BENEFITS insights

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Domestic Partner Benefits

A majority of the nation's largest corporations provide health insurance coverage for domestic partners of their employees. Regardless of the size of the business, the trend of offering domestic partner benefits is increasing primarily as a means of attracting and retaining talented employees. These benefits generally include medical and dental insurance, but may also include disability and life insurance, pension benefits, family and bereavement leave, education and tuition assistance, relocation and travel expenses, and inclusion of partners in company events.

Why offer domestic partner benefits?
Companies offer domestic partner benefits for many reasons. Some of the most commonly cited reasons for offering domestic partner benefits are:

- Equal pay for equal work. For most lesbian and gay employees, the portion of their employee benefit plans that covers dependents is unavailable to them, creating a disparity in compensation. By not making employee benefits available on equal terms (regardless of marital status or sexual orientation), a company that otherwise intends to be fair may be violating its own nondiscrimination policy.
- Hiring and retention. Domestic partner benefits can have a positive impact on hiring and retention. Employers increasingly look to domestic partner benefits as a means to promote a diverse workforce. A benefits package that appeals to a diverse workforce gives employers an edge on their competitors when it comes to recruiting. For present employees, a domestic partner benefit plan can yield an employee's satisfaction, willingness to stay with the employer and inclination to recommend the employer to others, all which strongly and positively relate to the company's diversity policy.
- Improved employee productivity. One purpose of a benefits program is to provide a safety net for employees and their families, thereby allowing them to better focus on work. Employee morale and productivity improve in environments where employees believe that the employer values its employees. Domestic partner benefits offer an easy method for employers to adapt to the changing needs of their employees by expanding the eligibility for existing benefits programs.
- Union demands. Companies may offer benefits as a result of collective bargaining in which an employees' union has determined that a majority of the employees request domestic partner benefits.
- Ethical concern for others. Many employers offer domestic partner benefits for ethical reasons, to allow non-married couples to have the same rights as married ones.

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Why may an employer choose not to offer domestic partner benefits?

- Cost. High cost is a common argument that employers have raised against offering domestic partner benefits. However, despite this perception, the overall cost of adding these benefits may be quite low.
- Fraud. Another reason cited for not offering domestic partner benefits is the fear that

employees will misrepresent their relationship to obtain benefits for individuals who are not their domestic partners. To address this concern, many employers require employees to sign a legally binding statement attesting to the existence of the partnership.

- Adverse publicity. Some companies refuse to implement domestic partner benefits for fear of adverse publicity. To show the public that domestic partner benefits are beneficial, employers can stress that their corporate policies are designed to foster an atmosphere of fairness and professional respect, not to change personal values.
- Complexity. Providing and administering domestic partner benefits can be complex. These benefits may be regulated by a combination of state and federal laws.

What is a Domestic Partner?
There are no uniform rules defining a domestic partner, and not all areas have state or local laws or regulations that define the term. Therefore, some employers choose to establish their definitions in accordance with the federal tax law's "dependent" provisions, while others reference state or local law domestic partner registration systems. Commonly used plan requirements stipulate that domestic partners:

- Have lived together for a specified period (generally, at least six months);
- Share financial responsibilities;
- Are not blood relatives;
- Are at least 18 years of age;
- Are mentally competent;
- Intend that the domestic partnership be of unlimited duration;
- Register as domestic partners if there is a local domestic partner registry ;
- Are not legally married to anyone or engaged in another domestic partnership;
- State that they would marry, form a civil union or register their domestic partnership if that option became available under the law (applicable to same-sex couples); and
- Agree to inform the company if the domestic partnership terminates.

Some plans require that affidavits affirming domestic partner status be submitted to plan administrators, and that an employee submit a "termination of domestic partnership" form if the partnership ends.

When drafting plans, employers should define the term "spouse," if used in the plan, and clearly state what benefits are available to domestic partners. They should also consider whether the plan will extend eligibility to the dependents of domestic partners.

Beyond that, summary plan descriptions must clearly state whether or not domestic partners are covered by the plan and the scope of the benefits provided to domestic partners.

The same-sex spouse debate
The majority of states have approved laws or constitutional amendments that prohibit same-sex marriages. As of November 2013, 16 states and the District of Columbia have legalized same-sex marriage, including California, Connecticut, Hawaii (effective Dec. 2, 2013), Illinois (effective June 1, 2014), Iowa, Maine, Maryland, Massachusetts, New Hampshire, New York, Vermont, Washington, Delaware, Rhode Island, Minnesota and New Jersey.

In states where same-sex marriage is legal, married same-sex couples are entitled to the same protections and benefits that are afforded to married opposite-sex couples.

