



August 2014

PENSION ANALYST

Action required—Plan administration and operation



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IRS provides additional guidance on application of the Windsor decision to qualified retirement plans

Who's affected

This guidance applies to sponsors of and participants in 401(a)-qualified defined benefit and defined contribution plans, section 403(b) plans, whether or not they are subject to ERISA. In addition, we believe it would be prudent for sponsors of governmental section 457(b) plans to follow this guidance, even though it is not specifically directed at these plans.

Background and summary

In its June 26, 2013 decision in *United States v. Windsor* (the "Windsor decision"), the US Supreme Court found that section 3 of the federal Defense of Marriage Act (DOMA), which prohibited recognition of same-sex spouses, was unconstitutional.

[IRS Revenue Ruling 2013-17](#) then provided that for all federal tax purposes, including the tax rules that apply to qualified retirement plans, those holdings would be applied prospectively as of September 16, 2013. Since the individual states' recognition of same-sex marriages continues to vary and is not always reciprocal, retirement plans were required to look to the jurisdiction (state, District of Columbia, territory or country) in which the marriage was celebrated to determine the legality of a same-sex marriage from that point forward (the "state of celebration rule").

While helpful, Revenue Ruling 2013-17 left the following unanswered questions:

- How should plans apply these rules to periods prior to September 16, 2013?
- Would it be acceptable to recognize a participant's same-sex spouse only if the participant lived in a state that recognized same-sex marriages ("state of domicile rule")?
- What plan amendments are required and what timing rules apply to any required amendments?

On April 21, 2014, the IRS published [Notice 2014-19](#) to provide answers to these questions. At the same time, the IRS posted additional [Frequently Asked Questions \(FAQs\)](#) on its website to address related issues, such as:

- The effect of the Windsor decision on pre-existing beneficiary designations.
- The proper operation of a plan governed by a document that provides that it will be operated in accordance with state law when that particular state's law does not recognize same-sex marriage.
- The application of previous IRS DOMA guidance (Rev. Rul. 2013-17 and Notice 2014-19) to 403(b) plans.

Finally, on June 2, 2014, the IRS published [Notice 2014-37](#) to provide guidance regarding mid-year amendments to safe harbor 401(k) and 401(m) plans to comply with this previous DOMA guidance.

