McGUIREWOODS
Relationships That Drive Results
www.mcguirewoods.com
Publications

BENEFITS ISSUES FOR DOMESTIC PARTNERS
(Updated through March 31, 2006)

Sally Doubet King
McGuireWoods LLP
77 West Wacker Drive
Suite 4100
Chicago, Illinois 60601-1818
T: 312.849.3684
F: 312.849.3050
sking@mcguirewoods.com

Marc E. Purintun
McGuireWoods LLP
901 East Cary Street
Richmond, Virginia 23219-4030
T: 804.775.1161
F: 804.698.2029
mpurintun@mcguirewoods.com

Overview

Employee benefits packages represent up to 40% of the value of an employee's total compensation package. These benefits include certain allocations for spouses and children. As the definition of marriage continues to evolve and family structures become more diverse, issues continue to arise regarding benefit plans.

Currently, the Defense of Marriage Act, a federal statute, prohibits the recognition of marriage between two persons of the same sex for all federal purposes. Therefore, any federal tax payments and disbursements under ERISA based plans will read the term "marriage" as strictly occurring between two persons of the opposite sex. This statute directly conflicts with a recent Massachusetts Supreme Court decision legalizing same-sex marriages. Although no other states permit same-sex couples to marry, several states recognize other forms of civil commitments.

This outline presents an overview of federal and state laws relating to domestic partnerships and marriage. It then discusses the major issues relating to employer sponsored benefit plans. These issues include the availability of access to benefits for domestic partners, the taxability of benefits to the employee which are non-taxable benefits when provided to a "legal spouse" and the circumstances under which a domestic partner may be treated as a surviving spouse for benefit purposes. The outline describes the benefits that may be offered to domestic partners and same-sex spouses. Next, the outline discusses some of the specific actions that employers must take when domestic partners terminate their relationship. Finally, the outline gives a general overview of federal income taxation issues relating to employer provided benefits for the domestic partners or same-sex spouses of employees.

The law in this area is constantly evolving. At times it can even be contradictory. The best means of handling these issues is for a company to clearly define the terms of benefits that it will provide in the plan itself. At this point, plan language that expands the definition of "spouse" to include domestic partners will generally override the definitions imposed by the Defense of Marriage Act. However, the law relating to domestic partner arrangements can change quickly and employers and plan sponsors must track these changes and the impact on benefit plans.

BENEFITS ISSUES FOR DOMESTIC PARTNERS

TABLE OF CONTENTS

BENEFITS ISSUES FOR DOMESTIC PARTNERS

I. Defining Domestic Partners for Employee Benefits Purposes.

1. There is no uniform definition of a Domestic Partner. In several states and municipalities there are formal procedures for couples to register as domestic partners. In the absence of a legally recognized domestic partnership, many employers have established policies that define eligibility for domestic partner benefits. Listed below are some of the common characteristics from these policies:
    a. The definition of a Domestic Partner can include same-sex or opposite-sex partners.
    b. A Domestic Partner stands in the place of a spouse for one or more employee benefits to which an employee may be entitled.
    c. Under most definitions, qualifications for recognizing a domestic partnership include one or more of the following: (i) living together for a specified period of time (*e.g.* six months); (ii) responsibility for each other's financial welfare; (iii) a requirement that partners are not blood relatives; (iv) a requirement that each partner is at least 18 years of age; (v) mental competency of both partners; (vi) partners would legally marry should the option become available; and (vii) neither partner is legally married to anyone else.[1]
2. Domestic partners should agree to inform the employer in the event that the domestic partnership terminates.
3. Employers may require registration or certification upon enrollment for benefits. These requirements may be dependent on the availability of registration or certification. Documentation of proof of a domestic partner relationship may include a written statement signed by the partners or proof of some financial relationship, such as a joint lease or mortgage. The employer may decide what documentation is appropriate, provided that the form of documentation is germane to the issue of validating a domestic partnership.

II. Same-Sex Marriages for Employee Benefits Purposes.

1. At this time, same-sex couples in the United States are able to legally marry in the Commonwealth of Massachusetts only. In addition, same-sex couples can be legally married in Canada, Spain, the Netherlands and Belgium.
2. Forty-five states specifically define marriage as between a man and a woman either by statute or constitutional amendment.
3. Courts in several states, including California, Connecticut, Maryland, New Jersey, Washington and Iowa, are considering whether state law prohibitions against same-sex marriages are constitutional.

4. Employers in Massachusetts and other states will need to consider how they will treat the same-sex spouses of their employees. . Key considerations include:
    a. whether the marriage is legally recognized in the state in which the employer's business exists;
    b. how federal and state laws treat the same-sex marriage and the benefits provided to the same-sex spouse and
    c. what effect declining to recognize an employee's same-sex spouse will have on the employer's relationship with the employee.

III. Issues Driving the Focus of Changes to Employee Benefits Provided by Employers.

1. Employee benefits represent up to 40% of the value of an employee's total compensation package.
2. Unmarried employees may forego some of this extra compensation or extra value derived from certain benefits.
3. Unmarried employees have raised the issues of fairness and, in some cases, filed claims or suits based on discrimination claims.
4. Employers must be aware of these issues, design plans in response to these issues, and balance competing or conflicting benefits issues under state and federal law.

IV. The Law Relating to Domestic Partner Benefits.

1. The Defense of Marriage Act ("DOMA") is a federal law that defines marriage. *28 USCA Sec. 1738C (1996).*
    a. DOMA states: "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."
    b. The language contained in the Defense of Marriage Act permits states to prohibit the recognition of legally contracted same-sex marriages. The pertinent language is: "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."

c. The Defense of Marriage Act applies to all interpretations of "marriage" and "spouse" under federal law, including ERISA plans.

i. The definition of "legal marriage" is not contained in any federal statute. This is significant because common law marriages may have tax implications. Employers should review benefit enrollment forms to ensure that the type of marriage is noted.

ii. It appears that common law marriages are "legal" marriages for the purposes of DOMA, but no courts have ruled on this since the inception of DOMA.

iii. Therefore, plan language defines what the plan will recognize as a spouse.[2]

iv. If there is no specific plan language, then state law defines what a "legal" marriage is.[3]

1. Only twelve states recognize common law marriages contracted within their borders: Alabama, Colorado, Iowa, Kansas, Montana, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Utah and the District of Columbia.

