December 18, 2013

IRS Issues Post-Windsor Guidance for Cafeteria Plans, Flexible Spending Arrangements and Health Savings Accounts

On December 16, the Internal Revenue Service (IRS) issued Notice 2014-1 (Notice), which provides additional guidance for cafeteria plans, including health and dependent care flexible spending arrangements and health savings accounts, as a result of the U.S. Supreme Court's decision in?*United States v. Windsor* in which the Supreme Court ruled that Section 3 of the Defense of Marriage Act (DOMA) was unconstitutional. (See our prior Client Alert, DOMA Unconstitutional: Impact on Employee Benefits Plans.)

Notice 2014-1 amplifies prior IRS guidance in Revenue Ruling 2013-17 (see our prior Client Alert, IRS Issues DOMA Guidance: Action Steps for Employers) and includes a series of Q&As that provide further guidance on the application of the *Windsor* decision with respect to certain rules governing cafeteria plans, health and dependent care flexible spending arrangements, and health savings accounts. A summary of the guidance in Notice 2014-1 is provided below.?

When may cafeteria plans permit midyear election changes for participants married to a same-sex spouse?

- A cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the *Windsor* decision (i.e., June 26, 2013) as if the participant experienced a change in legal marital status for purposes of the cafeteria plan midyear election rules.
- A cafeteria plan may also permit a participant who subsequently marries a same-sex spouse after the date of the*Windsor* decision (i.e., June 26, 2013), to make a midyear election change due to a change in marital status.

What if a cafeteria plan allowed a participant married to a same-sex spouse to make a midyear election on the basis that the change in tax treatment of health coverage for a same-sex spouse resulted in a significant change in the cost of coverage?

- A change in the tax treatment of a benefit under a cafeteria plan generally will not constitute a significant change in the cost of coverage under the cafeteria plan midyear election rules. However, if a cafeteria plan permitted a participant with a same-sex spouse to make a midyear election change between June 26, 2013, and December 31, 2013, as a result of the plan administrator's interpretation that the change in tax treatment resulted in a significant change in cost of health coverage, the cafeteria plan will not be treated as having violated the cafeteria plan rules.

When do the midyear election changes under the cafeteria plan take effect with respect to same-sex spouses?

- A cafeteria plan election made with respect to a same-sex spouse as a result of the *Windsor* decision will generally take effect as of the date that any other change in coverage would become effective.
- With respect to a change in status election made by a participant as a result of the *Windsor* decision between June 26, 2013, and December 16, 2013, the cafeteria plan will not be treated as having violated the cafeteria plan rules if the

coverage under the cafeteria plan becomes effective no later than the later of (a) the date that coverage under the cafeteria plan would be added under the cafeteria plan's usual procedures for change in status elections, or (b) a reasonable period of time after December 16, 2013.

When must an employer begin treating salary reductions for a same-sex spouse on a pretax basis?

- An employer who receives notice before the end of the cafeteria plan year that includes December 16, 2013 (i.e., by December 31, 2013, for calendar-year plans), that a participant is married to a same-sex spouse must begin treating the amount that the employee pays for the spousal coverage as a pretax salary reduction no later than the later of (a) the date that a change in legal marital status would be required to be reflected for income tax withholding purposes, or (b) a reasonable period of time after December 16, 2013.

How does the *Windsor* decision affect the tax treatment of health coverage for a participant who paid for same-sex spousal coverage on an after-tax basis?

- In the case of a participant who had been paying for same-sex spousal health coverage on an after-tax basis, the participant's salary reduction election is deemed to include the cost of spousal coverage, even if the employer reports the amount as taxable income and wages to the participant. Therefore, the amount that a participant pays for same-sex spousal coverage is excluded from the gross income of the participant and is not subject to federal income or federal employment taxes.
- This rule applies to the cafeteria plan year which includes December 16, 2013 (i.e., the 2013 plan year for calendar-year plans), and any prior years for which a participant can file a claim for credit or refund.

When may a cafeteria plan permit a participant's flexible spending arrangement (including a health, dependent care or adoption assistance FSA) to reimburse covered expenses of the participant's same-sex spouse?

- Cafeteria plans may permit a participant's FSA (including a health, dependent care or adoption assistance FSA) to reimburse covered expenses of the participant's same sex-spouse that were incurred during a period beginning on a date that is no earlier than (a) the beginning of the cafeteria plan year that includes the date of the *Windsor* decision (i.e., during the 2013 plan year for calendar-year plans), or (b) the date of marriage, if later.

How are the contribution limits for health savings accounts and dependent care assistance programs affected?

- Same-sex married couples will be subject to the maximum annual contribution limit for health savings accounts ($6,450 for 2013). This limit will apply to same-sex married couples who are treated as married for federal income tax purposes for a taxable year, including the 2013 taxable year.
- In the event that the combined health savings account contributions for a same-sex couple exceed the applicable contribution limit ($6,450 for 2013), contributions for one or both of the spouses may be reduced for the remainder of the plan year in order to avoid exceeding the contribution limit. To the extent that the combined contributions exceed the applicable contribution limit, any excess amounts may be distributed from the health savings accounts of one or both spouses no later than the due date of their tax returns. Any amounts that are not distributed by such date will be subject to excise taxes.
- Same-sex married couples will be subject to the $5,000 maximum annual contribution for dependent care flexible spending arrangements. This limit will apply to same-sex married couples who are treated as married for federal income tax purposes for a taxable year, including the 2013 taxable year.

If you have any questions on the guidance in Notice 2014-1, please contact a member of the firm's Employee Benefits/Executive Compensation group.