Action and next steps

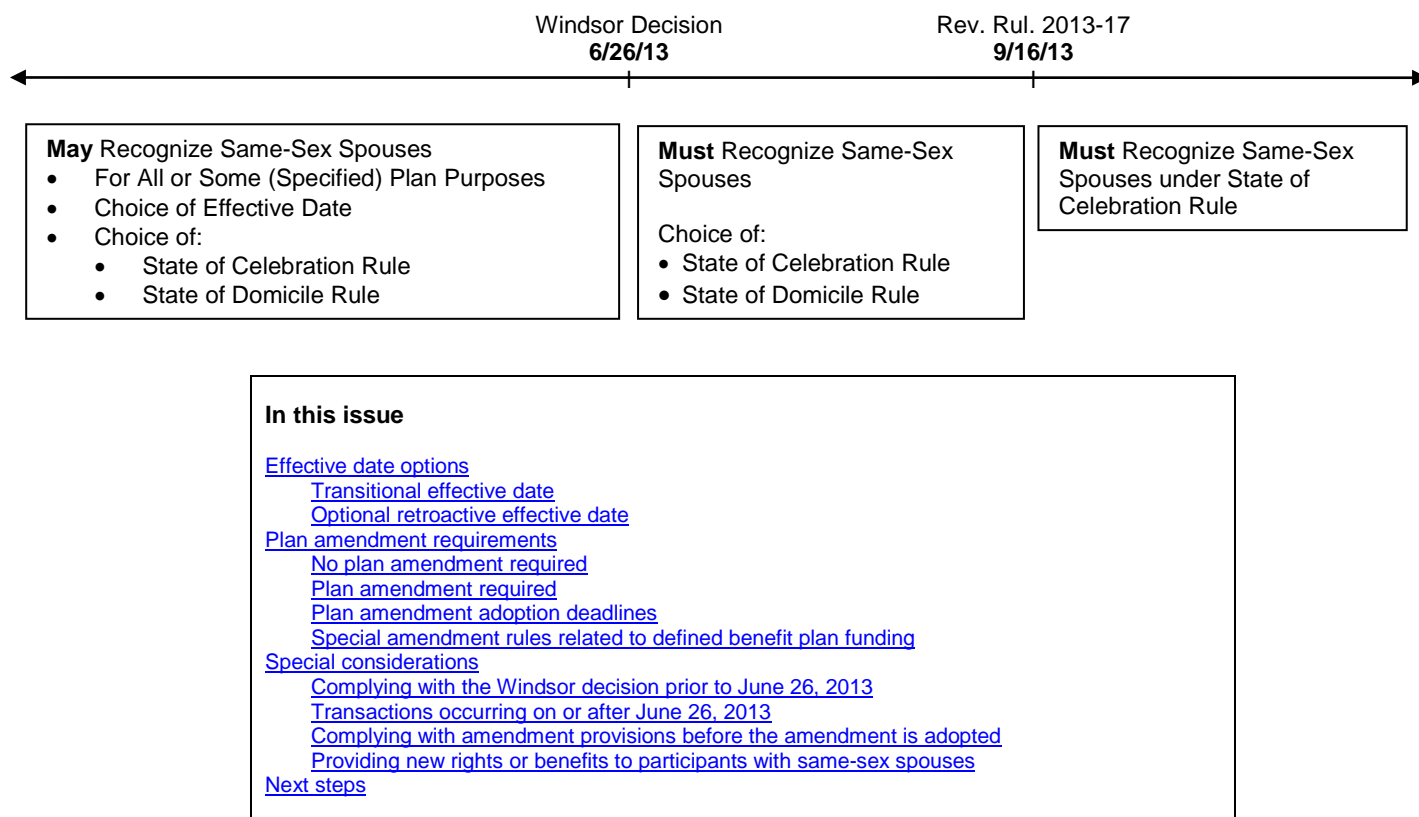
Plan sponsors should familiarize themselves with the options presented in this IRS guidance and will need to make plan amendment decisions based on their employee population and actual plan operation during the transitional period between June 26, 2013 and September 16, 2013, and possibly prior to the start of that period. Plan sponsors that use Prudential's Plan Document Services can expect to hear from their Prudential representative in the near future regarding plan amendments and related amendment adoption timing. Plan sponsors that do not use Prudential's Plan Document Services will need to provide Prudential with written direction for administering their plans in accordance with these rules (for example, executed plan amendments).

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The following diagram illustrate the options for recognition of same sex spouses before and after the Windsor decision, in accordance with the guidance provided in IRS Revenue Ruling 2013-17.



Beginning September 16, 2013, tax-qualified retirement plans must recognize same-sex spouses under a state of celebration rule. That is, if the participant entered into a legal marriage with a same sex spouse in a location that recognized such marriages, the plan must also recognize the marriage regardless of the laws of the state in which the participant works or lives. The most recent IRS guidance now provides direction regarding the treatment of same-sex spouses during the period from the date of the Windsor decision (June 26, 2013) to September 16, 2013, as well as options for recognizing same-sex spouses prior to June 26, 2013.

Effective date options

Transitional effective date

For the “transitional period” **beginning June 26, 2013 and ending September 16, 2013**, plans must recognize same-sex spouses. To do so, plans may apply the state of celebration rule. Alternatively, they may apply the state of domicile rule when recognizing same-sex spouses.

Sponsors of plans that covered participants who had same-sex spouses during this period should review transactions occurring during this period that offer different options or impose different restrictions on married and unmarried participants before electing either of these rules. The [“Special Considerations” section](#) of this document provides additional guidance regarding affected plan provisions. Transactions that were not consistent with the chosen rule will require corrective actions to maintain the plan’s qualified status, in addition to the adoption of the appropriate plan amendment to reflect that choice.

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Optional retroactive effective date

Plan sponsors may also amend their plans to recognize the Windsor decision as of **some date earlier than June 26, 2013**. The IRS cautions that this type of retroactive application could "trigger requirements that are difficult to implement retroactively (such as the ownership attribution rules)". However, if a plan does choose a pre-June 26, 2013 effective date, it can choose to recognize same-sex spouses for limited purposes. For example, a plan may be amended to recognize the Windsor decision solely for purposes of the spousal consent rules. In addition, it may apply the rules only to participants with annuity starting dates or dates of death on or after a specified date. Any retroactive amendment must satisfy the general nondiscrimination rules. In addition, corrective actions will almost certainly be needed to conform prior plan operations with the new amendment. Before making retroactive amendments, plan sponsors should consult with their plan's legal counsel and, if applicable, enrolled actuary.