2. The United States Constitution requires every state to accord "Full Faith and Credit" to the laws of its sister states. Thus, a common-law marriage that is validly recognized in a state where such marriages are legal will be valid even in states where such marriages are not permitted and may be contrary to public policy.

3. In a few jurisdictions, statutes regarding the recognition of foreign marriages may be interpreted to preclude local recognition of common law marriages allegedly entered into in another state. In the absence of such a statute, a common law marriage is recognized as valid if it was valid under the law of the jurisdiction where it was entered into regardless of whether common law marriages may be entered into in the state. *Am. Jur. POF 2d 441 §7.*

d. Since DOMA only refers to marriage, it does not directly affect state law regarding the status of domestic partners.

2. On July 14, 2004, the Senate voted against moving forward with a proposal to amend the United States Constitution to ban marriage between partners of the same sex.

3. Overview of state law relating to domestic partners.

a. Vermont, California, Connecticut, Hawaii, Massachusetts, Maine and New Jersey legally recognize some form of non-married partnership.

b. Forty-four states have statutes similar to the Defense of Marriage Act. Therefore, the law of these states bans the recognition of marriage between persons of the same sex.

i. States that ban the recognition of same-sex marriage include:

1. Nineteen states have amended their state constitution to ban same-sex marriage: Alaska, Arkansas, Georgia, Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, Oregon, Texas and Utah.

2. Twenty-five states have laws defining marriage as between a man and a woman: Alabama, Arizona, California, Colorado, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Minnesota, New Hampshire, North Carolina, Pennsylvania, South Carolina, South Dakota, Tennessee, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming.

3. Eight of these states have adopted the Uniform Marriage and Divorce Act.

a. This Act prohibits marriages between persons of the same sex. It declares marriages between persons of the same sex as void in the state.

b. States that have adopted the Act include Arizona, Colorado, Illinois, Kentucky, Minnesota, Missouri, Montana, and Washington.

ii. Six states and the District of Colombia do not ban the recognition of same-sex marriages: Connecticut, Massachusetts, New Jersey, New Mexico, New York, Rhode Island.

4. Survey of Specific state law developments.

a. **Vermont:** As of July 1, 2000, Vermont recognizes same-sex civil unions granting same-sex couples all of the same rights and obligations under state law as marriage. *15 VT. STAT. ANN. §§ 1201(4); 23.*

i. Insurers in Vermont must cover partners in civil unions and their dependents if they cover traditional spouses and dependents.

ii. ERISA pre-empts benefit programs of private employers, unless the program is governed by state insurance law. Therefore, self-insured ERISA benefits programs are not required to cover partners in civil unions and their dependents.

b. **Massachusetts:** As of May 18, 2004, the state recognizes same-sex marriages.

i. On November 18, 2003, the Supreme Judicial Court of Massachusetts held that "barring an individual from the protections, benefits, and obligations of civil marriage solely because that person would marry a person of the same sex violates the Massachusetts constitution." *Goodridge v. Dept. of Public Health*, 440 Mass 309 (2003).

1. Because of the change in law, employers must review their plan documents.

    a. Since same-sex spouses are treated differently under federal law than state law, employers may need to improve documents to clarify whether a spouse is a same-sex spouse or an opposite-sex spouse.

    b. If employers would like to include same-sex spouses, plans should be amended to specifically include same-sex spouses so as to prevent confusion of applicable law in the interpretation of who is covered by the plan.

2. The fair market value of employer provided benefits that extend to same-sex spouses may be taxable as income for the employee for federal tax purposes, but tax free for state tax purposes. Employers are required to withhold the appropriate taxes.

3. Although state law requires same-sex marriages to be treated the same as opposite-sex marriages, employers may not be required to provide benefits to same-sex spouses.

4. ERISA was created to implement a uniform method of providing benefits to employees. In accordance with *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001), the language of an ERISA plan will trump state family law definitions

5. A proposed constitutional amendment is working its way to the legislature. If it is approved in two successive sessions, it will be on the state ballot in 2008.

ii. On March 30, 2006, the Supreme Judicial Court of Massachusetts Court upheld the constitutionality of a 1913 state ban on providing the issuance of marriage licenses to couples who live in states where their marriages would be prohibited. Based on the 1913 statute, Governor Mitt Romney had ordered that county and city clerks not provide marriage licenses to any out of state same-sex couples. The Supreme Judicial Court narrowed this application of the statute to those states that specifically prohibit same-sex marriages. The court returned to the Superior Court the cases of

three couples from New York and Rhode Island, states that do not specifically prohibit same-sex marriages for a determination of whether the couples are eligible for marriage licenses in Massachusetts. *Cote-Whitacre et al. v. Dept. of Public Health,* 2006 Mass. Lexis 110.

c. **Connecticut:** On April 21, 2005, the Connecticut legislature approved Substitute Senate Bill 963 which creates civil unions for same-sex couples (effective Oct. 1, 2005).

   i. The law confers all state-level spousal rights and responsibilities on parties to a civil union.

   ii. Connecticut is the first state to establish civil unions voluntarily, without having been ordered to do so by a court.

   iii. For state income tax purposes, employer and employee contributions will be exempt from income taxation.

d. **California:** Developments are occurring at the state and local level.

   i. The California Domestic Partners Rights and Responsibilities Act of 2003. *Cal. Fam. Code § 308.5*

      1. Effective January 1, 2005, domestic partners in California will have most of the rights and duties associated with marriage and will be treated as "spouses." This includes the right to family medical leave to care for a domestic partner.