Some states, including New Jersey, Illinois, Hawaii, Oregon, California, Colorado, Wisconsin and Nevada, have legalized same-sex civil unions or domestic partnerships that offer some rights and protections similar to marriage. Be aware that rights granted vary by state; some offer only limited rights, while others offer full protections akin to marriage.

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In addition, some states, including Oregon, recognize same-sex marriages performed in other states, while others prohibit public employers from offering any health benefits to same-sex or domestic spouses. It is important for employers to always stay current on changing individual state laws.

DOMA
The federal Defense of Marriage Act of 1996 (DOMA) defined the term "marriage" to mean only a legal union between one man and one woman as husband and wife. DOMA does not prohibit employers from providing domestic partner benefits.

Since its enactment, DOMA was the subject of both political and legal controversy. In February 2011, the Obama Administration announced its position that DOMA's definition of

marriage is unconstitutional and directed the Justice Department to stop defending the law in federal court. However, Republican leaders in the House of Representatives intervened to defend DOMA in legal challenges.
On June 26, 2013, the U.S. Supreme Court struck down DOMA's definition of marriage by ruling that it violates the U.S. Constitution's guarantee of equal protection.

As a result of the Supreme Court's ruling, legally married same-sex couples are entitled to the same benefits and protections under federal law as opposite-sex married couples. In states that allow or recognize same-sex marriage, employers may conclude that because same-sex couples and opposite-sex couples are treated the same for employee benefits, domestic partner benefits are no longer needed.

In addition, after the Supreme Court's DOMA ruling, the IRS and the Department of Labor (DOL) adopted a "**state of celebration" rule** for recognizing same-sex marriages for federal tax and employee benefits purposes. Under the state of celebration rule, same-sex couples who are legally married in states (including foreign jurisdictions) that recognize their marriages will be treated as married for federal purposes. This rule applies regardless of whether the couple lives or works in a jurisdiction that recognizes same-sex marriage or not.

Tax implications
The Supreme Court's DOMA decision applies only to same-sex marriages that are valid under state law. It does not affect same-sex couples in civil unions or domestic partnerships. These couples will generally remain ineligible for the federal benefits provided to spouses.

The IRS has confirmed that a domestic partner is not a legal spouse for federal tax purposes. Employers are obligated to report and withhold taxes on the fair market value (FMV) of the domestic partner's and the partner's children's coverage. This is not true for health insurance coverage for legal spouses (including same-sex spouses due to the Supreme Court's DOMA ruling).

There is no clear rule on what constitutes fair market value. The FMV of coverage is determined based on the amount an individual would have to pay for the particular coverage in an arm's-length transaction. It does not depend on usage of the coverage or claims actually paid or the cost incurred by the employer.
FMV is usually determined by the difference between the cost of employee and employee-plus-one coverage.

This raises both the employee's taxable gross income and the employer's payroll taxes. Payroll deductions to cover a non-qualifying domestic partner and the partner's children must also be taken on an after-tax basis. Many employers account for this inequity by "grossing up" an employee's salary to cover the cost of additional taxes from the imputed income of domestic partner benefits. Employers should disclose the methodology used for imputing employee income to employees. This would allow affected employees to make informed decisions about the cost of coverage and the tax consequences of providing their domestic partners with health coverage through their employer.

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Domestic partner benefits may be considered non-taxable only if the domestic partner qualifies as a "dependent" under the definition of a "qualifying relative" pursuant to Internal Revenue Code (IRC) section 152. To qualify as a dependent, the domestic partner must have the same primary address as the employee/taxpayer for the year and be a member of the employee/taxpayer's household. In addition, the domestic partner must receive more than half of his or her support for the year from the employee/taxpayer. Traditionally, plans ask that the employee certify the following: that the domestic partner is the employee's tax dependent as of the date the annual enrollment form is completed; and the employee expects that the domestic partner will continue to be the employee's tax dependent for the upcoming year.

If an employee's same-sex domestic partner qualifies as a dependent, the value of the health coverage and benefits paid under the health plan are tax-free to the employee and domestic partner. A domestic partner or the partner's child does not have to be claimed as a "dependent" on the employee's federal tax return in order to be eligible for tax-free health coverage. Furthermore, a domestic partner's child is unlikely to be the employee's dependent because, in most cases, the child will be the qualifying child of another taxpayer, such as the domestic partner or the child's other parent.

While most domestic partners are not eligible to pay their portion of health insurance premiums with pretax dollars under federal law, certain states do exempt such benefits from state taxes. Because of the ever-changing laws regarding this issue, employers should regularly check the laws and regulations of any state they operate in to determine how tax withholdings should be handled at the state level.

