American Benefits Council

Benefits Briefing Webinar:
U.S. Supreme Court DOMA Decision

Background on Windsor
and Implications for Health and welfare Plans

July 2, 2013

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Overview

- State of spousal recognition rules
- Brief background on DOMA
- Overview of the Court’s holding in *Windsor*
- Potential implications for H&W plan sponsors and administrators
- Open issues
State of Relationship Recognition

- Currently 12 states and the District of Columbia provide for legal same-sex marriage

| ✓ Maine | ✓ Vermont (2009) |


+ California (ND counties, other?)
State of Relationship Recognition

- Additionally, 7 states and D.C. provide for state-level spousal rights (i.e., rights short of full marriage)

- California
  (Domestic partnerships, 1999, 2005)

- Hawaii
  (Civil Unions, 2010)

- Illinois
  (Civil unions, 2011)

- New Jersey
  (Civil unions, 2007)

- Nevada
  (Domestic partnerships, 2009)

- Oregon
  (Domestic partnerships, 2007)

- Washington
  (Domestic partnerships, 2007)
And don’t forget...

- Wisconsin: Provides some spousal rights to registered domestic partners

- New Mexico: AG issued an advisory opinion stating the state can recognize same-sex marriages from other jurisdictions; the legal effect of this opinion remains unclear

- Wyoming: On June 6, 2011, the Wyoming Supreme Court effectively ruled that trial courts can issue DROs for same-sex marriages performed in other jurisdictions
The Anatomy of DOMA

• 1996 federal statute
  – Section 1: The title
  – Section 2: Full faith and credit clause
    • Provides that one state does not have to recognize a same-sex marriage from another state
  – Section 3: Provides a federal definition of “spouse” and “marriage”
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The Anatomy of DOMA

• Section 3: Provides a federal definition of “spouse” and “marriage”
  
  – States that in determining the meaning of any Act of Congress, or 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 (Pub. L. No. 104-99, § 1 (Sept. 21, 1996), codified at 1 U.S.C. § 7 (1997))
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Ruled Unconstitutional
The Anatomy of DOMA

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Windsor Decision

- Plaintiff, Edith Windsor, and her partner were residents of NY state.

- In 2007 they were married in Canada; the marriage was recognized by NY state following the state legislature’s enactment of a law allowing for/recognizing same-sex marriages.

- Following her wife’s death, Ms. Windsor filed a claim for refund of approximately $363,000 of estate taxes. The IRS denied the claim on the basis that she was not an opposite-sex spouse within the meaning of DOMA.

- Ms. Windsor then sued the Department of the Treasury for a tax refund of the $363,000, alleging that she should have been eligible for a spousal deduction for federal estate tax after her wife died and that DOMA operated to violate her Constitutional rights.

- By a 5-4 decision, Supreme Court ruled that Section 3 of DOMA is an unconstitutional deprivation of liberty protected by the Fifth Amendment of Constitution.

- The Court specifically did NOT address constitutionality of Section 2 of DOMA, which remains the law... for now.
The Anatomy of DOMA

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Remains Law...

Ruled Unconstitutional
Potential Implications for ER-Sponsored Plans

• Full scope and extent of implications may not be known for some time

• While *Windsor* was unequivocal in overturning Section 3 of DOMA, the decision provides no guidance with respect to ER plans

• Some very important questions remain unanswered at present
  – Who will answer them?
  – When will they be answered?
  – What do I do now?
Potential Implications for ER-Sponsored Plans

• What are some of the open questions?

Q1: Do I HAVE to provide benefits to same-sex spouses?

Q2: If I want to provide 100% equivalent benefits to same-sex spouses, can I?

Q3: Will I have to go back and re-administer some or all of my plans in order to maintain their tax-qualified status?

Q4: Might I have potential liability for back benefits?

Q5: Can I as employer, or my employees, file a refund claim for taxes paid?
Potential Implications for ER-Sponsored Plans

Q1: Do I have to provide benefits to same-sex spouses?
Potential Implications for ER-Sponsored Plans

Q1: Do I have to provide benefits to same-sex spouses?

A1: Appears very likely with respect to at least certain benefits
Potential Implications for ER-Sponsored Plans

• ERISA and the IRC generally allow employers to establish their own rules regarding eligibility (with limited exceptions, such as 1,000 hour for DC/DB plans, IRC-based nondiscrimination rules, etc.)