      2. Under Cal. Fam. Code § 308.5, employers are not required to extend benefits to domestic partners.

      3. This act includes a provision requiring that some domestic partner registrations from outside California will be recognized. Currently only Vermont civil unions meet these requirements.

   ii. California's Equal Benefits in State Contracting Act. *AB 17.*

      1. This act will be effective for contracts executed or amended on or after January 1, 2007.

      2. Any company contracting with California will be required to provide domestic partner benefits to all of the company's employees who provide goods or services that relate to the contract.

      3. This act applies only to domestic partnerships registered with the California Secretary of State.

   iii. On March 14, 2005, a San Francisco Superior Court held that statutes limiting marriage to a union between a man and a woman

do not rationally relate to a legitimate state purpose and violate the state equal protection clause. *In re Coordination Proceeding*, 2005 WL 583129, March 14, 2005. This decision is currently on appeal.

iv. On September 5, 2005, the California Legislature passed the Religious Freedom and Civil Marriage Protection Act, *A.B. 19*, which would have permitted same-sex-couples to legally marry in California. Governor Schwarzenegger vetoed the bill on September 29, 2005.

v. San Francisco:

1. San Francisco Mayor, Gavin Newsom, ordered approval of licenses for same-sex marriages on February 12, 2004. These acts were temporarily halted on March 11, 2004 pending legal challenges. The California Supreme Court ruled on August 12, 2004 that Mayor Newsome exceeded his authority and that the marriage certificates issued to same-sex couples were invalid. *Lockyer v. San Francisco,* 17 Cal. Rptr. 3d 225 (Cal. 2004).

2. San Francisco has adopted an ordinance prohibiting discrimination in benefits for parties contracting with the City. *Chapter 12B of the San Francisco Administrative Code.* The Ordinance was upheld as an exception to ERISA preemption in situations where the City acts as a "market participant," wielding no more power than an ordinary consumer, but not when the City's role is one of a regulator. Thus, when the City deals with airlines at its city-owned airport and acts as a regulator, the ordinance is preempted by ERISA. *Air Transport Association of America v. The City and County of San Francisco,* 266 F. 3d 1964 (9th Cir. 2001).

e. **Hawaii:** Hawaii's Reciprocal Beneficiaries Law provides some marriage-like benefits. *Haw. Rev. Stat §43:10A.*

i. Any two state residents who are over 18 and not permitted to marry can register as reciprocal beneficiaries.

ii. Couples who sign up gain some of the rights and benefits granted by the state to married couples. These rights and benefits include hospital visitation rights, the ability to sue for wrongful death, and property and inheritance rights.

f. **Nebraska**: On May 12, 2005, a federal district court struck down Nebraska's constitutional amendment banning marriage between same-sex couples.

i. The state filed an appeal in the U.S. Court of Appeals for the 8th Circuit. *Citizens for Equal Protection, Inc., et al v. Attorney General Jon Bruning, et al*, case number 05-2604. Oral arguments were February 13, 2006. A decision is expected later this year.

g. **New Jersey:** Legislation entitled the Domestic Partnership Act was signed on January 12, 2004. This legislation will extend health and pension benefits to domestic partners of state and government employees. This act took effect on July 10, 2004. This legislation covers opposite-sex couples over the age of 62 and same-sex couples of all ages.

i. Included in these rights is the right to make healthcare decisions and have spousal-status for hospital visitation.

ii. Health insurers must provide coverage if the employer includes domestic partners. This rule applies only to insured arrangements.

iii. Employers are not mandated to provide domestic partner coverage.

iv. Under this Act, domestic partners can take a $1,000 state income tax dependent deduction for a non-working partner.

v. Domestic partners would qualify for a state inheritance tax exemption on the same basis as a spouse.

vi. This act also includes protection against discrimination in employment and housing.

h. **New York:** No provision of New York Law bans the recognition of same-sex marriages celebrated in another jurisdiction.

i. The Attorney General has interpreted New York's Domestic Relations Law to prevent the authorization of the issuance of licenses to same-sex couples in New York. The Domestic Relations Law does not have a specific requirement that marriage be between a man and a woman, but it does make gender specific references. *§15(1)(a) of DRL; §12, §6.*

ii. It appears that same-sex marriages and civil unions lawfully entered into in other jurisdictions outside the state will be recognized in New York.

iii. On June 7, 2004, New York City Mayor, Michael Bloomberg, vetoed legislation to require all city contractors to provide equal employment benefits to all employees, whether they are married or in domestic partner relationships. The City Council passed the measure over Mayor Bloomberg's objections. On February 14, 2006, the Court of Appeals upheld a lower court ruling that held that the city statute conflicted with competitive bidding requirements in state law and was invalid.

iv. On February 5, 2005, the New York state Supreme Court ruled that under the state constitution, same-sex couples could not be denied the right to marry. *Hernandez v. Robles*, 794 N.Y.S.2d 579 (N.Y. Sup. 2005). On December 8, 2005, the Appellate Division of the Supreme Court of New York vacated the lower court's ruling. *Hernandez v. Robles*, 805 N.Y.S.2d 354 (N.Y. App. Div. 1st Dep't 2005). This decision has been appealed to the New York's highest court, the Court of Appeals.

i. **Illinois:** Illinois expressly prohibits marriages between same-sex couples.

i. The Illinois Codes states: "The following marriages are prohibited… a marriage between 2 individuals of the same sex." *750 ILCS 5/212 (a)(5).*

ii. Illinois also will not recognize same-sex marriages validly contracted outside of the state.

