

IRS Issues Guidance on Same-Sex Spouses in Cafeteria Plans and HSAs

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The IRS has issued Notice 2014-1 which provides guidance in the form of Q&As on the application of the rules under §125 of the Internal Revenue Code (Code) (relating to cafeteria plans, including health and dependent care flexible spending arrangements (FSAs)), and section 223 of the Code (relating to health savings accounts (HSAs)), as they apply to same-sex spouses following the Supreme Court decision in *United States v. Windsor*. (“Windsor decision”)

Background

On June 26, 2013, the Supreme Court struck down provisions of the Defense of Marriage Act (“DOMA”). The Windsor decision raised many questions, answered in part by Rev. Rul. 2013-17 which said that same-sex couples legally married in a state that recognized such marriages would now be treated as married for purposes of federal taxation, regardless of the status of same-sex marriages in the couple’s state of residence. The IRS announcement was made retroactive, allowing for such marriages to be recognized back to the date on which the marriage occurred.

This new Notice 2014-01, clarifies some of the outstanding issues with respect to the federal tax treatment of same-sex spouses in certain employee benefit plans, specifically, cafeteria plans and health savings accounts. This guidance acknowledges mid-year election changes made by employees in same-sex marriages and draws attention to corrections needed in the event same-sex spouses have made excess contributions to dependent care FSAs and HSAs.

Mid-Year Election Changes

A cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the Windsor decision (June 26, 2013) as if the participant experienced a change in legal marital status. A cafeteria plan may permit such a participant to make election changes in a manner consistent with the change in legal marital status. A cafeteria plan may also permit a participant who marries a same-sex spouse after June 26, 2013, to make a mid-year election change due to a change in legal marital status.

Elections due to a change in legal marital status as a result of the Windsor decision may be filed with the cafeteria plan at any time during the cafeteria plan year that includes June 26, 2013, or the cafeteria plan year that includes December 16, 2013. Of course, while these §125 rules allow for election changes over a broad range of time, plan rules and insurance company eligibility rules may impose restrictions on the time frame allowed to make coverage changes.

The change in tax treatment for same-sex spousal coverage generally does not result in a significant change in the cost of spousal health coverage. However, for periods between June 26 and December 31, 2013, a cafeteria plan will not be treated as having failed to meet the requirements of §125 or Treas. Reg. § 1.125-4 if an election change was made based on the plan administrator’s interpretation that a significant change in the cost of health coverage occurred as a result of the Windsor decision.

Flexible Spending Account (“FSA”) Reimbursements

A cafeteria plan may permit a participant’s flexible spending account (“FSA”), including a health care, dependent care, or adoption assistance FSA, to reimburse covered expenses of the participant’s same-sex spouse or the same-sex spouse’s dependent that were incurred during the period of coverage which includes the date of the

Windsor decision (e.g., January 1 to December 31, 2013 for a calendar year plan) or which begins with the date of marriage, if later.

Contribution Limits for Health Savings Accounts

The maximum annual deductible contribution for a married couple if one person elects family coverage under a high deductible health plan ("HDHP") is \$6,450 for the 2013 taxable year. In the case of married individuals, either one of whom has family coverage under a HDHP, the HSA deduction limitation is divided equally among the spouses unless they agree on a different division.

Prior to the Windsor decision, both individuals in a same-sex marriage would have been allowed to contribute up to the "family" maximum if they were both covered by family HDHP coverage. The married couple deduction limit now applies to same-sex married couples who are treated as married for federal tax purposes with respect to a taxable year (that is, couples who remain married as of the last day of the taxable year), including the 2013 taxable year.

If the combined HSA contributions elected by two same-sex spouses exceed the applicable HSA contribution limit for a married couple, contributions for one or both of the spouses may be reduced for the remaining portion of the tax year in order to avoid exceeding the applicable contribution limit. To the extent that the combined contributions to the HSAs of the married couple exceed the applicable contribution limit, any excess may be distributed from the HSAs of one or both spouses no later than the tax return due date for the spouses, as permitted under section 223(f)(3).

Contribution Limits for Dependent Care Flexible Spending Accounts

The maximum annual contribution to one or more dependent care FSAs for a married couple is \$5,000. This limit applies to same-sex married couples who are treated as married for federal tax purposes with respect to a taxable year (that is, couples who remain married as of the last day of the taxable year), including the 2013 taxable year.

If the combined dependent care FSA contributions elected by the same-sex spouses exceed the applicable contribution limit for a married couple, contributions for one or both of the spouses may be reduced for the remaining portion of the tax year in order to avoid exceeding the applicable contribution limit.

Administrative Considerations

Plan sponsors of cafeteria plans who have accepted a change in status election due to an employee's change in legal marital status or significant change in the cost of a same-sex spouse's coverage do not need to take any action. Plans that have not accepted a change in status election due to an employee's change in legal marital status as a result of the Windsor decision should do so now. In the event a participant notifies the plan that a change in legal marital status has occurred, the plan should accept the election change (provided the plan allows for such election changes) for the remainder of the plan year that includes December 16, 2013. Administrators of FSAs should accept claims submitted for expenses incurred by same-sex spouses through the rest of the plan year.

Administrators of Dependent Care FSAs should accept an election change of an employee who may wish to reduce his or her election so as not to exceed the contribution limit.

Written Plan Amendment

If a cafeteria plan permits a change in election upon a change in legal marital status, it would not need to be amended to permit a change in status election with regard to a same-sex spouse. To the extent that the

cafeteria plan sponsor chooses to permit election changes that were not previously provided for in the written plan document, the cafeteria plan must be amended to permit such election changes on or before the last day of the first plan year beginning on or after December 16, 2013. Such an amendment may be effective retroactively to the first day of the plan year including December 16, 2013, provided that the cafeteria plan operates in accordance with the guidance under Notice 2014-01.

Summary

Notice 2014-01 acknowledges that the tax rules for same-sex spouses are the same as for opposite-sex spouses. Calendar year cafeteria plans have a limited time to make any new changes as a result of this guidance for 2013. However, plan administrators will want to be ready to respond to employee questions and requests.

Notice 2014-01 also contains a number of examples of how the guidance will work. Notice 2014-01 can be found at: www.irs.gov/pub/irs-drop/n-14-01.pdf

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