• Moreover, self-funded ERISA plans generally have been found to be excepted from state nondiscrimination laws or coverage rules based on ERISA preemption. (Insured plans may be subject to state nondiscrimination rules if cited in insurance law)

• Self-funded ERISA plan sponsors, therefore, generally have had broad discretion in determining the class of beneficiaries who are entitled to benefits

• Nothing about Windsor appears to alter this general proposition
Potential Implications for ER-Sponsored Plans

- **However**, ERISA and the IRC **do** require that certain benefits, rights and features be provided to a “spouse” to the extent an employer sponsors a plan (e.g., QJSA, COBRA)

- ERISA and the IRC do **not** include a definition of “spouse” for these purposes; **thus, could a plan sponsor choose to use a definition that excludes same-sex spouses?**

- Existing case law provides little guidance on whether a plan sponsor could choose to define spouse more narrowly than applicable state law
  - Relevant case law looks primarily at who constitutes a “spouse” for purposes of an ERISA plan where the term is undefined or based on applicable state law (such as common law marriage)

- With respect to ERISA or IRC-mandated spousal benefits, appears to be a federal law mandate versus a plan-based contractual right
Potential Implications for ER-Sponsored Plans

• Unless and until IRS/DOL guidance is issued, there may be some basis for limiting “spouse” to opposite-sex in plan documents, **but seems highly risky, especially in context of pension/retirement plans**

  • Depending on how “spouse” is clarified – by plan amendment or administrative interpretation – would seem to invite judicial review either way. If based on interpretation, *Firestone* deference would still seem to attach, but would the definition be arbitrary and capricious?

  • Seems that doing so could result in fiduciary liability or tax disqualification, or, at minimum, employee relations issues and litigation risk

  • Hopefully guidance is forthcoming, although issue may be resolved by the courts
Potential Implications for ER-Sponsored Plans

Q2: If I want to provide 100% equivalent benefits to same-sex spouses, can I?

• There is an open question about when a same-sex spouse ceases to qualify as a “spouse” under federal law.

  - For example: Where same-sex couple moves to state that does not recognize same-sex marriage.

• IRS rules have traditionally looked to state of domicile in determining whether an individual is a “spouse” for federal law purposes.

• Similarly, based on existing federal common law, the courts have traditionally looked to state law of domicile (with certain exceptions) in determining whether an individual is a “spouse” for ERISA purposes, where the plan either (i) does not define “spouse” or (ii) defines “spouse” by reference to state law.
Potential Implications for ER-Sponsored Plans

Q2: If I want to provide 100% equivalent benefits to same-sex spouses, can I?

A2: If the same-sex spouse resides in a state that recognizes same-sex marriage- YES. If the same-sex spouse resides elsewhere- HOPEFULLY YES, BUT NOT CLEAR AT PRESENT
Potential Implications for ER-Sponsored Plans

• There is an open question as to whether a plan sponsor must effectively track an employee’s state of domicile in determining his or her entitlement to certain spousal benefits or favorable tax treatment, or whether the sponsor can treat a same-sex married spouse as a “spouse” regardless of where the individual resides

  – IRS rules have traditionally looked to an individual’s state of domicile in determining whether he or she is a “spouse” for federal law purposes

  – Similarly, regarding ERISA, existing federal common law has traditionally looked to an individual’s state law of domicile (with certain exceptions) in determining whether an individual is a “spouse” for ERISA purposes, where the plan either (i) does not define “spouse” or (ii) defines “spouse” by reference to state law

  – Existing case law is limited regarding ERISA plans – in large part because ERISA wasn’t enacted until 1974, well after *Loving v. Virginia*. Additionally the Constitution’s Full Faith and Credit Clause generally requires one state to recognize another state’s marriage laws. Here we have the public policy exception thereto as well as Section 2 of DOMA
Potential Implications for ER-Sponsored Plans

- To the extent that employers are **ONLY** permitted to provide these certain benefits/preferential federal tax treatment to a legally married spouse based on domicile, then full parity will likely only be available for same-sex spouses residing in a state that recognizes same-sex marriage