1. Marriages contracted outside of the state are valid unless they are contrary to public policy.

2. "A marriage between two individuals of the same sex is contrary to public policy of this state." *750 ILCS 5/213.1.*

j. **District of Columbia:** No provision of D.C. law explicitly addresses same-sex marriages.

i. Washington, D.C. offers domestic partnership registry.

ii. Washington, D.C. does not ban the recognition of same-sex marriages.

k. **Alaska:** On October 28, 2005, the Alaska Supreme Court unanimously held that the state's constitutional amendment barring same-sex marriages does not permit the government to ban benefits for same-sex partners of its public employees. *Alaska Civil Liberties Union v. State of Alaska*, __ P.3d __ (Alaska 2005).

5. Public and private employer initiatives in the recognition of domestic partner benefits.

a. State employers.

i. California, Connecticut, New Jersey, New Mexico and Washington provide benefits to same-sex domestic partners only.

ii. Illinois, Iowa, New York, Oregon, Rhode Island, Vermont and the District of Columbia provide benefits to both same-sex and opposite-sex domestic partners.

b. As of the end of 2004, 185 cities, county and quasi-governmental agencies provide benefits to same-sex domestic partners.

c. Private employers.

i. 23% of companies now offer domestic partner benefits.[4]

ii. As of March, 2006, 8,280 private sector employers offer domestic partnership benefits.[5] 249 are Fortune 500 companies.

6. Equal benefits ordinances.

a. Eleven jurisdictions require parties contracting with them to provide domestic partners with equal benefits as spouses.[6] These jurisdictions include the State of California; Berkely, CA; Davis, CA; King County, WA; Los Angeles, CA; Minneapolis, MN; Oakland, CA; San Francisco, CA; San Mateo County, CA; Seattle, WA; Salt Lake City, Utah; and Turnwater, WA.

b. Similar ordinances exist in other jurisdictions.

i. Portland, ME requires organizations that receive funds from the city's Housing and Community Development Program to provide the same benefits to employees' domestic partners as it offers to employees' legal spouses. *Portland Code of Ordinances, Sect. 13.6-34.*

ii. Broward County, FL permits the county to extend a bidding preference of 1% of the bid or proposal price to a contractor providing equal benefits to domestic partners. *Broward County Code of Ordinances Sec. 16 1/2-15.*

iii. Sacramento, CA requires that contractors that are required to have non-discrimination provisions are also required to allow employees to take leave to care for domestic partners if they allow unpaid related personal leave to any other group of employees. *Sacramento City Code, Ch. 2.120.070.*

c. New York City Mayor Bloomberg introduced an initiative to help businesses with 50 or fewer employees expand coverage for domestic partners of employees. *Exec. Order 72.*

7. Insurance coverage requirements.

a. State insurance law may stipulate that if coverage is provided for spouses and dependents, it must also cover domestic partners and their dependents.

b. State insurance law requirements do not apply to self-insured group health plans covered by ERISA.

i. Vermont Insurance Law requires insurance contracts and policies offered to married persons and their families to be made available to parties to a civil union and their families. *15 VSA 23 1204(e)(5).*

ii. In Massachusetts and states requiring the recognition of valid same-sex marriages, insured group health, life, or disability plans will treat same-sex spouses as opposite-sex spouses.[7]

iii. Maine law requires group health insurance policies to offer coverage to an insured employee's non-spousal domestic partner at appropriate rates and under the same terms and conditions as those benefits or options for benefits are provided to spouses of married enrollees covered under the policy. *Maine Rev. Stat. Ann. 24-A §§ 2319-A; 2832-A; 4249.*

iv. California Health Care Service Plans. *Cal. H. & S. Code § 1374.58; Cal. Ins. Code § 10121.7*

1. Effective January 2, 2005, this act requires group health plans in California to offer the same level of coverage for registered domestic partners of employees as is provided for employees' spouses.

2. For this purpose, "registered" means that the partner is the subject of a valid Declaration of Domestic Partnership filed with the California Secretary of State.

V. Overview of Domestic Partnership Issues Related to Employer Sponsored Plans.

1. The major issues under employer-sponsored benefit plans include: (1) the availability of or access to benefits for domestic partners; (2) the taxability of benefits to the employee, which are non-taxable benefits when provided to a "legal spouse"; and (3) whether or when a domestic partner may be treated as the surviving spouse for benefit purposes.

2. Employers should determine whether the plan or benefit in question is covered by ERISA or another federal statute such as CHAMPUS, FEHBP or NLRA.

   a. Plans or benefits that are <u>not</u> covered by ERISA, will generally be governed by state law.

   b. In general, plans or benefits covered by ERISA will be governed by federal statute. If there is a conflict in law, the federal statue will generally pre-empt state law.

3. If the plan is covered by ERISA, the term "spouse" will be given the meaning set forth in the Defense of Marriage Act for purposes of federal law. Thus, when a plan says "spouse", "surviving spouse", or "legal spouse", the interpretation will be the legal union of a man and a woman.

4. Employers can design benefit plans with terms and conditions that are broader than is required by ERISA and the Internal Revenue Code (the "Code"), as long

as the tax consequences are addressed and they do not violate federal, state or local law.

a. For example, employers can define "spouse" to include a same-sex spouse in a marriage valid under applicable state law.

b. No cases have stated that this practice of extending coverage beyond spouses is impermissible. In addition, the IRS or the DOL have not published guidance prohibiting plans from offering broader coverage than is required.

c. Employers should be accurate in defining who can receive benefits under plans because courts have held that the consequences of an inaccurate SPD are placed on the employer. *Burke v. Kodak Retirement Income Plan* 336 F.3d 103 (2d Cir. 2003).

5. It is important for employers to be cognizant of (1) the range of employee benefit plans that may be offered to domestic partners; (2) the additional benefits that may be available to employees with domestic partners; and (3) administrative and tax issues for domestic-partner benefits under specific plans.