Plan amendment requirements

Depending on existing plan document provisions and actual plan operation, plan amendments may or may not be required.

No plan amendment required

If a plan document does not make a distinction between opposite-sex and same-sex spouses, either explicitly or by reference to section 3 of DOMA, and chooses to follow the standard provisions of Revenue Ruling 2013-17 and Notice 2014-19, a plan amendment is not required. These plans must simply comply with the Windsor decision in operation. However, plan sponsors may want to adopt a clarifying amendment to document the plan's use of either the state of celebration rule or the state of domicile rule during the transitional period.

Plan amendment required

If a plan document defines marriage by reference to section 3 of DOMA or otherwise differentiates between opposite-sex and same-sex spouses, a plan amendment is required.

Also, some plans had extended spousal rights and benefits to same-sex spouses prior to the Windsor decision under special provisions that may have also covered domestic partners and civil union partners. Sponsors of these plans need to carefully review all such provisions and make appropriate amendments, keeping in mind that domestic partners and civil union partners are not considered to be spouses under any IRS guidance issued so far.

In addition, any plan that wishes to apply the Windsor decision rules prior to June 26, 2013 for any purpose, must be amended to specify the effective date and manner in which the new rules will apply.

Plan amendment adoption deadlines

In those situations requiring amendments to **401(a)-qualified plans (including church plans)**, the amendment is considered to be an "interim amendment". In general, an interim amendment must be adopted by the last day of the plan year in which the change is first effective or the due date of the employer's tax return for the tax year including the date the change is first effective. However, Windsor decision amendments must be adopted by the later of this general adoption deadline or **December 31, 2014**.

In the case of a 401(a)-qualified **governmental plan**, this amendment deadline is no earlier than the close of the first regular legislative session of the legislative body with the authority to amend the plan that ends after December 31, 2014.

For a **403(b) plan**, amendments must be adopted by the general amendment deadline specified in IRS Revenue Procedure 2013-22, which has not yet been announced. However, to aid plan administration, we suggest that amendments be adopted by December 31, 2014.

No amendment deadline has been specified for **governmental section 457(b) plans**. Nevertheless, we recommend that plan sponsors adopt these amendments by December 31, 2014.

While plan sponsors generally cannot amend **safe harbor 401(k) and 401(m) plans** (including Qualified Automatic Contribution Arrangements, or “QACAs”) in the middle of a plan year, the IRS will permit the mid-year adoption of amendments to reflect the Windsor decision. This exception appears to apply to amendments that are required for compliance with Windsor, as well as clarifying amendments and voluntary amendments that apply the new rules to periods before June 26, 2013.

Special amendment rules related to defined benefit plan funding

In general, an amendment to a **single-employer defined benefit plan** that increases plan liabilities cannot take effect unless the plan’s adjusted funding target attainment percentage (AFTAP) is sufficient or the employer makes an additional required contribution to the plan. If a plan sponsor adopts an amendment reflecting the Windsor decision effective June 26, 2013, this rule does not apply. However, if a plan sponsor chooses to apply the Windsor decision provisions to periods before June 26, 2013 for any purpose, the special funding rule does apply.

Similarly, an amendment increasing the liabilities of a **multiemployer defined benefit plan** that is in the yellow or red funding zone is generally not permitted. However, an amendment reflecting the Windsor decision effective June 26, 2013 is permitted. Optional amendments and amendments applying the Windsor decision provisions to periods before June 26, 2013 are not permitted.

