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Freedman Benefits news

Supreme Court ruling on same-sex marriage

On June 26, 2015, the U.S. Supreme Court issued its decision in *Obergefell v. Hodges*,* ruling that the 14th Amendment requires all states (and the District of Columbia and U.S. territories) to recognize same-sex marriage. The ruling also requires states to recognize same-sex marriages lawfully performed in another state.

Background

Previously, in 2013, the Supreme Court had ruled in *United States v. Windsor*** that Section 3 of the Defense of Marriage Act (DOMA) was an illegal denial of equal protection rights guaranteed by the Constitution. DOMA is an all-encompassing statute that applies to more than 1,100 federal laws and regulations administered by federal departments and agencies, including the Internal Revenue Service (IRS) and the Department of Labor (DOL).

Section 3 of DOMA had defined the term “marriage” as “a legal union between one man and one woman as husband and wife” and the term “spouse” as “a person of the opposite sex who is a husband or a wife,” thereby precluding same-sex couples from being considered married under federal law. After the Supreme Court held Section 3 of DOMA to be unconstitutional, same-sex married individuals in states allowing same-sex marriage became entitled to the same general rights as opposite-sex married partners.

Qualified plan spousal rights

Prior to *Windsor*, spousal qualified plan rights were not available to same-sex partners, but now they are available nationwide, with the following retirement plan rights and requirements applying to both same-sex and opposite-sex married couples:

- The need for spousal consent to name someone other than the spouse as beneficiary
- Qualified joint and survivor annuity (QJSA) protections
- For plans subject to the QJSA rules, the need for spousal consent for such things as distributions, loans, or hardship withdrawals
- Availability of hardship distributions for a spouse’s hardship
- For purposes of calculating required minimum distributions, use of the joint life tables that apply where the spouse is more than 10 years younger than the account owner

- Ability of a spouse to roll over plan assets into his or her own individual retirement account (IRA) or his or her own qualified plan account, if the plan permits such rollovers
- Ability of the spouse to roll over the IRA of the deceased spouse into the surviving spouse’s own IRA or into an inherited IRA
- Availability of qualified domestic relations orders (QDROs)

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- Family attribution rules must reflect the spousal relationship for purposes of determining highly compensated employees, key employees, and controlled groups

14th Amendment

State and local governments are subject to the 14th Amendment guarantee of equal protection. The Supreme Court held that same-sex couples may not be deprived of that right and liberty. The *Obergefell* decision holds that the 14th Amendment now requires a state to license a marriage between two people of the same sex and to recognize a same-sex marriage lawfully licensed and performed out of state.

Retirement plan impact

Retirement benefits and spousal benefits under employer-sponsored plans in the private sector are regulated by federal law. As a result, after the *Windsor* decision and IRS guidance on income tax and qualified plan matters, private sector retirement plans recognized same-sex spouses as spouses for all qualified plan purposes. However, certain types of retirement plans sponsored by public sector employers and churches are not subject to ERISA, which is a federal law, and therefore were not impacted by the *Windsor* decision. Thus, the *Obergefell* decision will have a greater impact on public sector and church plans.

Going forward

States that recognize domestic partnerships or civil unions have a greater chance of being affected by the *Obergefell* decision than the *Windsor* decision since same-sex marriages are now legal in all states. The purpose of civil unions and domestic partnerships was to afford individuals some of the benefits of marriage (such as medical power of attorney) because the state did not have same-sex marriage laws. If a couple that entered into a domestic partnership or civil union does not wish to get married, perhaps due to the expense of restructuring all the documents they created under the domestic partnership or civil union rules, then the members of the domestic partnership or civil union will not be recognized as marital spouses. Thus, they will not be entitled to rely on the qualified plan spousal rules.