VI. Benefits That May be Offered to Domestic Partners or Employees with Domestic Partners.

1. Group health plan coverage.

a. The tax treatment of employer-provided health coverage.

i. Employees, spouses, and dependents are not taxed on employer-provided health coverage. *IRC Sec. 106.*

ii. An employee will be taxed on the value of coverage provided to the employee's domestic partner unless the domestic partner qualifies as the employee's dependent under IRC Sec. 152(a).

iii. To qualify as an employee's dependent under IRC Sec. 152(a), the domestic partner must qualify as a "qualifying relative" as defined in IRC Sec. 152(d)(1). The following criteria must be established:

1. The employee's home must be the domestic partner's principal residence for the entire year.

2. The domestic partner must be considered a member of the employee's household.

3. The domestic partner's gross income for the calendar year is less than the exemption amount as defined in IRC Sec. 151(d). **Note: This requirement does not apply for purposes of the exclusion from income of employer provided group health coverage.**

4. The employee provides more than half of the domestic partner's support for the year.

5. The domestic partner must not be a qualifying child, as defined in IRC Sec. 152(c), of the employee or any other person during the taxable year.

iv. Under IRC Sec. 152(f)(3), a domestic partner will not be considered a member of a taxpayer's household "if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law." This provision was added to the statute in the 1960s after a court case which involved a married taxpayer claiming as a dependent his mistress. Some commentators have suggested that local laws prohibiting same-sex sexual contact would be applicable and therefore prevent a taxpayer from claiming a domestic partner as a dependent. However, as the Supreme Court has struck down all laws prohibiting private sexual contact between consenting adults, it appears that domestic partnerships between persons of the same or opposite sex cannot be deemed a violation of local laws. *Lawrence v. Texas*, 539 U.S. 558 (2003). Therefore, this requirement appears to have not effect.

v. When a domestic partner does not qualify as a spouse or dependent under IRC Sec. 152, the value of the health coverage provided to the domestic partner and dependents of the domestic partner, less the amount paid by the employee for the coverage, is taxable income to the employee for federal income and FICA tax purposes and most state income tax purposes (see Section IX for specific discussion of state income tax treatments).

1. A fringe benefit provided in connection with the performance of services is considered to be compensation for services. *Treas. Reg. Sec. 1.61-21(a)(3).*

2. A taxable fringe benefit must be included in an employee's income. *Treas. Reg. Sec. 1.61-21(a)(4).*

3. The includible amount is the fair market value of the benefit, less the amount paid for the benefit and any amount specifically excluded from gross income by another Code Section.

a. If a domestic partner is not a dependent, the employee must pay tax on the fair market value of the health plan provided to the domestic partner. *PLR 200339001.*

i. The fair market value is the amount that an individual would have to pay for the benefit in an arm's length transaction. *IRC Reg. §1.61-21(b)(2).*

ii. The value is includable in wages for employer withholding purposes. *Rev. Rul. 56-632.*

b. Therefore, if the fair market value of the health coverage for the domestic partner and the domestic partner's dependents is not excludable under IRC Sec. 106, the fair market value, less the premium paid by the employee, is included in the employee's gross income as non-cash compensation.

i. An IRS Private Letter Ruling indicates that the fair market value will be the cost of coverage in the individual insurance market;

ii. Generally, this approach is not widely followed. Instead, the predominant valuation of the fair market value is the COBRA rate less 2%.[8]

4. Currently, the Domestic Partner Health Equity Act is pending in Congress. The act would eliminate the inequities in the Code by including in the definition of "dependent" any individual who is an eligible beneficiary as defined in the insurance arrangement which constitutes medical care. *S. 1360.*

vi. When benefits are paid under the group health plan to or on behalf of the domestic partner, neither the domestic partner nor the employee will be taxed on those payments. The tax treatment of domestic partner benefits is discussed in further detail in IRS Private Letter Rulings PLR 200339001, PLR 200108010, PLR 9850011, and PLR 9717018.

vii. The amount of includable income with respect to domestic partner benefits is subject to FICA and FUTA taxes.

1. Both the employer and the employee must pay 7.65% FICA payments on the taxable amount. They will only need to pay 1.45% for the Hospital Insurance amount if the employee's compensation exceeds the Social Security taxable wage base. In 2006, this amount is $94,200. *IRC Sec. 3306(b)(2).*

2. This additional income is also subject to contributions under FUTA. This tax will only be paid by the employer. It is important to note that the additional income will have a limited impact since FUTA is payable only on the first $7,000 in compensation. *IRC Sec. 3306(b)(1).*

3. *Example*: A has a salary of $45,000 and is in the 28% bracket. His employer gives him health coverage including $3,500 for his domestic partner, B. A must include $3,500 in income at a tax cost of $980. He also must pay social security taxes of $267.75 (consisting of $217 for OASDI (6.2% of $3500)) and $50.75 for HI (1.45% of $3500). A realizes no income as a result of the coverage. Neither A or B will be charged when either received services under the plan.[9]

viii. The Employer can deduct health care costs relating to the employee and the domestic partner or dependents of the domestic partner.

ix. State regulation of stop loss coverage will probably not impact employer group health plans because stop loss coverage is designed to protect employers. Courts generally refuse to impose state coverage mandates on these types of plans.[10]

b. Social repercussions.

i. Currently, marriage is not a legally protected class. Therefore, it is not discriminatory to offer benefits to married persons that are not offered to unmarried persons. However, the issue of domestic benefits can be important to both current and potential employees.

ii. A decision to restrict family benefits to married persons could limit the pool of available employees. Additionally, if marital status becomes a protected class, employers may be held liable for not offering equitable benefits.

2. Cafeteria Plans, FSAs and COBRA Issues for Domestic Partners.

a. Domestic partner benefits are available only on an after-tax basis; therefore, premiums for domestic partner coverage are not payable through an IRC Sec. 125 plan.

b. Similarly, medical expenses of domestic partners or their dependents generally may not be reimbursed under a health flexible spending account.

c. Domestic partners who qualify as "dependents" under IRC Sec. 152 may be eligible for pre-tax benefits under IRC Sec. 125, including a health flexible spending account.

d. If an employee terminates employment, dies or separates from his domestic partner, the domestic partner will not be considered a "qualified beneficiary" for COBRA purposes.

i. Qualified beneficiaries are limited to spouses and dependent children. The definition contained in the Defense of Marriage Act will be used to interpret "spouse" as the employee's opposite-sex legal spouse.

ii. Some states have mini-COBRA laws for employers with 2-19 employees. Under these laws, same-sex spouses may be entitled to continuation rights. Employers should look to insurance contracts and stop loss policies to make sure claims by a same-sex spouse or domestic partner are covered.

e. Timing issues.

i. Federal law (HIPAA) generally requires medical plans to provide special enrollment periods.

