Retirement Programming Ltd.

Qualified Retirement Plan
Administration & Consulting

631.727.3631
consult@retirementprogramming.com

Benefit Insights® – A non-technical review of qualified retirement plan legislative and administrative issues December 2013

Down with DOMA

Signed into law in 1996, the federal Defense of Marriage Act (DOMA) is a small law that has caused big controversy.

Introduction and Background

DOMA is small in the sense that it consists of only three sentences, making it shorter to include the full text of the law here rather than attempting to explain it.

Section 1. Short Title

This Act may be cited as the "Defense of Marriage Act."

Section 2. Powers reserved to the states

No State, territory, or possession of the United States, or Indian tribe, shall be required to give effect to any public act, record, or judicial proceeding of any other State, territory, possession, or tribe respecting a relationship between persons of the same sex that is treated as a marriage under the laws of such other State, territory, possession, or tribe, or a right or claim arising from such relationship.

Section 3. Definition of Marriage

In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife.

In short, DOMA provided that for all federal legal purposes, including operating a qualified retirement plan, only marriages between men and women were considered valid. In other words, marriages between same-sex couples were not recognized even if those marriages were valid under certain state laws.

The Big Decision

Everything changed over the summer with the United States Supreme Court's decision in *United States v. Windsor*, which found Section 3 of DOMA to be unconstitutional. In a nutshell, Windsor was required to pay a six-figure estate tax bill that she would not have had to pay if her same-sex marriage was recognized

for federal tax purposes. The Court held that this violated the constitutional principle of equal protection.

Although Section 2, which allows each state to determine whether it will recognize same-sex marriages performed in other states, still stands, the Internal Revenue Service and Department of Labor issued Revenue Ruling 2013-17 and Technical Release 2013-04, respectively, to clarify that for retirement plan purposes, same-sex marriages are now recognized as long as they were valid at the time in the state where performed.

This so-called "state of celebration" rule means that employers in states that do not recognize same-sex marriages must still treat same-sex couples as married with respect to their company-sponsored retirement plans.

Practical Impact on Plan Operations

While many have considered the recognition of same-sex marriage to be primarily a social issue, the *Windsor* decision and subsequent agency guidance have a direct impact on the day-to-day operations of qualified plans.

Highly Compensated and Key Employees

One of the foundations of retirement plans is that they cannot discriminate in favor of highly compensated employees (HCEs) and/or key employees, thus requiring the litany of annual tests. One way in which a person can be an HCE or key employee is based on ownership of the company sponsoring the plan.

While a detailed discussion is beyond the scope of this article, there is a separate rule that says a spouse is deemed to own what his or her spouse owns. In other words, if an employee owns enough of an interest in the company (usually more than 5%) to be considered an HCE or key employee, that employee's spouse will also be an HCE or key employee due to the attributed ownership. Now that federal law recognizes same-sex marriages, the attribution rules apply to such couples, causing spouses to be classified as HCE or key when they would not have been in the past.

It is important to consider how this shift may impact annual testing and plan design. For example, assume Mandy and Mindy are married, and Mandy owns 100% of M & M Company. M & M sponsors a 401(k) plan and both Mandy and Mindy are eligible. Mindy has elected not to make any deferrals.

Prior to *Windsor*, the marriage would not have been recognized, making Mindy a non-HCE and causing her 0% deferral rate to have a negative impact on the ADP test. Now that the same-sex marriage is recognized, Mindy is an HCE through spousal attribution, and her 0% deferral rate improves the ADP test results.

This change in classification could be sufficient to cause a previously failing plan to pass. Of course, the opposite could also be true, so it is important to decide whether any plan design changes are warranted. In addition to nondiscrimination testing, spousal attribution may also impact whether or not two companies have enough overlapping ownership to be part of the same controlled group.

Beneficiary Designations and Spousal Consent

If a plan participant is married, the default beneficiary in the event of death is that participant's spouse. If a single participant gets married, his or her new spouse automatically becomes beneficiary, overriding any previous elections that had been made. In order for the participant to designate someone else as beneficiary, the spouse

must consent in writing and that consent must be notarized.

With the newly-expanded definition of spouse, it is important for participants to review their existing designations to determine whether any changes are warranted. For a participant who wishes to name a same-sex spouse as beneficiary, it is probably not as important since the recognition of their marriage now makes the spouse the automatic default beneficiary.