  - The employer would then need to treat other same-sex spouses like domestic partners in offering near parity (under pre-\textit{Windsor} approach)
  
  - Downside of this is that it is administratively very complex and costly
  
  - Also, could result in unfortunate scenarios where accrued benefits are effectively lost based upon an individual’s current state of domicile
  
  - Note that this would matter **ONLY** where (i) spousal-equivalent benefits cannot be provided voluntarily by contract, or (ii) status as “spouse” is required to access favorable tax treatment

  - **Note that the Administration seems to favor a rule that does not rely on an individual’s state of domicile – merely that they hold a valid marriage license**
Potential Implications for ER-Sponsored Plans

Example: Bob and Joe are married and residing in NY. Joe is covered under Bob’s employer’s major medical plan. Bob and Joe then move to NJ where their marriage is not recognized. (Assume Joe does not qualify as Bob’s Code section 152-modified dependent for tax-free employer-paid coverage)

• If domiciliary requirement does **NOT** apply, then because Bob and Joe hold a valid NY marriage license, regardless of their move to NJ, the employer-paid coverage provided to Joe would **NOT be taxable** to Bob.

• If domiciliary requirement **DOES** apply, then because Bob and Joe move to NJ where their marriage is not recognized under state law, the employer-paid coverage provided to Joe would **be taxable** to Bob.
Potential Implications for ER-Sponsored Plans

Q3: Will plans have to go back and re-administer certain benefits in order to maintain their tax-qualified status?

• Unclear understanding is that the IRS is currently looking at the issue, specifically as it relates to tax-qualified retirement and pension plans.
• Similar to what happened after Heinz, guidance is hoped for that precludes and/or limits the need for plans to go back and re-administer benefits.
• Perhaps just 2013 plan year?
Potential Implications for ER-Sponsored Plans

Q3: Will plans have to go back and re-administer certain benefits in order to maintain their tax-qualified status?

A3: Unclear (but if so, hopefully, very limited)

• Our understanding is that the IRS is currently looking at the issue, specifically as it relates to tax-qualified retirement and pension plans

• Similar to what happened after Heinz, guidance is hoped for that precludes and/or limits the need for plans to go back and re-administer benefits
  – Perhaps just 2013 plan year?
Potential Implications for ER-Sponsored Plans

Q4: Will a plan have potential liability for back benefits?

- Unclear
  - Answer likely to come from the courts
  - While agencies will almost certainly be helpful in clarifying what, if any, retroactive steps have to be taken to maintain tax-qualified status, seems less certain they will seek to issue guidance that has the effect of divesting individuals of ERISA rights
  - Is Heinz an analog?
Potential Implications for ER-Sponsored Plans

Q4: Will a plan have potential liability for back benefits?

A4: MAYBE

• Answer likely to come from the courts
• While agencies will almost certainly be helpful in clarifying what, if any, retroactive steps have to be taken to maintain tax-qualified status, seems less certain they will seek to issue guidance that has the effect of divesting individuals of ERISA rights
• Is Heinz an analog?
• Expect employees with same-sex spouses to request back benefits or possibly litigate
Potential Implications for ER-Sponsored Plans

Q5: Can my employees, or I as employer, file a refund claim for taxes paid?

A: Appears, yes

• Guidance is expected to be forthcoming from the IRS
• IRC section 7805 provides IRS with authority to make changes in tax law prospective only; however, not clear that this authority will extend to the Windsor case
• Appears likely that taxpayers will have the ability to claim refunds for any "open years"
Potential Implications for ER-Sponsored Plans

Q5: Can my employees, or I as employer, file a refund claim for taxes paid?

A5: Appears, YES

- Guidance is expected to be forthcoming
- IRC section 7805 provides IRS with authority to make changes in tax law prospective only; however, not clear that this authority will extend to the *Windsor* case
- Appears likely that taxpayers will have the ability to claim refunds for any “open years”
- Interesting issue on tax “gross-ups”
Health and Welfare Plans

- Will need to closely review plan terms
- Likely to result in changes to benefits and administration
- Likely to affect broad array of plans, including:
  - Health and welfare plans
  - Excludable fringe benefits
  - Qualified pension and retirement plans
  - Nonqualified deferred compensation
- Be very thoughtful regarding plan redesign and administrative changes, especially in the short-term as we await guidance from the agencies and the courts
Health and Welfare Plans