1. Spouses and dependents may be added in the case of birth, marriage, adoption or placement for adoption.

2. The Defense of Marriage Act applies. Therefore, there is no statutory right to add a same-sex spouse outside of the enrollment period.

ii. Employers can amend their plans to permit changes outside of the enrollment period. Employers should check for the effect of the amount paid, on a pre-tax basis, on the cafeteria plan.

3. Survivor benefits.

a. Life insurance on the employee and "surviving spouse" benefits.

i. In the absence of a contrary definition in the plan, ERISA plans that provide death benefits for the "spouse" or "surviving spouse" will be interpreted to mean the opposite-sex husband or wife of the employee.

1. ERISA plans will follow the definition of "spouse" under the Defense of Marriage Act.

2. Plan language should be reviewed to correct any ambiguities.

3. Employers that wish to extend this coverage to domestic partners should amend plans, summary plan descriptions, beneficiary designation forms and other employee communications to ensure that policies and procedures are clear.

4. An employer's failure to include specific language informing employees that domestic partner certification is required to receive survivor benefits violates ERISA. *Burke v. Kodak Retirement Income Plan*, 336 F.3d 103 (2d Cir. 2003), cert. denied, 124 S. Ct. 1046 (2004).

ii. When plans provide for beneficiary designations, absent prohibitive language in documents and forms, the employee may designate the domestic partner as his beneficiary under group term life insurance, accidental death and dismemberment and supplemental life insurance on the life of the employee.

1. ERISA doesn't interfere with state law relating to insured arrangements.

2. However, employers with insured plans should consult with the insurance carrier to determine whether the carrier will provide coverage for the employee's domestic partner or the dependent children of the employee's domestic partner.

b. Survivor benefits under qualified retirement plans.

i. Profit-sharing, 401(k) and other defined contribution plans.

1. Same-sex spouses aren't entitled to protections extended to spouses in traditional marriages.[11] These include the right to survivor and pre-retirement survivor annuities under pension plans, the right to death benefits under 401(k) plans and the right to consent to the distribution of tax qualified retirement plans or to employee's non-qualified designation of a non-spouse beneficiary.

2. Plan design options.

a. For the most part, employers are free to extend benefits as they choose. However, under current laws, there are some limits on an employer's ability to extend qualified retirement plans.

i. Favorable minimum required distribution rules for couples who are less than 10 years apart can't be extended to same-sex married couples.[12]

ii. Same-sex spouse can't defer commencement of benefits to the date when the spouse would have been 70.5 years old.[13]

iii. Rollover rules for IRAs and other tax favored retirement plans do not extend to same-sex spouses.[14]

b. Absent specific plan provisions equating a domestic partner to a surviving spouse, the only way to ensure benefits for a domestic partner is a valid beneficiary designation form. These forms should use the specific name, and not only a designation of "spouse" or "domestic partner."

ii. Traditional defined benefit pension plans.

1. A domestic partner will not be considered the surviving spouse for purposes of the qualified joint and survivor annuity (QJSA) or the qualified pre-retirement survivor annuity (QPSA) under IRC Sec. 417.

2. Under the Defense of Marriage Act, the surviving spouse will be the opposite-sex husband or wife of the employee.

3. If an employer wants to extend QJSA and QPSA benefits to domestic partners or same-sex spouses, the plan documents, including SPDs and forms, must be amended and administrative procedures must be revised to provide for the expanded definition of "surviving spouse" under the plan.

4. Plan extension is not prohibited, but the plan documents must accurately reflect the extension.

iii. Rollover effects.

1. A domestic partner will not be considered a "surviving spouse" for purposes of an eligible rollover distribution to an IRA or another qualified plan.

2. Under IRC Sec. 402(c)(9), the rollover rules apply to the spouse of an employee who receives a distribution from a qualified retirement plan after the employee's death.

3. Because the Defense of Marriage Act applies to the interpretation of IRC Sec. 402(c)(9), requiring the spouse to be the opposite-sex husband or wife of the employee, the plan sponsor cannot at this time amend or operate the plan to provide for eligible rollovers to domestic partners or same-sex spouses.

4. Therefore, only opposite-sex spouses are entitled to the benefit of a tax free rollover.

iv. Spousal consent to elect a non-spouse beneficiary is required by IRC 401(a)(13)(C)(iii).

1. The Code uses the word "spouse." This indicates that the Defense of Marriage Act will apply. Therefore, there is a presumption that the spousal consent requirement will not apply to same-sex spouses.

2. In each section, the Code uses "such spouse." Therefore, the Defense of Marriage Act's interpretation of "spouse" will apply to the application of the spousal consent section of the Code.

