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California Same-Sex Marriage Ruling: Employee Benefit Plan Implications

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Ruling provides further impetus for employers to address conflicting federal and state benefits-law regimes.

California has become the second state (behind Massachusetts) to allow full marriage rights for same-sex partners. On May 15, 2008, the California Supreme Court found that California legislative and initiative measures limiting marriage to opposite-sex couples violated the state constitutional rights of same-sex couples, despite an existing state registration and rights regime for domestic partners. The ruling overturns a 2000 ballot measure approved by 61 percent of California voters that stated only marriage between a man and a woman is valid or recognized.

The California Supreme Court did not rule that California must allow same-sex couples the right to enter into marriage; rather it found, to the same practical effect, that if the state allows opposite-sex couples to enter into marriage, same-sex couples must be treated equally. The decision, which becomes final and effective on June 14, 2008 (unless delayed by court order), directs state officials to ensure that state and local offices permit same-sex couples to marry as of the effective date. The decision does not revive the approximately 4,000 same-sex marriages performed at San Francisco City Hall in 2004, and later annulled by court order.

The ruling affects more than 100,000 same-sex couples in California (approximately a quarter of whom have children). Unlike Massachusetts, the California ruling does not prevent out-of-state couples from coming to California to get married. However, same-sex couples that travel to California to marry will likely find that their home state does not recognize the marriage.
The ruling will have little direct effect on California's current domestic partnership regime. Barring further legal changes, domestic partners presumably would not need to dissolve domestic partnerships in order to marry, and the domestic partnership regime would continue for those who do not wish to marry.

Beyond the immediate consequence of allowing same-sex marriages, a possible far-reaching effect of the California Supreme Court's decision is its finding that sexual orientation, like race, sex and religion, represents a "suspect classification" and that same-sex couples have a fundamental right in having their family relationship accorded the same respect and dignity enjoyed by an opposite-sex couple. These underpinnings of the decision, by what many argue is the most influential and most conservative state supreme court in the United States, if followed by other states, would require that a state wishing to maintain a statutory distinction between same-sex and opposite-sex marriage would not be able to defend the distinction merely by showing a rational, constitutionally legitimate interest that supports the differential treatment, but instead would require that the state provide a compelling interest for the distinction and show that the distinction was necessary to further the compelling state interest. The California Supreme Court is the first court to rule that a state's constitution forbids discrimination based on sexual orientation to the same extent as bias based on race, sex or religion.

Opponents of same-sex marriage have quickly mobilized. They have already submitted enough signatures, if verified, to put a state constitutional amendment on the November 2008 California ballot that would ban same-sex marriages by expressly defining marriage in the California constitution as between a man and a woman. The amendment, which would need majority approval from voters, would overturn the May 15, 2008, ruling on the right to marry, although the portion of the decision banning discrimination based on sexual orientation would remain in place. The ballot initiative does not clarify whether it would retroactively annul marriages performed before November 2008. To address this issue, it is likely

that groups supporting the ballot initiative will attempt to ask the California Supreme Court to put its ruling on hold until after the November election. At this early date, the California Supreme Court appears unlikely to grant such a request.

Same-Sex Marriages Complicate Benefit Plan Administration

To date, five countries (Canada, Belgium, The Netherlands, South Africa and Spain) and the states of Massachusetts and California have legalized same-sex marriage. Two courts, New Jersey (2006) and Vermont (1999), ruled that same-sex couples should have the benefits of marriage, but not the title. A similar case will shortly be decided by the Connecticut Supreme Court, and Iowa's top court is expected to decide a same-sex marriage case next year.

The legalization of same-sex marriage in Canada and Massachusetts has had significant consequences for employers throughout the United States, since some of their employees travel to these destinations to wed a same-sex partner. Thus far, more than 7,500 U.S. same-sex couples have been married in Canada, and more than 10,000 in Massachusetts. In California, with a population almost six times that of Massachusetts (approximately 12 percent of the U.S. population) and no ban on out-of-state couples coming to the state to marry, same-sex marriages will undoubtedly have an even greater impact on employee benefits throughout the United States.

