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April 17, 2009

Iowa Supreme Court Case - Varnum v. Brien **Impact on Employee Benefit Plans Covering Iowa Employees**

There has been considerable press lately regarding the Iowa Supreme Court ruling on same-sex marriages. While there are still unanswered questions as to its impact, we thought it would be helpful to send these Q&As that reflect our initial interpretation as to the ruling's impact on employee benefit plans covering Iowa employees.

1. What does the decision say?

The decision strikes down, as a violation of the Iowa Constitution, an Iowa statute requiring that a marriage be between a man and a woman. It further directs that the statute be interpreted and applied in a manner allowing same-sex marriage in Iowa.

2. When is the decision effective?

April 27, 2009.

3. What impact does the decision have on employee benefit plans covering Iowa employees?

To a large extent, impact depends on the answer to two questions. First, does ERISA or other federal law govern the benefit plan? Second, is the plan fully insured or self-funded? ERISA governs pension and welfare plans other than plans sponsored by government and church entities. ERISA generally preempts state law to the extent the

state law relates to an employee benefit plan subject to ERISA. However, an exception applies for state insurance laws as discussed in Q &A 8 below.

Generally, the impact of the Varnum case will not require pension plans and self-insured welfare plans subject to ERISA to recognize an Iowa same-sex spouse as a “spouse” under these plans, but it generally will require benefit plans not subject to ERISA and fully insured plans, even if subject to ERISA, to recognize same-sex spouses as a “spouse” under the plans.

4. What is the significance of ERISA preemption?

The Federal Defense of Marriage Act (“DOMA”) only recognizes a marriage between a man and a woman, and the word “spouse” refers only to a person of the opposite sex who is a husband or wife. DOMA applies to all federal laws. ERISA is a federal law. After the Varnum decision, federal and Iowa state law definitions of spouse and marriage are in direct conflict. Thus, if ERISA preemption applies, a marriage in Iowa between two individuals of the same sex would not have to be recognized for benefit purposes.

5. What benefit plans are subject to ERISA?

First, plans sponsored by government entities and church plans are not subject to ERISA (although church plans can elect to be subject to ERISA). All other pension and welfare plans sponsored by an employer or an employee organization are subject to ERISA. Common examples of pension plans include defined benefit plans, 401(k) plans and profit sharing plans. Common examples of welfare plans include health plans (including dental, vision and prescription drug benefits and medical reimbursement accounts in cafeteria plans), group term life insurance plans and long-term and short-term disability plans.

6. If ERISA preemption applies, can the plan sponsor voluntarily decide to recognize an Iowa same-sex spouse as a spouse under a benefit plan?

Yes, just as some plan sponsors have already decided to extend certain benefits to same-sex domestic partners. However, because the federal DOMA statute does not recognize a same-sex individual as a spouse, the spousal benefits may be subject to income tax. See Q&A 9 for a discussion of tax consequences.

In addition, an employer who provides benefits for same-sex spouses should also consider the effect of other rights offered to spouses under the plan. These additional rights may include spousal rights relating to qualified domestic relation orders, spousal consent requirements for waiver of qualified joint and survivor annuity rights or preretirement survivor annuity requirements in pension plans, as well as COBRA and FMLA rights.

The bottom line is that a same-sex spouse will not be considered a spouse for federal purposes, but an employer may offer these types of spousal benefits as an option.

Employers should review their plan documents and consider amending the definition of spouse to clarify the meaning they wish to use in their plans.

7. If ERISA preemption does not apply to a benefit plan, what is the significance of the Varnum decision?

Since Iowa law prohibits discrimination in employment based on, among other things, sexual orientation, the same-sex spouse of an employee will have to be recognized as a spouse under the plan since an opposite-sex spouse is recognized under the plan.

Types of plans not subject to ERISA include governmental and non-electing church plans* and other benefit plans not considered pension or welfare plans under ERISA. Examples of non-ERISA plans where same-sex spousal coverage may be required include certain employee assistance plans that do not rise to the level of a health plan and bereavement leave policies.

*Bona fide religious institutions and certain affiliated institutions are exempt from the Iowa employment discrimination statute based on religion, sexual orientation or gender identity when such qualifications are related to a bona fide religious purpose. Thus, even non-electing church plans may not have to recognize same-sex spouses for benefits if they fit within this exemption.

8. What about fully insured welfare plans such as health, dental, group life insurance and long-term disability policies?