4. Dependent Life Insurance Coverage.

    a. The spouse or dependents of an employee may participate in group term life insurance coverage. The employee will be taxed on this coverage to the extent that the cost exceeds a *de minimis* fringe benefit under IRC Sec. 132(e)(1).

    b. Domestic partners and dependents of domestic partners may be covered under the employer's dependent group life insurance plan. However, no part of the cost of the coverage to the employee can be excluded as a *de minimis* fringe benefit under the IRC Sec. 132 regulations unless the Domestic Partner is the employee's dependent under IRC Sec. 152(a).

    c. Thus, the cost of the coverage is determined in accordance with the applicable tables under IRC Sec. 79 regulations.

    d. The proceeds payable upon death of a covered domestic partner or dependent of the domestic partner will be excluded from taxable income pursuant to IRC Sec. 101(a). *See PLR 97017918.*

5. Other Fringe Benefits.

    a. Employers may extend other non-taxable benefits to employees and domestic partners. Examples include family/sick leave, bereavement leave, relocation benefits, access to employer facilities, attendance at employer functions and education/tuition assistance.

    b. While employers generally are free to design policies that include or recognize domestic partners, the courts have often concluded that there is no legal basis for mandating coverage.

        i. Since the Family and Medical Leave Act is a federal statute, it does not regulate time off to care for a sick domestic partner or relative of a domestic partner. Therefore, if an employer grants an employee leave to take care of the employee's domestic partner or same-sex spouse, this leave will not be FMLA leave. The employee will not have diminished the FMLA leave for which the employee is eligible. If the employee becomes eligible for FMLA leave, the employer will be obligated to permit the employee to take additional leave time up to the FMLA limit.

ii. The Defense of Marriage Act will interpret "spouse." Therefore, employees are not entitled to paid time off or family leave to care for a domestic partner.

iii. Several states require employers to allow employees to take comparable family leave for domestic partners (California, New Jersey, Hawaii, Vermont and the District of Columbia).

iv. A funeral leave policy covering state employees that grants paid leave for the death of a close relative of an employee's spouse, but not for a domestic partner, does not violate the privileges and immunities clause of the Indiana constitution. *Cornell v. Hamilton*, 791 N.E. 2d 214 (Ind. Ct. App. 2003).

VII. Employer's Role When Partners Terminate Their Relationship

1. When domestic partners terminate their relationship, employers must take certain actions.
2. Employers should make sure all materials and certifications indicate that the employee is responsible for notifying the employer of termination of the domestic partner relationship. Failure to do so may be cause for termination of the employee's benefits or other disciplinary action. It is good practice to extend this clause to married couples. Therefore, liability for wrongfully paid domestic benefits will be imposed on the employee.
3. Domestic partners and dependents of domestic partners are not entitled to COBRA continuation coverage under the employer's group health plan. A self-funded plan may be amended to provide for continuation coverage; insured plans will be subject to applicable state law.
4. Employers should use Summary Plan Descriptions and open enrollment reminders to advise employees to change beneficiary designation forms.
5. Under IRC Sec. 414(p), a spouse or former spouse for purposes of a Qualified Domestic Relations Order ("QDRO") would be the opposite-sex husband or wife of the employee.
    a. In accordance with the Defense of Marriage Act, same-sex spouses will not be recognized as a "spouse" for purposes of a QDRO as an alternate payee.
        i. An alternate payee can only be a spouse, former spouse, child or other dependent of the participant.[15]
        ii. Federal courts have exclusive jurisdiction over determining whether an issued domestic order is a Qualified Domestic Relations Order.[16]
        iii. In divorces, plan benefits can be apportioned only under a QDRO.

1. This is important because plan assets may not be transferred to anyone other than a participant.
2. Divorce orders for same-sex spouses will not qualify.
3. ERISA requires these types of plans to provide death benefits to spouses.
4. The Defense of Marriage Act prevents distribution of all or part of the account balance of a same-sex alternate payee.[17]
5. Benefits can be voluntarily extended.

b. However, it is not clear at this time how a plan administrator would handle a domestic partner/same-sex spouse seeking a QDRO as a dependent of the employee.

VIII. Federal Income Taxation Issues

1. Tax treatment of employer provided benefits generally.
    a. Medical benefits or reimbursement paid under an employer's plan are not taxable income to employees, their spouses and dependents.[18]
    b. Generally, amounts paid by employers as premiums for coverage of employees and their spouses and dependents are not taxable.[19]
    c. Employees can pay employer provided health premiums on a pre-tax basis.[20]
    d. Employers can deduct premiums paid for health coverage of employees. The deduction is not lost or reduced when the employer chooses to cover a domestic partner.[21]
2. Tax treatment of employer provided benefits for the employees same-sex spouse of domestic partner.
    a. Under DOMA, a "spouse" is defined to be the opposite-sex married spouse of an individual. DOMA provides that a legal same-sex marriage is disregarded for all federal purposes. In addition, DOMA permits any state to disregard a same-sex marriage validly solemnized in another state.
    b. The provisions of DOMA apply to all acts of the United States Congress, including the Code. Therefore, benefits provided to an employee's same-sex spouse will be treated for federal tax purposes the same as benefits provided to an employee's domestic partner.
    c. In a private letter ruling, the IRS has stated that while a domestic partner is not the employee's "spouse" for purposes of the Code, the domestic partner may be the employee's dependent if the requirements of Code Section 152(a) are met. In order for a same-sex spouse or domestic

partner to be an employee's dependent for purposes of health care coverage the following requirements must be met:

i. the domestic partner or same-sex spouse must receive more than half of his or her support for the tax year from the employee, and

ii. he or she must have been a member of the employee's household during the employee's entire taxable year.

d. If the domestic partner or same-sex spouse is an employee's dependent under Code Section 152, the value of the coverage provided will not be included in the employee's taxable income and will not be subject to FICA taxes. In addition, the employee's share of premiums for health coverage may be deducted from the employee's pay on a pre-tax basis. The IRS has ruled that an employer may rely on an employee's notarized affidavit that his or her domestic partner [or same-sex spouse] qualifies as a dependent under Code Section 152, if the affidavit is renewed annually.

3. Dependent care assistance programs under IRC Sec. 129(a) gross income does not include amounts paid or incurred by the employer for dependent care assistance provided to the employee for care of the employee's spouse or dependent. Thought the spouse must be an opposite-sex spouse, a domestic partner or same-sex spouse who is also the employee's dependent, may be eligible to coverage under such plans.