- Tax treatment of employer-paid health care generally
- HSAs, HRAs, FSAs
- Code section 125 salary reduction
- COBRA
- HIPAA special enrollment rights
- FMLA
- Excludable employer-paid fringe benefits
**Tax Treatment of ER-Paid Health Care**

- **BEFORE Windsor**
  - Employer-paid coverage is excludable from an employee’s wages (just like coverage paid for by an employer with respect to an employee’s opposite-sex spouse) if the domestic partner or same-sex spouse qualifies as IRC section 152-modified “dependent”
  
  - Generally, to be an IRC section 152-modified “dependent”, the same-sex spouse or domestic partner must satisfy the following criteria:
    - Live with the employee; AND
    - Receive over ½ of his or her financial support from the employee
    » Note: no income threshold imposed

- Applies for both federal income and payroll taxes
Tax Treatment of ER-Paid Health Care

• **AFTER** *Windsor*
  - For same-sex spouses residing in state which recognizes same-sex marriage, employer-paid coverage is excludable from an employee’s wages . . . period.
Tax Treatment of ER-Paid Health Care

• **AFTER Windsor**
  
  – For same-sex spouses **residing in a state which does NOT recognize same-sex marriage**, tax treatment remains unclear:
    • If no domiciliary requirement, then coverage is **not** taxable
    • If domiciliary requirement applies, then it appears that coverage would be taxable, **UNLESS** the same-sex spouse qualifies as Code section 152-modified “dependent” under the “Before Windsor” rule (see preceding slides)
Tax Treatment of ER-Paid Health Care

- **AFTER Windsor**
  - What about domestic partners and civil union-ers?
    - Same “Before Windsor” rule applies (see preceding slides)
FSAs, HRAs and HSAs

• An employee can only reimburse tax-free the qualifying medical expenses of his or her “spouse” or qualifying as the Code section 152-modified “dependent”
  – **BEFORE Windsor:** Qualifying medical expenses of an employee’s same-sex spouse, domestic partner or civil union-er were not eligible for tax-free reimbursement unless he or she qualified as Code section 152-modified “dependent”
  – **AFTER Windsor:**
    • Same-sex spouse’s expenses are eligible for tax-free reimbursement (depending on domiciliary requirement)
    • Expenses of employee’s domestic partner or civil union-er remain eligible for tax-free reimbursement ONLY if such partner or civil union-er qualifies as the employee’s Code section 152-modified “dependent”
    – Alternative: With respect to FSAs and HRAs, may be able to impute as income the FSA/HRA coverage on the front-end to allow for reimbursements; not possible with HSAs, which are subject to a 20% penalty tax
FSAs, HRAs and HSAs

• Additional comment regarding HSAs:
  – Applicable tax rules require annual HSA maximum contribution limit to be apportioned among “spouses”
    • **BEFORE Windsor:** Couples in a same-sex marriage, domestic partnership, or civil union, did not qualify as “spouses.” Thus, such couples were able to effectively contribute 2X the maximum statutory amount (albeit into separate HSAs)
    • **AFTER Windsor:** It appears that same-sex spouses will now be subject to the same spousal apportionment rule that applies to opposite-sex spouses. Domestic partners and civil union-ers appear able to continue to contribute 2X the maximum amount
Code Section 125 Salary Reduction

• Generally, an employee can only elect to pay for coverage for a “spouse” or Code section 152-modified dependent via Code section 125 salary reduction
  
  – **BEFORE Windsor:** An employee with a same-sex spouse, domestic partner or civil union-er generally could not elect to pay for the coverage for such individuals on a pre-tax basis through a cafeteria plan
  
  – **AFTER Windsor:**
    
    • An employee may now pay for his or her same-sex spouse’s coverage on a pre-tax basis through a cafeteria plan (subject to domiciliary requirements)
    
    • An employee cannot pay for his or her domestic partner or same-sex spouse’s coverage on a pre-tax basis (unless he or she qualifies as a Code section 152-modified dependent)
COBRA

• Generally requires that continuation coverage be provided to a “qualified beneficiary,” which is defined, in part, as a “spouse” and “child” of the employee

