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Retirement PLAN news

The Supreme Court DOMA decision

The Defense of Marriage Act (DOMA), enacted in 1996, is an all-encompassing statute that applies to more than 1,100 federal laws and regulations administered by various federal departments and agencies, including the Internal Revenue Service (IRS) and the Department of Labor (DOL). The recent decision by the Supreme Court striking down certain sections of DOMA has already begun affecting benefit plans, including 401(k) qualified retirement plans.

The case of *United States v. Windsor** originated when a legally married same-sex spouse was denied the federal estate-tax marital exemption after her partner died. She had to pay more than $360,000 in estate taxes on inherited assets and sued the IRS in an attempt to receive a refund. However, the spousal exemption on federal estate tax was not granted because DOMA did not permit the couple's same-sex marriage to be recognized under federal income-tax laws.

DOMA Section 3 defines the term "marriage" to be between one man and one woman and the term "spouse" to be a person of the opposite sex who is a husband or wife, which precludes same-sex couples from being married under federal law.

Qualified plan spousal rights

Under DOMA, spousal rights were not available to same-sex partners, and the following retirement plan provisions *did not* apply:

- Spousal consent was not needed to name someone other than the spouse as beneficiary.
- Qualified joint and survivor annuity (QJSA) requirements or protections were not provided.
- Spousal consent was not required for distributions, loans, or hardship withdrawals.
- Hardship distributions made on behalf of the spouse's hardship were not available.
- Required minimum distribution joint life tables where the spouse is more than ten years younger could not be used.
- A deceased participant's plan assets could not be rolled over by a same-sex spouse into his or her own IRA.
- Qualified domestic relations orders (QDROs) were not applicable.
- Rollover privileges available only for a spouse (such as rolling over an IRA to the surviving spouse's own IRA) were not available.
- Family attribution rules used in determining highly compensated employees, key employees, and controlled groups did not reflect the spousal relationship in same-sex marriages.

* *United States v. Windsor*, 570 U.S. __ (2013)

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PENTEGRA RETIREMENT SERVICES

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Supreme Court decision

On June 25, 2013, in a five to four decision in *United States v. Windsor*, the U.S. Supreme Court ruled that Section 3 of DOMA was an illegal denial of equal protection rights guaranteed by the Constitution. This landmark decision has a major impact on retirement plan spousal benefit rules. In states that allow same-sex marriage, same-sex partners will now have the same rights that have always been available to opposite-sex married partners.

> **Section 3 of DOMA:** "*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 wife.*"

However, the ruling did not invalidate Section 2 of DOMA, which permits states that do not allow same-sex marriages to refuse to recognize such marriages. As a result, the changes made to Section 3 of DOMA appear to be much clearer at this time in instances when same-sex partners reside in states where same-sex marriages are recognized.

> **Section 2 of DOMA:** "*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.*"

Same-sex marriage states

We are in uncharted territory. At the time DOMA was enacted, there were no states that recognized same-sex marriage. Massachusetts became the first state to permit same-sex marriage in 2004. Currently, same-sex marriages are authorized in Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont, Washington, and Washington, D.C.

States that recognize domestic partnerships or civil unions are not directly affected by the *Windsor* decision. The purpose of civil unions and domestic partnerships is to afford individuals some of the benefits of marriage (such as medical power of attorney) without actually recognizing the relationship as a marriage. States with civil unions include Colorado, Hawaii, Illinois, and New Jersey. Those with domestic partnerships are Nevada and Oregon. Since domestic partnerships and civil unions are not marriages, recognition of a same-sex spouse is not required but may be permitted.

More questions than answers

The DOMA decision creates many more questions than it answers, and plan sponsors and administrators have no precedent to follow. Current state laws determine who is a spouse for purposes of determining if two individuals are legally married. However, retirement plans are governed by federal law. Right after the Supreme Court decision, there was confusion as to how to administer retirement plans when different states did not recognize a same-sex marriage validly celebrated in another state. Recent IRS guidance has clarified that the place of the marriage's celebration determines the law for the marriage that will be recognized for federal income-tax purposes, including qualified plans — regardless of whether a state recognizes same-sex marriages.

There may be many additional issues requiring statutory or regulatory fixes that will take time to settle as they work their way through the state and federal legal systems.

Treasury, IRS, and DOL guidance

The Treasury Department and the IRS have issued guidance (Revenue Ruling 2013-17 and FAQs) regarding how the DOMA decision applies to the filing of federal income-tax returns and qualified plans. The ruling covers same-sex marriages entered into in one of the 50 states, Washington D.C., a U.S. territory, or a foreign country. It does not cover domestic partnerships, civil unions, and similar arrangements.

The Treasury/IRS ruling generally requires same-sex couples to file their federal tax returns as married (either married filing jointly or married filing separately) as of the 2013 tax year. If the couple was married in a state that recognizes same-sex marriage and now resides in a state that does not, the couple must still file as married. In addition, an amended federal tax return may be filed for all open years (2010, 2011, and 2012).

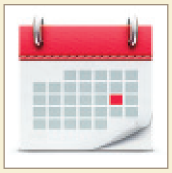
In the revenue ruling's accompanying FAQs, the IRS stated, "*A qualified retirement plan must treat a same-sex spouse as a spouse for purposes of satisfying the federal tax laws relating to qualified retirement plans.*" "*. . . a qualified plan must recognize a same-sex marriage that was validly entered into in a jurisdiction whose laws authorize the marriage, even if the married couple lives in a domestic or foreign jurisdiction that does not recognize the validity of same-sex marriages.*" For ERISA purposes, the DOL guidance (Technical Release No. 2013-04) agrees.