IX. State Income Taxation Issues

1. General State Law Treatment of Benefits for Same-sex Spouses and Domestic Partners

   a. Most states treat the benefits provided to domestic partners or same-sex spouse of an employee the same as the federal government.

   b. Massachusetts is the only state to authorize same-sex marriages. To date, no other state has recognized a same-sex marriage from Massachusetts (or a foreign country such as Canada or Spain), though this may happen in New York, even before the state permits same-sex couples to get married in New York. If and when a state recognizes a same-sex marriage, the state tax treatment of benefits provided to the same-sex spouse will likely change.

2. State-by-state variations on taxation of benefits for same-sex spouses and domestic partners.

   Several states have crafted alternative arrangements for unmarried couples such as civil unions and domestic partnerships. Of the states that have created some recognition for non-married couples, three states, California, Vermont and Connecticut, have extended some tax benefits to the non-married couple. In general, the benefits provided to an employee's domestic partner are treated as if

the partner is the employee's legal spouse under state withholding laws, provided the partnership has been solemnized through the appropriate state agency.

a. Massachusetts

i. Because same-sex couples may legally marry with all of the state rights and benefits of marriage, if an employee benefit is tax-exempt when extended to the opposite-sex spouse of an employee, or to the children of the spouse, the benefit is tax-exempt when extended to a same-sex spouse or his or her children. Employer-provided benefits that extend to spouses, such as health insurance benefits, are excluded from gross income for Massachusetts tax purposes.

ii. Employee contributions to a cafeteria plan attributable to spousal benefits are excluded from gross income for Massachusetts tax purposes.

b. Vermont

i. The Vermont legislature passed a civil union statute in response to a state Supreme Court decision that declared the state must either create a separate but equal arrangement for same-sex couples or permit same-sex couples to become legally married.

ii. The Vermont Civil Union statute provides that for all purposes under state law, a same-sex couple in a civil union will be treated the same as an opposite-sex married couple.

iii. Under Vermont law, "[i]n determining wages subject to Vermont withholding, employers should apply the federal rules as if the employee were married to the civil union partner." Vermont Tax Bulletin-23, revised November 25, 2002. The tax bulletin provides that the Vermont Civil Union statute permits employees to exclude from wages (for purposes of Vermont wage withholding) health and other fringe benefits provided to the employee's eligible same-sex partner.

iv. The tax bulletin further provides that the statute has no effect on flexible spending accounts.

v. Under the Vermont statute, only same-sex couples are eligible to be part of a civil union.

c. Connecticut

i. The Connecticut Civil Union statute became effect October 1, 2005.

ii. The Connecticut Civil Union statute mirrors the Vermont Civil Union statute.

iii. For state income tax purposes, the same exclusions available to opposite-sex married couples are available to same-sex partners who solemnize their relationship through a civil union.

iv. The summary of the statute in the legislative history provides that employer contributions to health insurance will be exempt from taxation under Connecticut personal income tax.

v. The summary does not specifically mention income exclusion for other employee benefits; however, the language of the statute suggests that any benefit provided on a tax-favored basis for Connecticut income tax purposes to a married couple will also be available to a same-sex couple in a civil union.

vi. Under the Connecticut statute, only same-sex couples are eligible to be part of a civil union.

d. California

i. California's Domestic Partner Registry has been in existence since 1999. Same-sex couples and unmarried opposite-sex couples (if one (or both) of the parties has reached age 62 and is eligible for old-age Social Security benefits) may register as domestic partners in California. Initially, an employee could exclude from California personal income tax employer-provided health insurance premiums to his or her registered Domestic Partner; however, such premiums were included in wages for purposes of Unemployment Insurance (UI), Employment Training Tax (ETT) and State Disability Insurance (SDI).

ii. Effective January 1, 2005, California Assembly Bill 205 revised the state code to provide that registered Domestic Partners would receive the same rights, benefits and obligations as married couples. The California Employer's Guide 2005 provides that effective January 1, 2005, registered domestic partners will be treated the same as “spouses” for personal income tax, UI, ETT and SDI.

[1] Human Rights Campaign Foundation – www.hrc.org (See example certification forms attached to this outline obtained from this website.)

[2] Stahl v. Exxon Corp., 212 F. Supp.2d, 657 (S.D. Tex. 2002).

[3] Grabois v. Jones, WL 158756 (April 3, 1998) *citing* Cartledge v. Miller, 457 F.Supp. 1146, 1154 (S.D.N.Y.1978); Bond v. Trustees of STA-ILA Pension Fund, 902 F.Supp. 650, 655 (D.Md.1995).

[4] "Stephanie Armour, *Same-Sex Couples Don't Get Same Benefits,* USA Today, April 14, 2004, at B.01.

[5] Human Rights Campaign Foundation' *supra* note 1.

[6] *See id.*

[7] Alden J. Bianchi, "Employment and Benefits Involving Same-Sex Marriages in Massachusetts: An Employer's Guide.", *available at* www.mintz.com/images/dyn/publications/EBEC-Advisory-0504.pdf

[8] Alden J. Bianchi, "Employment and Benefits Involving Same-Sex Marriages in Massachusetts: An Employer's Guide." May 2004. *see id.*

[9] Pension & Benefits Week, 6/19/2000 Vol. 06, No. 26.

[10] Alden J. Bianchi "Employment and Benefits Involving Same-Sex Marriages in Massachusetts: An Employer's Guide." May 2004. Bianchi, *supra* note 7.

[11] S*ee id.*

[12] S*ee id.*

[13] *S*ee id.

[14] *See id.*

[15] U.S. Department of Labor, "QDROs...The Division of Pensions Through Qualified Domestic Relations Orders." *available at* http://www.dol.gov/ebsa/pdf/qdronet01.pdf (last checked June 23, 2004).

[16] *See id.*

[17] Bianchi, *supra* note 7.

[18] I.R.C. §105.

[19] *See id.* §106.

[20] *See id.* §125.

[21] Pension & Benefits Week, 6/19/2000 Vol. 06, No. 26.