  – **BEFORE Windsor:** No affirmative requirement to provide COBRA coverage to domestic partners or same-sex spouses; but many employers provided for voluntary continuation coverage

  – **AFTER Windsor:**

    • To the extent an employer offers health coverage to a same-sex spouse, it appears that an employer will need to extend COBRA coverage to such same-sex spouse

    • Still no affirmative requirement to provide COBRA coverage to domestic partners or civil union-ers; but can provide such coverage voluntarily

    • Issue of notice
HIPAA Special Enrollment Rights

• Requires employers to provide an enrollment opportunity to an employee’s new spouse, or where the spouse loses coverage under another employer’s plan
  – **BEFORE Windsor:** Employers were only required to extend these rights to an opposite-sex spouse; however, an employer could voluntarily extend these enrollment rights to an employee’s same-sex spouse, domestic partner or civil union-er
  – **AFTER Windsor:** Appears employers must now extend these rights to a same-sex spouse (depending on the domiciliary requirement), to the extent an employer provides same-sex coverage generally
    • An employer may voluntarily extend these enrollment rights to an employee’s domestic partner or civil union-er
FMLA

• Requires employers to permit employees to take a time-limited leave of absence to care for a “spouse” or child.
  
  – **BEFORE Windsor:** Employers were only required to extend these leave rights to an opposite-sex spouse; however, an employer could voluntarily extend these enrollment rights to an employee’s same-sex spouse, domestic partner or civil union-er

  – **AFTER Windsor:** Appears employers must now extend these rights to an employee to care for a same-sex spouse (depending on the domiciliary requirement)
    • An employer may voluntarily extend equivalent leave rights to an employee’s same-sex spouse, domestic partner or civil union-er
ER-Paid Fringe Benefits

• The IRC provides for a host of tax-free employer-paid fringe benefits. They are generally limited to the employee, his “spouse” and dependents
  
  - **BEFORE Windsor:** Otherwise excludable fringe benefits provided to a same-sex spouse, domestic partner and civil union-er generally were taxable as wages to the employee
  
  - **AFTER Windsor:**
    
    • Qualifying fringe benefits provided to a same-sex spouse (depending on domiciliary requirement) should be excludable from the employee’s income
    
    • The same qualifying fringe benefits provided to an employee’s domestic partner or civil union-er should remain taxable as wages to the employee (unless, in certain instances, they qualify as a dependent of the employee)
QUESTIONS?

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American Benefits Council Benefits Briefing Webinar: U.S. Supreme Court DOMA Decision Impact on Retirement Plans and Executive Compensation

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July 2, 2013
Overview

• Application of *Windsor* Decision to Retirement Plans

• Plan Administration Perspective

• Key Points to Keep in Mind:
  - Potential for Guidance from Government
  - Potential Evolution of Law
  - Desired Consistency Among Benefit Programs
  - Communications to Participants
  - Communications with Recordkeepers and Service-Providers
  - Attention to Plan Documents, Policies, Disclosures, Agreements
Recognition of Same-Sex Marriages

• Which Same-Sex Marriages Will Plan Recognize?
  ▪ Retirement plans are required to recognize spouses for certain purposes
  ▪ Internal Revenue Code and ERISA require plans to give surviving spouses rights to death benefits and to recognize spouses under anti-assignment provisions (among other things)

• What Drives Decision?
  ▪ IRS rules regarding tax-qualification
  ▪ Individual private rights of action under ERISA
  ▪ Company philosophy (e.g., with respect to domestic partner benefits)
Recognition of Same-Sex Marriages

• What Drives Decision (*continued*)
  - Section 2 of DOMA remains intact, questions about which state law applies, state of celebration versus state of residence, etc.
  - Plan administration considerations
    - Increased administrative complexity resulting from potentially limited recognition of same-sex marriage
    - Disclosures to participants and obligation to update to reflect possible repeal of DOMA section 2 and changes in state laws
    - Recordkeeper’s ability to administer a limited recognition provision
    - Current practice with respect to proof of marriage (including common-law marriages)
  - Desirability for consistency across benefit programs
Application on Prospective Basis

• Apply New “Spouse” Definition on a Prospective Basis
  ▪ Review and amend spouse definition in plan documents
  ▪ Review and update summary plan descriptions and other general participant communications (e.g., benefit descriptions on company intranet)
  ▪ Review and update beneficiary designation forms, benefit election forms
  ▪ Work with vendors to ensure they update their internal procedures and guidelines/plan manuals