Special considerations

Complying with the Windsor decision prior to June 26, 2013

A plan sponsor that is considering complying with the Windsor decision for periods before June 26, 2013 should carefully explore the options available and may want to recognize same-sex spouses for some provisions and not others. Spousal status is important with respect to the following aspects of plan design and administration:

- Qualified Joint and Survivor Annuity (QJSA) and Qualified Optional Survivor Annuity (QOSA) coverage, waivers, and consent.
- Qualified Preretirement Survivor Annuity (QPSA) coverage, waivers and consent.
- Qualification for the Profit Sharing Exception provision, as the spouse must receive 100% of the participant’s account balance at death unless he or she consents to another beneficiary.
- 401(k) hardship withdrawals for medical, tuition and funeral expenses of a spouse.
- Rollovers may be made by a surviving spouse to his or her own IRA or other eligible plan account.
- Plan loans may be subject to spousal consent.
- Qualified Domestic Relations Orders (QDROs) may name the former spouse as an alternate payee.
- Required Minimum Distribution (RMD) rules provide surviving spouses with a deferred payment option.
- Ownership attribution rules involving a participant’s spouse may affect:
 - Highly compensated employee (HCE) determinations and related coverage and nondiscrimination tests, including ADP and ACP tests;
 - Key employee determinations under top-heavy rules; and
 - Controlled group determinations, in general, and under Code section 415.

In addition to deciding which plan provisions will recognize same-sex spouses prior to June 26, 2013, plan sponsors will have to choose an effective date for the amendment. Some options to consider include: the earliest date that same-sex marriages were permitted in the United States (2004, in Massachusetts); the date that same-sex marriages were first permitted or recognized in the state of the plan sponsor’s principal place of business; or the enactment date of DOMA (September 21, 1996). Just as careful consideration must be given when deciding which plan provisions should recognize same-sex spouses, equally careful consideration must be given when choosing a retroactive effective date.

Transactions occurring on or after June 26, 2013

On or after June 26, 2013, a participant's same-sex spouse must be recognized and treated as the participant's surviving spouse for purposes of beneficiary provisions, Required Minimum Distribution (RMD) rules, rollover eligibility, and spousal consent to certain distribution and loan transactions. During the transitional period ending September 16, 2013, these individuals may not have been treated as spouses because plan sponsors were awaiting IRS guidance. Regardless of how a plan is amended to recognize same-sex spouses during this period, the plan sponsor should review all potentially-affected transactions that occurred during this period and may need to take corrective actions to ensure operational compliance. Such actions may be as simple as obtaining retroactive spousal consent to a distribution made to a non-spouse beneficiary, in a situation where the parties agree that this was the participant and spouse's intent.

When deciding which rule to apply during the transitional period, it is important to remember that benefit claims for some deaths occurring during this period may be submitted after September 16, 2013. To some extent, plan sponsors may be able to limit exposure by adopting the state of domicile rule.

Complying with amendment provisions before the amendment is adopted

In all situations where a plan is amended retroactively to recognize same-sex spouses, plan administrators must take steps to ensure that the amendment is correctly implemented. For example, if a non-spouse beneficiary was elected or a non-QJSA form of payment was chosen without obtaining spousal consent, the plan may obtain retroactive spousal consent in the [manner described under the IRS Employee Plans Compliance Resolution System \(EPCRS\)](#).

Providing new rights or benefits to participants with same-sex spouses

Plan sponsors may amend their plans to provide new rights or benefits to participants who have same-sex spouses. For example, a defined benefit plan may be amended to give a participant the opportunity to elect a QJSA if that option had not previously been available.

Next steps

Plan sponsors should familiarize themselves with the design options that are available for complying with the Windsor decision and then with the potentially-affected transactions under their plans that have taken place since June 26, 2013, to determine how to best amend their plans. Careful consideration should be given to amending plans to recognize same-sex marriages prior to June 26, 2013, given the potential need for corrective actions, as well as impacts on the funded status of defined benefit plans.

Sponsors that use Prudential Retirement's Plan Document Services will receive additional communications and related plan amendments to review and adopt. While some plans may have a later adoption deadline, we recommend that all plan sponsors adopt Windsor plan amendments no later than December 31, 2014. This recommendation applies to 401(a)-qualified defined benefit and defined contribution plans, 403(b) plans, and governmental section 457(b) plans, even though the IRS has not provided specific guidance or instructions for 457(b) plans.

Plan sponsors that identify issues with plan operations during the transitional period or later should contact and work with their recordkeepers to take corrective action. In most situations, service providers will not be able to identify same-sex spouse issues on their own since their records will not contain the data necessary to make such determinations.

Pension Analyst by Prudential Retirement

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