Same-sex marriages present benefits-related difficulties for employers because federal and state governments have given mixed messages regarding the status of same-sex couples throughout the United States. Consider the following:

- Two states now allow same-sex marriage (California and Massachusetts); four states allow same-sex couples to enter into civil unions (Vermont, New Hampshire, Connecticut and New Jersey), and four other states allow same-sex couples to register as domestic partners (Hawaii, Maine, Oregon and Washington).
- However, the federal Defense of Marriage Act (DOMA) allows states to refuse to recognize other states' same-sex marriages, and, in addition to the federal DOMA, 44 states (now that California statutes have been held invalid) have laws or constitutional provisions (often called mini-DOMAs) prohibiting the performance of same-sex marriage in their states and the recognition of same-sex marriages performed in other states (California, Massachusetts, New Jersey, New Mexico, New York, Rhode Island and the District of Columbia are exceptions).
- Some state courts (including those in Massachusetts, Iowa and California) have found their state laws defining marriage as the union of one man and one woman unconstitutional. Similarly, many states have offered domestic partner benefits to their own government employees. At the same time, other states (including Michigan and Ohio) have passed state constitutional amendments defining marriage as between one man and one woman and, in some instances, even banning certain employers from offering benefits to employees' domestic partners.
- More confusingly, some states have inconsistent rulings. For example, although same-sex couples may not legally marry in New York, New York recognizes same-sex marriages that were performed elsewhere.

In light of these conflicting trends and the prevalence of spousal rights and features in employee benefit plans, employers should consider the following issues as they design and administer their plans.

Why an Employer Should Formulate a Policy Now

Given the current legal flux, some employers question whether they should establish same-sex marriage policies at all. However, individuals are marrying same-sex partners right now (with many more likely to be doing so after June 14, 2008) and will make demands (or already have made demands) for employee benefits for their same-sex spouses. Employers that are not prepared to address this issue may find themselves ill-equipped to retain and compensate their valuable employees.

What Employers Can Do: Three Questions to Ask

The most common employee requests for same-sex spouse benefits are for coverage under health and dental plans and spousal survivor annuity coverage under defined benefit pension plans. When presented with a request to provide

benefits to same-sex spouses under any type of employee benefit plan, an employer should ask the following questions:

Question One: Where was the marriage performed?

The jurisdiction in which the same-sex marriage was performed affects the "legality" of the marriage, and thus, the plan's obligation to recognize it. Was the employee legally wed in California, Massachusetts or Canada, for example? Or, did the employee participate in a marriage of "civil disobedience" performed in various locations around the United States (including San Francisco in 2004 and counties in New Mexico, New Jersey, Oregon and upstate New York) but not recognized by any state?

Question Two: Where does the employee live?

The employer's response may also depend on whether the employee lives in a state with a mini-DOMA or a state with no mini-DOMA. If the employee lives in a mini-DOMA state, the employer does not have to recognize same-sex marriages for plan eligibility purposes, although many employers voluntarily choose to extend eligibility in this situation. If eligibility is extended, it is considered an optional benefit akin to a domestic partner benefit program. (Note the tax consequences discussed below.)

If the employee resides in a state without a mini-DOMA, the employer may have to recognize same-sex marriage for plan eligibility purposes, depending on whether the plan is a self-insured plan or a fully insured plan. This is because self-insured plans (*i.e.,* plans that pay benefits out of company general assets) are governed only by federal law (including ERISA and the Internal Revenue Code) and have the flexibility to recognize or not recognize otherwise valid same-sex marriages. However, insured plans are subject to state law benefit mandates and may have to recognize same-sex marriages depending upon where the policy is issued. For example, under the California Insurance Equality Act, insurance policies issued in California must cover registered domestic partners, and insurance policies in Massachusetts now cover same-sex spouses. Presumably, California's insurance policies will have to cover same-sex spouses after June 14, 2008.

Question Three: What is the plan's definition of "spouse"?

In addition to determining what law applies to the plan, employers must also decide how to define or interpret the term "spouse." If the plan does not define the term or simply incorporates a state law definition of spouse, it should be amended to clarify the definition the employer wishes to use.

Tax Consequences

If an employer does cover same-sex spouses under its plans, it must understand the related tax consequences. The federal DOMA provides that, for all purposes of federal law, the definition of "marriage" is limited to the legal union between one man and one woman as husband and wife, and the word "spouse" means only a person of the opposite sex. For example, the federal DOMA prevents same-sex spouses from receiving benefits offered under federal statutes, including the Family Medical Leave Act, ERISA and the Internal Revenue Code. As a result, same-sex spouses (*e.g.,* those legally married in California, Massachusetts or Canada) will not receive any federal tax advantages associated with employee benefit plans unless the same-sex spouse meets the Internal Revenue Code definition of "dependent."