• Communicate Changes to Plan Participants
  ▪ How plan will be administered and what participants need to do
  ▪ Particularly important with respect to beneficiary designations
  ▪ Consider one communication addressing all benefit programs
Retroactive Implications

• Consider Retroactive Implications

  ▪ “Final” judgment expected on or about July 22, 2013
  ▪ Scope of potential impact limited to participants who entered into same-sex marriage or later then passed away or started benefit payments
  ▪ “Pre-retirement” survivor benefits already paid, in part or in full, to someone other than same-sex spouse
  ▪ “Post-retirement” survivor benefits not payable or payable to someone other than same-sex spouse
  ▪ Plan’s prior recognition of same-sex spouses (e.g., domestic partner benefits)
Retroactive Implications

• Death benefit paid in full to non-spouse beneficiary
  
  - *Example:* 401(k) plan participant had same-sex spouse at time of death, beneficiary form named someone other than same-sex spouse, spouse did not consent to beneficiary designation, plan paid the named beneficiary
  
  - *Example:* Same facts as above, but defined benefit plan that paid lump sum pre-retirement death benefit to non-spouse beneficiary
Retroactive Implications

- Death benefit not yet paid but participant in pay status (e.g., annuity starting date occurred pre-\textit{Windsor})
  - \textit{Example}: Defined benefit plan participant had same-sex spouse on annuity starting date; participant elected single life annuity; participant spouse did not consent
  - \textit{Example}: Defined benefit plan participant had same-sex spouse on annuity starting date; participant elected joint and survivor benefit with respect to survivor other than same-sex spouse; spouse did not consent
  - \textit{Example}: Defined benefit plan participant had same-sex spouse on annuity starting date; participant elected lump sum; spouse did not consent
Retroactive Implications

• Possible Plan Approaches to Retroactivity
  
  ▪ “Wait-and-see” approach with respect to IRS or other applicable guidance
  
  ▪ Determine marital status as of date benefits became payable
    
    ❖ For benefits in pay status, determined as of annuity starting date
    
    ❖ For pre-retirement death benefits, determined as of date of death (subject to plan provisions)
  
  ▪ Allow participants in pay status to change payment elections
    
    ❖ Code section 401(a)(9) regulations allow participant to change payment election to QJSA in connection with participant “becoming married” – perhaps IRS may clarify
    
    ❖ Consider administrative complexities (new election process, what happens if participant doesn’t respond, what implications for prior death benefits)
  
  ▪ Regardless of approach, will likely need to address individual cases
Summary

• Decide Which Same-Sex Spouses Will Be Recognized
  ▪ Consider factors that drive the decision

• Application Going Forward
  ▪ Review and amend plan document as needed
  ▪ Update summary plan description, beneficiary designation forms, benefit election forms, other disclosures
  ▪ Ensure service providers update internal procedures and guidelines
  ▪ Communicate with participants

• Consider Retroactive Implications
  ▪ Scenarios where liability could arise
  ▪ Develop plan and communicate with participants

• Consider Consistency Among Benefit Programs
Implications for Retirement Plans

- Benefit Payment Elections
  - Spousal consent to form of payment other than QJSA

- Death Benefits
  - Availability of qualified pre-retirement survivor annuity (primarily defined benefit and money purchase plans)
  - Beneficiary designations and spousal consent to non-spouse beneficiary
  - Timing and calculation of payments under Section 401(a)(9)

- Qualified Domestic Relations Orders
  - All or part of participant’s benefit may be assigned to spouse

- Hardship Distributions from 401(k) Plans
  - Employee may receive hardship distribution with respect to spouse’s medical, tuition, or funeral expenses

- Rollover rules differentiate between spouses and non-spouses
Executive Compensation

• Stock options, non-qualified deferral plans and SERPs, LTIPs, etc.

• Contractual v. statutory framework

• Limited population

• Potential implications
  ▪ Spousal death benefits
  ▪ Unforeseeable emergency under Section 409A
  ▪ Section 409A grandfathered plans linked to retirement plan
  ▪ Domestic relations orders
  ▪ Fringe benefits
Questions?

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