Since state insurance laws related to insurance policies issued in the state are “saved” from ERISA preemption, it is likely that insurance policies issued in the state of Iowa will be required to include, or be interpreted to include, same-sex spouses in the definition of spouse, since Iowa law would govern, not DOMA. However, no guidance has yet been issued from the Iowa Division of Insurance.

9. What is the tax treatment of benefits provided to an employee’s same-sex spouse?

Because of DOMA, federal tax law under the Internal Revenue Code does not recognize same-sex marriages. As a result, the value of benefits extended to same-sex spouses will be taxable under federal law unless the same-sex spouse otherwise qualifies as the employee’s dependent under federal law. However, those same benefits may not be taxable for Iowa income tax purposes if the Iowa Department of Revenue applies Varnum to Iowa tax law. At this point, it is unclear how benefits for same-sex spouses will be treated by the Iowa Department of Revenue. Thus, employers generally will have to report the fair market value of benefits provided to an employee’s same-sex spouse as income to the employee and withhold for federal income, FICA and FUTA taxes, but may be required to carve out the value of those benefits for Iowa tax purposes.

Since extension of benefits to domestic partners is not uncommon, this is not a new issue. The IRS has issued very little guidance on how to determine the value of these benefits. However, different methodologies have been developed and used by employers.

10. What if the benefit plan already includes coverage for domestic partners?

In order to cover same-sex spouses legally married in Iowa (whether mandated for non-ERISA plans or voluntarily for ERISA plans), the definition of spouse in the plan should be reviewed and amended, if necessary, to include a same-sex spouse. Domestic partner coverage would continue in the same manner as before with benefits being taxable under both federal and state law. However, the difference would be that benefits provided to a same-sex spouse would be taxable under federal law but may not be taxable under Iowa law.

11. What is the impact on other benefit programs?

Because of federal DOMA, an Iowa same-sex spouse will not be recognized as a spouse under federal law for purposes of other ERISA benefits such as health flexible spending arrangements, dependent care reimbursement arrangements and health reimbursement plans (“HRAs”). However, if an employee’s same-sex spouse qualifies as a dependent under federal law, benefits under these types of arrangements may be offered on a tax favored basis.

12. Will federal COBRA rights extend to Iowa same-sex spouses?

Federal COBRA rights are not required to be extended to same-sex spouses because of federal DOMA, but an employer may voluntarily offer COBRA-like coverage.

13. Will Iowa’s continuation of benefit rights statute (“Iowa COBRA”) extend to Iowa same-sex spouses?

With respect to insured health plans, Iowa COBRA will likely have to be extended to same-sex spouses. However, be aware that Iowa COBRA only covers hospital, surgical or major medical insurance, or a combination of these. A separate dental insurance policy is not covered by Iowa COBRA.

14. What about the federal Family and Medical Leave Act (“FMLA”)?

A same-sex spouse will not qualify as a spouse under the federal FMLA because of federal DOMA. An employer may voluntarily choose to offer FMLA type rights to an employee for care of a same-sex spouse. However, a non-FMLA leave will not count toward the minimum family leave required under FMLA, meaning that the employee may be entitled to a second leave for care of another family member under FMLA.

15. What about Health Savings Accounts (“HSAs”) established by an employee in connection with a high deductible health plan?

An HSA is generally not subject to ERISA since it is an account established by the employee. However, federal tax law does apply. Claims paid from the account to cover health expenses of a same-sex spouse would be taxable income to the employee (plus a

10% penalty) since these expenses would not be paid for a spouse recognized under federal DOMA. The only exception would be if the same-sex spouse qualifies as a dependent.

16. Can it make a difference how a spouse is defined in a plan document?

Yes. If the term “spouse” is not defined or if the plan only includes a general definition and ERISA preemption applies, same-sex spouses will be excluded from coverage. Employers should review their plan documents, including the summary plan description (SPDs), and consider amending the definition of “spouse” to clarify the meaning intended to be used in the plan.

There are still some unanswered questions as to how the Varnum case will impact employee benefits for Iowa employers and Iowa employees. Hopefully, these Q&As help. The Q&As, however, are not intended to provide complete explanation of the impact of the case on employee benefits or to provide advice or guidance for specific situations. We will be happy to assist in providing legal advice on issues that arise because of the Varnum case. Please contact any member of our Employee Benefits Group or Labor and Employment Law Group listed below, or any other member of the firm with whom you have regular contact.

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