Unless the same-sex spouse otherwise qualifies as a dependent for federal income tax purposes, the employer must impute income to the employee equal to the fair market value of the health coverage given to the same-sex spouse. In addition, the employee may not make pre-tax contributions to a section 125 cafeteria plan on behalf of the same-sex spouse (*i.e.*, contributions for the spouse must be after tax) and may not receive reimbursement for the expenses of the same-sex spouse from flexible spending accounts (FSAs), health reimbursement accounts (HRAs) or health savings accounts (HSAs).

State tax treatment depends again on whether the employee resides in a mini-DOMA state or a state without a mini-

DOMA. In mini-DOMA states, employers must impute income for state tax purposes equal to the fair market value of the benefit coverage provided to same-sex "spouses" as they do for federal tax purposes. (The New York State Department of Taxation and Finance recently issued two advisory opinions confirming this treatment for New York residents.) On the other hand, in the six states that do not have laws or constitutional provisions limiting marriage to one man and woman, which states might recognize same-sex marriage, and in states that have special laws favoring domestic partners or civil union partners (*e.g.,* California, Massachusetts, Vermont, Connecticut, New Hampshire, New Jersey, Oregon and the District of Columbia), employers may have to subtract, for state tax purposes, any income imputed to the employee for federal tax purposes, thereby creating an additional administrative hurdle.

Steps Employers Should Take Now

Whether or not faced with a request for benefits from a same-sex couple, employers should consider the following issues in formulating their policies:

Analyze Existing HR Policies

If the employer has a policy banning sexual orientation discrimination, the employer may wish to cover same-sex spouses, regardless of legal requirements, in order to avoid the possibility of lawsuits by same-sex spouses for sexual orientation discrimination. With respect to non-ERISA plans, the employer may want to consider whether state or local laws prohibit employment discrimination on the basis of sexual orientation. Numerous states (including Illinois) have such laws that could easily apply to a failure to provide employee benefits. In New Hampshire, for example, a district court found that a public employer's refusal to provide health and leave benefits to same-sex couples violated the state's anti-discrimination statute.

Determine the Home State's Legal Requirements

If the employer's home state recognizes same-sex marriages, the employer may have to cover same-sex spouses in its fully insured plans, and the employer should consider amending its plans to cover same-sex spouses. If, however, the employer's home state does not recognize same-sex marriages, then the employer's plans may not have to cover same-sex spouses. In this case, the employer should consider amending its plans to reflect the DOMA definition of "spouse." Obviously, this analysis can be very complicated for employers operating in multiple states.

Talk to the Health Insurance Provider

Determine what action vendors and insurers are taking and where the insurance policies are sited. Depending on which state insurance laws govern the insurer, the insurer may require the employer to provide coverage of domestic partners and/or same-sex spouses that the employer has not considered.

Review Plan Documents, SPDs, Enrollment Forms and Administrative Procedures

Inventory where the employer's plan documents use the term "spouse." Consider adding, clarifying or amending the definition of "spouse" and requiring additional proof of employee marriages (*e.g.,* spouse's sex, state of marriage and licenses). Ensure that all plan documents have appropriate *Firestone* language providing for plan administrator discretion in interpreting the plan.

Coordinate Plan's Same-Sex Spouse and Domestic Partner Coverage

If the employer has a domestic partner plan, then the employer may wish to enroll same-sex spouses as domestic partners, even if the employer is in a mini-DOMA state. Note that "spousal" coverage under an employer's health plan may cost less and have different state income tax treatment than domestic partner coverage. The employer also should carefully consider the potentially discriminatory consequences of imposing any domestic partner eligibility requirements on same-sex couples that the employer does not impose on opposite-sex couples. If the employer does not have a domestic partner plan, then the employer may wish to rely on the federal and/or state DOMAs to exclude same-sex

spouses from its plans.

Ensure the Payroll Department Can Address Taxation Issues

To the extent that the employer will provide any sort of same-sex or domestic partner coverage, it will need to work with its payroll department to ensure that the payroll department can accurately comply with the tax consequences described above.

Communicate to Employees

If the employer chooses to provide coverage to same-sex spouses and/or domestic partners, the employer should consider how to best communicate its offering. There may be employee recruiting and retention advantages and possibly customer contracting advantages the employer may want to highlight. However, these benefits may offend some employees, shareholders or customers, so the employer may decide that a more “low key” rollout is appropriate.

Stay Abreast of Local and National Legislation

This area of law is constantly evolving and new developments occur on an almost weekly basis. For instance, one week prior to the California Supreme Court ruling, the Michigan Supreme Court ruled that a 2004 amendment to Michigan’s constitution prohibited public entities in the state form providing domestic partner benefits.

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