Future IRS guidance will address how the IRS will apply the Supreme Court's decision retroactively to employee benefit plans, specifically to plan sponsors, the plan or arrangement, employers, affected employees, and beneficiaries. This is particularly critical for defined benefit plans and plans subject to spousal consent where distributions have already occurred.

Going forward

More guidance clarifying the impact of the DOMA ruling on retirement plan administration will be forthcoming. This newsletter will address changes as they occur. In the meantime, plan sponsors (especially those in states that recognize same-sex marriage) can consider some best practice action steps, including:

- Reminding all plan participants to review their current beneficiary designations to ensure they are accurate and up to date.
- Recording same-sex marriage as a status code for your human resource records.



One-time extension of participant disclosure notice

Almost three years ago,* the U.S. Department of Labor's (DOL's) Employee Benefits Security Administration (EBSA) issued final regulations requiring plan sponsors to provide participants and beneficiaries in individual account plans,** such as 401(k) plans, with information regarding fees and expenses charged to the participants' accounts, including investment fees and expenses, plan administrative fees, and specific transaction fees.

The annual participant fee disclosure (Section 404(a)(5)) includes a chart of the plan's investment options grouped by category to allow participants to compare investment returns, fees and expenses, and annuity options. Under the regulations, the deadline for administrators of calendar-year plans to provide the initial participant disclosure was August 30, 2012, with subsequent disclosures to be provided within 12 months.

Bad timing

The retirement plan industry expressed concern that the timing of this annual disclosure requirement does not correspond to the timing of any other required annual participant disclosures (e.g., safe harbor notices, QDIA notices, automatic enrollment notices).

Temporary one-time extension

On July 22, 2013, the DOL issued Field Assistance Bulletin (FAB) 2013-02 providing a temporary, one-time extension for plan administrators to furnish the annual Section 404(a)(5) participant disclosures. Under the extension, plan administrators have up to 18 months from the prior disclosure to furnish either the 2013 *or* the 2014 disclosure. The relief allows plan administrators to reset their annual deadline for providing these types of disclosures.

Prior to FAB 2013-02, if a plan administrator wanted to align the participant disclosure with other required disclosures (while still meeting the DOL's annual 12-month disclosure timing requirement), they would have to issue two disclosures within the same 12-month period to reset the timing.

More timing issues

Since FAB 2013-02 was released close to the August deadline for providing the annual participant disclosure, many plans had either already satisfied or made plans to satisfy their obligations within the 12-month time frame from the initial disclosure. As a result, they did not take advantage of the extension for 2013. Following are examples of how the extension applied to 2013 disclosures and how it may be utilized for 2014 disclosures.

Examples from FAB 2013-02

The examples provided by the DOL in FAB 2013-02 use August 25, 2012, as the hypothetical date a hypothetical plan administrator furnished the initial participant disclosure, making the deadline for providing the next disclosure August 25, 2013.

2013 extension example: If a plan administrator furnished the first comparative chart on August 25, 2012, the "2013 comparative chart" would be due no later than August 25, 2013. In accordance with this Bulletin, however, the Department will take no enforcement action based on timeliness if the plan administrator furnishes the "2013 comparative chart" by February 25, 2014.

2014 extension example: If a plan administrator furnished the first comparative chart on August 25, 2012, and intends to furnish the second comparative chart on August 25, 2013, the "2014 comparative chart" would be due under the terms of the final regulation no later than August 25, 2014. In accordance with this Bulletin, however, the Department will take no enforcement action based on timeliness if the plan administrator furnishes the "2014 comparative chart" by February 25, 2015.

"Date creep"

The DOL is interpreting the 12-month rule between disclosures in a very strict manner. Here's an example: The initial deadline was August 30, 2012. If a plan sponsor sent the first disclosure early, say on August 10 of 2012, the next annual disclosure would be due by August 10, 2013. This is known as date creep. Some thought that since the initial deadline was August 30, 2012, they would have until August 30, 2013, to provide the next disclosure, even if the initial disclosure was sent before the August 30 deadline in 2012. Barring the one-time reset, annual notices are due within 12 months — to the day — of when the prior notice was mailed.

* October 14, 2010

** This requirement does not apply to plans in which the employer directs all the plan investments.

RECENT developments

DOL advisory opinion on revenue sharing payments

Retirement plan service providers often receive payments through revenue sharing arrangements. The payments are based on the overall expense ratio of a plan's investments and are paid by investment companies in exchange for services such as recordkeeping. They are used to reduce fees that plan participants would otherwise be paying the service provider.

The Department of Labor (DOL) addresses revenue sharing in Advisory Opinion 2013-03A. The opinion was issued in response to a question about whether certain types of revenue sharing payments were considered plan assets under the Employee Retirement Income Security Act (ERISA). The issue is significant because plan assets are subject to certain fiduciary requirements under ERISA.

The facts presented in the query involved a typical revenue sharing arrangement whereby a recordkeeper received revenue sharing payments from plan investments, credited the amounts to a general account (held by the recordkeeper) outside of the plan, and then applied the credits to pay certain plan expenses. In this specific case, the plan had a contractual right to receive the revenue sharing amounts or have them applied to pay plan expenses. The DOL's opinion is that this arrangement is acceptable. If there are any residual amounts that are not used to pay plan expenses, the plan would have a claim against the recordkeeper for the residual amounts and the claim itself would be an asset of the plan. Plan sponsors often direct that excess revenue sharing payments be used to pay other plan expenses, such as services provided to the plan by accountants, consultants, or attorneys.

It is the responsibility of the plan sponsor to obtain sufficient information to ensure that all direct and indirect compensation received by service providers is reasonable. This includes verifying that amounts are correctly calculated and applied for the benefit of the plan.