However, assume that same participant had designated another person such as a child, parent or sibling as beneficiary. The *Windsor* decision essentially invalidates that designation and replaces it with the same-sex spouse. In order for the participant to re-designate that person, his or her same-sex spouse must provide written and notarized consent.

In addition to beneficiary designations, plans that include qualified joint and survivor annuity provisions set an annuity as the default form of distribution. If a participant wishes to elect a different form of benefit payment (such as a lump sum) or wants to take a plan loan, the newly-recognized same-sex spouse must consent in writing.

Qualified Domestic Relations Orders (QDRO)

Anytime one has to deal with marriage, there is the possibility of having to deal with divorce. And, divorce in the retirement plan context often means QDROs. The expansion of recognized marriage to include same-sex couples means that the same-sex spouse of a plan participant is now able to seek a portion of the plan account via a QDRO if the couple goes through a divorce.

Unfortunately, there are some additional complications that arise. Although *Windsor* and the guidance from the DOL and IRS make things easy from a federal perspective, marriage and divorce are matters of state law. Keeping in mind that Section 2 of DOMA was not struck down, state A is not required to recognize a same-sex marriage performed in state B. That means that if a same-sex couple married in state B now lives in state A and wants to get a divorce, A may not be willing and is not required to grant that divorce.

If there is no valid divorce, legal separation or other domestic relations matter, there cannot be a QDRO. This could place plan sponsors in an uncomfortable position in determining whether a court order awarding benefits is sufficient to allow for the payment. Given the nuances involved and the interaction between state and federal law in this area, it may be the prudent course of action to consult an attorney or seek clarification from the court in determining how to proceed.

A Different Type of Discrimination

Usually, when thinking of retirement plan issues, discrimination means failing an ADP test or something like that. However, there are certain employment discrimination issues that can arise in the context of same-sex marriage.

The day-to-day operational items described above require plan sponsors to potentially collect information they have not been required to collect in the past. At first blush, the easy solution is to simply ask those who might be impacted. Unfortunately, singling out certain classes of employees to provide additional personal information could give rise to claims of employment discrimination. This is especially true in locales where same-sex relationships may not be as accepted or could be subject to some type of stigma.

Since same-sex couples have pursued other types of legal relationships such as civil unions, employers might be inclined to request a marriage certificate or other documentation to confirm the couple is legally married. But again, requiring certain employees to provide marriage certificates while not requiring the same documentation from opposite-sex couples could be discriminatory.

Conclusion

The downfall of DOMA has levelled the field in how married participants are treated for purposes of retirement benefits; however, there are a number of items to be addressed, from plan design to operational procedures. Although many of these are straightforward, working through them with experienced and knowledgeable professionals will ensure a thorough decision-making process and go a long way toward preventing unintended or unanticipated outcomes.

IRS and Social Security Annual Limits

Each year the U.S. government adjusts the limits for qualified plans and social security to reflect cost of living adjustments and changes in the law. Many of these limits are based on the "plan year." The elective deferral and catch-up limits are always based on the calendar year. Here are the 2014 limits as well as the 2013 limits for comparative purposes:

Limit	2014	2013
Maximum compensation limit	$260,000	$255,000
Defined contribution plan maximum contribution	$52,000	$51,000
Defined benefit plan maximum benefit	$210,000	$205,000
401(k), 403(b) and 457 plan maximum elective deferrals	$17,500	$17,500
Catch-up contributions	$5,500	$5,500
SIMPLE plan maximum elective deferrals	$12,000	$12,000
Catch-up contributions	$2,500	$2,500
IRA maximum contributions	$5,500	$5,500
Catch-up contributions	$1,000	$1,000
Highly compensated employee threshold	$115,000	$115,000
Key employee (officer) threshold	$170,000	$165,000
Social security taxable wage base	$117,000	$113,700

RPL
Retirement Programming Ltd.

318 Roanoke Avenue
Riverhead, NY 11901
Tel 631.727.3631
Fax 631.722.7575
www.retirementprogramming.com

Qualified Plan Design, Implementation, Administration & Consulting for:

- 401(k) Plans
- Profit Sharing Plans
- DB Pension Plans
- DB/401(k) PS Combo Plans

Est. 1975