An additional rule concerns retroactive application of the *Obergefell* decision. Generally, when the Supreme Court holds a law to be unconstitutional, it is as if the law never existed. After the *Windsor* decision, the IRS issued guidance which, for the most part, eliminated any requirement for retroactively changing decisions made in the past under qualified plans. This issue is particularly critical for defined benefit plans and plans subject to spousal consent under which distributions have previously been made. For example, if a participant's beneficiary received a distribution prior to the *Windsor* decision and there was no spousal consent deemed necessary for the designation of that beneficiary — because same-sex spouses were not recognized — the IRS's position was that *Windsor* would not apply retroactively. Whether the IRS will see a need to issue any additional guidance after the *Obergefell* decision remains to be seen.

As a best practice, plan sponsors should remind all plan participants to review their current beneficiary designations on a recurring basis to ensure they are accurate and up to date. Many commentators suggest that reviews be made every five years and whenever there is a life event, such as a birth, death, marriage, or divorce.

* 576 U.S. ___ (2015)

** 570 U.S. ___ (2013)

For decades, the "three-legged stool" concept has been used as a model to help educate employees about preparing for retirement.

- **Leg #1** represents the employee's personal savings, including IRAs and possible home equity.
- **Leg #2** represents the private retirement system.
- **Leg #3** represents the "public system" of Social Security payments.

Historically, the second leg of the stool consisted substantially of defined benefit (DB) retirement plans. These were the employee's reward for long years of service, and the investment risk for providing a pension income was the employer's responsibility. However, over recent decades, many DB plans have been replaced by defined contribution (DC) plans, such as 401(k)s, which are funded by both employer *and* employee contributions.

The combination of the widespread termination of DB plans and the proliferation of DC plans is putting more pressure on participants to fund their own retirement benefits and thereby take on the investment risk for the second leg of the stool.

The third leg, Social Security, has had funding issues in the past, but Congress has previously resolved these in a bipartisan fashion. Currently, Social Security is funded through the 2030s. This leaves Congress with a significant amount of time to take the action needed to keep Social Security going for future generations.

Changes in the stability of one or more of the stool's three legs could cause it to become wobbly or unstable. The hoped for changes to Social Security will bear careful watching.

Longevity products, such as target date funds that contain annuities and qualified longevity annuity contracts, have become available for inclusion in the 401(k) distribution mix to help retirees make their nest eggs last longer. We will keep you posted when additional products are introduced.

Eliminating qualified joint and survivor annuity options

Qualified joint and survivor rules apply to all qualified plans, i.e., both defined benefit and defined contribution plans. However, a 401(k) plan or a profit sharing plan may be exempt from the qualified joint and survivor annuity (QJSA) rules when certain conditions are met.

Plans can be designed to permit an annuity contract option in order to provide participants with lifetime benefit options. These types of plans may also be amended at a later date to remove the annuity contract option. This article will explain which types of plans can be amended to remove QJSAs, identify the types of plans that must retain QJSAs, and list some alternative types of products that can offer retirement income benefits to participants in defined contribution plans without a QJSA.

QJSA basics

A QJSA provides a life annuity to a participant and a survivor annuity to the participant's spouse if the participant dies. In a defined contribution plan, the participant (if married, with the spouse's consent) may waive the QJSA option and elect another form of benefit payment, such as a lump-sum payment. Plans must require a plan representative or notary to witness the spouse's consent. If a participant is not married, a life annuity would be the normal form of benefit in a plan subject to the QJSA rules. If the vested value of a participant's benefit is $5,000 or less, the plan can pay a lump sum of cash instead of a QJSA without obtaining either the participant's or the spouse's consent.

A qualified plan, such as a defined benefit plan, money purchase plan, or target benefit plan, must provide a QJSA to all married participants as the only form of benefit unless the participant (and spouse, if applicable) consents in writing to another form of benefit payment.

