alternative Action Item: Plan sponsors can accept mid-year coverage changes during the window described above from any employee that has a legally valid same-sex spouse.

2. Is the change in tax treatment of same-sex coverage a basis for making a coverage change: If a cafeteria plan allowed an employee to change his/her coverage elections (such as for health insurance) based on the belief that *Windsor* required the plan to allow the change (i.e., because the change in the tax treatment of benefits was a significant change in the cost of coverage under IRS Regulation Sec. 1.125-4(f)), the IRS will permit that interpretation of the rules **BUT only for changes that occur between June 26, 2013 and December 31, 2013.**

Action Item: Plan sponsors must stop permitting these changes after December 31, 2013.

3. When does a same-sex coverage change take effect: A cafeteria plan coverage change made because of a same-sex spouse as a result of the *Windsor* decision will generally take effect as of the date that any other change in coverage would become effective. For a change in status election made as a result of the *Windsor* decision between June 26, 2013, and December 16, 2013, the cafeteria plan will not be treated as violating the cafeteria plan rules if the coverage change becomes effective by the later of (a) the date that coverage under the cafeteria plan would be added under the cafeteria plan's usual procedures for change in status elections, or (b) a reasonable period of time after December 16, 2013.

Action Item: Plan sponsors must ensure that the effective date of election changes be consistent with these guidelines.

4. When must the employer change the employee's payments to pre-tax for same sex spouse coverage: If a plan sponsor receives notice, before the end of the cafeteria plan year that includes December 16, 2013, that a participant is married to the same-sex spouse for whom the employee has been paying for health plan coverage on an after-tax basis, then the plan sponsor must begin treating the amount that the employee pays for the spousal coverage as a pre-tax salary reduction under the plan. This treatment as pre-tax salary reduction must occur by the later of: (i) the date that a change in legal marital status would be required to be reflected for income tax withholding purposes under IRC Section 3402 (i.e., with an employee's filing of a Form W-4) or (ii) a reasonable period of time after December 16, 2013. For this purpose, a participant may provide "notice" of the (existing) marriage by (1) making an election under the employer's cafeteria plan to pay for the employee cost of spousal coverage through salary reduction or (2) by filing a revised Form W-4 stating that the participant is married.

Alternative: If an employee who has been paying for health coverage for his/her same-sex spouse on an after tax basis notifies the plan sponsor that he/she is married to the same-sex spouse before the end of the cafeteria plan year that includes December 16, 2013, then, the plan sponsor must change the tax treatment of the payments that the employee has been making to pre-tax instead of after-tax. The employer must make this change by the later of: (i) the date that a change in legal marital status would be required to be reflected for income tax withholding purposes under IRC Section 3402 (i.e., with an employee's filing of a Form W-4) or (ii) a reasonable period of time after December 16, 2013. For this purpose, an employee may provide "notice" of the (existing) marriage by (1) making an election under the cafeteria plan to pay for the employee cost of spousal coverage through salary reduction or (2) by filing a revised Form W-4 stating that the employee is married.

Action Item: If a plan sponsor receives notice of a same-sex spouse, it should begin treating the amount the employee pays for the same-sex spouse's coverage as pre-tax salary reductions by the prescribed deadline.

5. An employee who paid on an after-tax basis can apply for a tax refund: If an employee paid for same-sex spousal health coverage on an after-tax basis, his/her salary reduction election is considered (for tax purposes) to include the cost of spousal coverage. This is true even if the employer reported (for prior years and/or reports for 2013) the amount as taxable income and wages to the employee. Therefore, the amount that the employee pays for same-sex spousal coverage is excluded from the gross income of the employee and is not subject to federal income or federal employment taxes. This rule applies to the cafeteria plan year which includes December 16, 2013 (i.e., the 2013 plan year for calendar-year plans), and any prior years. As a result, the employee can file a claim for credit or refund of applicable federal employment taxes.

Action Item: Plan sponsors need to adjust payroll procedures to reflect that the amount a participant pays for same-sex spousal coverage is excluded from the gross income of the participant and is not subject to federal income or federal employment taxes. Employers should consider whether the cost of quantifying and applying for a refund of employer paid employment taxes exceeds the potential refund that will be due.

Flexible Spending Account Reimbursements

1. Reimbursement plans can recognize expenses back to first day of 2013 plan year: FSA reimbursement for adoption, health care, and dependent care expenses is permitted for an employee's legally married same-sex spouse for a cafeteria plan year that includes the date of the *Windsor* decision. For a calendar-year plan for 2013, that means that the plan may be written to reimburse these expenses if they are incurred as early as Jan. 1, 2013 (or a later date if the spouse becomes married after that date).

Action Item: Plan sponsors need to decide whether their reimbursement plans will recognize a legally valid same-sex spouse of a participant as includible for reimbursement purposes and amend the plans, if applicable.

Contribution Limits for HSAs and Dependent Care Programs

1. What to do when HSA contributions have been too large: There are two alternatives for same-sex couples with combined HSA contributions that exceed the applicable HSA contribution limit for a married couple: (i) contributions for one or both of the spouses may be reduced for the remaining portion of the tax year in order to avoid exceeding the applicable contribution limit or (ii) any excess may be distributed from the

HSAs of one or both spouses no later than the tax return due date for the spouses. Any excess contributions that remain undistributed as of the due date for the filing of the spouse's tax return (including extensions) will be subject to excise taxes.

2. What to do when Dependent Care contributions have been too large: There are two alternatives for same-sex couples with combined dependent care contributions that exceed the applicable contribution limit for a married couple: (i) reduce the amount being withheld for the rest of 2013 to avoid exceeding the contribution limit or (ii) include the excess in their gross income.

Action Item: To avoid taxes for excess contributions, spouses can either have their remaining contributions for the rest of the year reduced or have the excess distributed to them (for HSAs only), which must be done before the due date (including extensions) of their tax return.

Plan Amendments

1. When do plans need to be amended? A cafeteria plan containing written terms permitting a change in election upon a change in legal marital status generally is not required to be amended to permit a change in status election with regard to a same-sex spouse in connection with the *Windsor* decision. To the extent that the cafeteria plan sponsor chooses to permit election changes that were not previously provided for in the written plan document, the cafeteria plan must be amended to permit the new election changes on or before the last day of the first plan year that begins on or after December 16, 2013. Such an amendment may be effective retroactively to the first day of the plan year that includes December 16, 2013, provided that the cafeteria plan operates in accordance with the guidance under the Notice.

Action Item: Plans that are not in compliance with the provisions of the Notice need to be amended no later than the last day of the first plan year beginning on or after December 16, 2013. For calendar year plans, this date is December 31, 2014.

If you have any questions or concerns regarding the implications of the Notice 2014-1 and compliance with the post-DOMA spousal recognition rules, please contact Carol L. Myers, Esq. at (941) 893-4001 or Edward K. Kim, Esq. at (941) 536-2034.

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