Defined contribution plans that require a QJSA

Money purchase plans and target benefit plans are types of defined contribution plans that are required to comply with the QJSA rules. Neither a 401(k) plan nor a profit sharing plan holding money purchase plan assets due to a plan merger may eliminate a QJSA option associated with the money purchase plan assets. However, the money purchase plan assets may be kept in a separate source, and in that situation, the QJSA requirements will apply only to that source, and not to the entire plan. Separate distribution notices will be required for the different kinds of money.

Eliminating a QJSA

A plan not considered to be a transferee plan requiring that the QJSA options be continued may be amended to eliminate the annuity option, since annuity options in these types of plans are considered optional forms of benefits not subject to anti-cutback rules. As set forth in Q&A-2(a)(3)(ii) of Treas. Reg. §1.411(d)-4, a plan may be amended to remove the annuity distribution option and replace it with a lump-sum distribution option.

Amendment to remove the QJSA

A profit sharing, 401(k), or stock bonus plan that holds no account balances containing amounts received as the result of a merger with or the amendment of a money purchase plan, target benefit plan, or a direct or indirect transferee of a defined benefit plan may be exempt from having to offer a QJSA, or may be amended to remove the QJSA from the plan, if the following four requirements of IRC §401(a)(11)(B)(iii) are met:

1. The spouse must be the sole primary beneficiary of 100% of the participant's account, unless the spouse has consented in writing to the naming of another beneficiary.
2. A life annuity option cannot be selected.
3. The account balance does not include a direct transfer of funds from a plan that was subject to the QJSA rules. **Note:** A participant rollover from such a plan is not subject to the QJSA rules because at the time of the rollover the spouse's options were exercised with regard to consent.
4. There is no floor offset arrangement with a defined benefit plan maintained by the same employer that sponsors the defined contribution plan.

Alternative lifetime income options

With defined benefit plans declining and people generally living longer, there are growing concerns that retirees will outlive their retirement nest eggs. In recent years, regulations and products have been created to allow 401(k)s to provide participants and beneficiaries with lifetime income options — without bringing on the QJSA rules — such as:

Qualified longevity annuity contracts. This is a type of straight-life annuity that can be purchased with up to the lesser of 25% of the participant's balance or $125,000. The annuity payments begin at an advanced age (such as 80 or 85) and, until the commencement of the payout, are not included in the required minimum distribution calculation.

Target date fund (TDF) annuities. TDFs may contain a portion of deferred annuities at levels based on age groups. When the TDF reaches its target date, participants with an interest in that TDF would be entitled to either immediate or deferred annuity payments.

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RECENT developments

Determination letter program changes

Based on its need to direct its limited resources more efficiently, the IRS stated in Announcement 2015-19 that effective January 1, 2017, the staggered five-year determination letter remedial amendment cycles for individually designed plans will be eliminated. There will be a cycle E PPA restatement and a cycle A of the third five-year restatement cycle, which will end January 31, 2017. In addition, effective July 15, 2015, the IRS no longer accepts determination requests submitted off-cycle, with limited exceptions. The IRS will be limiting the issuance of determination letters for individually designed plans to the initial qualification of new plans and plan termination qualification and to other situations to be determined by the Treasury and IRS.

Individually designed plans could see an increase in plan document failures arising during plan audits as the IRS will rely on auditing to keep plans in compliance. We may see some sponsors of individually designed plans move onto preapproved documents. We could also see the use of ERISA attorneys and other service providers to regularly review individually designed plans for compliance.

Defined benefit plan RMD changes

The IRS is limiting the ability of defined benefit plan sponsors to allow participants who are receiving annuity payments to take a lump-sum distribution. Required minimum distribution regulations allow for payment of increased benefits resulting from a plan amendment, but only for a plan's termination or a participant's death or retirement. Some plan sponsors had interpreted these rules to mean that a plan can be amended to permit a lump-sum option for a participant receiving minimum distributions, but the IRS will no longer permit this approach. The new rules were effective on July 9, 2015, though there are exemptions for plans that met certain pre-July 9, 2015 requirements.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.

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