Flexible Spending Accounts (FSA)
Money contributed on a pretax basis to an FSA can be used to pay for medical expenses not covered by health insurance. Unless a domestic partner qualifies as a dependent under the IRS definition, premiums for domestic partner

coverage cannot be offered on a pretax basis under a cafeteria plan, and an FSA cannot be used to cover the medical expenses of a domestic partner, even if the employer offers domestic partner health insurance benefits.

Health Savings Accounts (HSA)
Medical expenses incurred by or on behalf of domestic partners or their children are ineligible for tax-free reimbursement from an HSA unless the domestic partner qualifies as a dependent under IRC section 152.

Group-term life insurance
Group-term life insurance of an employee is excludable from income, up to a certain limit. This exclusion does not apply to group-term life insurance for a spouse, another family member or any other person. In terms of this exclusion, domestic partners are treated no differently than spouses.

Specifically, domestic partners cannot obtain group-term life insurance in an employer's group insurance plan on a tax-advantaged basis. Domestic partners can, however, be named as a beneficiary of life insurance purchased by an employee (their domestic partner) or by an employer for the employee to the same extent as legal spouse.

HIPAA
Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), special enrollment rights apply when employees gain new dependents or when dependents lose coverage. The extent to which domestic partners are eligible for special enrollment depends in large part on the particular health plan's eligibility rules. However, HIPAA special enrollment rights are not triggered when an employee acquires a domestic partner.

COBRA
The Consolidated Omnibus Budget Reconciliation Act of 1995 (COBRA) requires that a group health plan provide continuation of coverage when certain triggering events cause an employee, the employee's spouse and/or a dependent child to lose coverage under the plan terms. COBRA triggering events may include termination of employment, divorce or a dependent no longer qualifying as a dependent under the plan terms. Domestic partners cannot qualify as a "spouse" for COBRA purposes and do not have their own COBRA election rights.

Even though an employee's domestic partner has no independent COBRA rights in the instance of a qualifying event, an employer may choose to extend comparable benefits with the approval of the insurance carrier or HMO. If the former employee elects and pays for COBRA coverage in a timely way, he or she can add the domestic partner to the plan during an open enrollment period. The domestic partner's plan coverage will end when the former employee's COBRA coverage ends. If the domestic partner's children are covered as dependents under the plan, they will be qualified beneficiaries in connection with any COBRA qualifying event.

Before extending benefits to domestic partners, an employer should determine the status of the domestic partner rules in each state in which it operates.

Again, state laws vary greatly in regards to this issue, so it is vital for employers to keep up to date on their particular state's laws.

FMLA
The Family and Medical Leave Act of 1993 (FMLA) is a federal policy designed to offer leave annually for certain family or medical reasons. A domestic partner is not considered a spouse or family member for FMLA leave purposes, even if the partner qualifies under IRC section 152. Though many do, employers are not legally required to extend family and medical leave to an employee to care for a domestic partner. At this time, only a handful of states require employers to extend FMLA-type leave for employees with domestic partners.

Hardship withdrawals and account balance rollovers
The Pension Protection Act (PPA) contains provisions affecting hardship withdrawals and account balance rollovers from retirement plans, which are beneficial to employees who are in a domestic partnership. Before the passage of the PPA, a retirement plan could only allow a participant to receive a hardship withdrawal due to a financial hardship affecting the participant, the participant's spouse or the participant's dependent. The PPA allows hardship distributions for medical, educational and funeral expenses for a primary beneficiary under the plan. A primary beneficiary is defined as an individual who is named as a beneficiary under the plan and has a right to all or a fraction of the participant's account balance following the participant's death. This provision is optional for plans, and requires a plan amendment.

The PPA also allows a non-spouse beneficiary to roll over the deceased participant's account balance to an inherited IRA, where previously a non-spouse beneficiary was required to withdraw the account balance in a lump sum or during a five-year period following the year of the date of the participant's death.

Insurance
When domestic partner benefits were first offered, few insurance carriers wrote these policies. Those that did usually added a charge to cover any unexpected cost increase. Today, many insurance companies will cover domestic partners, and most have stopped adding a surcharge. For companies that are self-insured, adding domestic partner benefits is a relatively simple process since it does not require state regulatory approval. To get this type of coverage, fully-insured

companies usually need to negotiate the specifics of the additional coverage with their insurer and get their plan approved by state insurance regulators. In the event that an insurance provider cannot be located, employers may ask the domestic partner or employee to purchase the additional insurance and accept reimbursement for a portion of the premium cost.

Over a dozen states require that any employer who provides health benefits to employee spouses must offer the same to domestic partners of employees. It is also important to remember that, despite state laws and employers' policies, the federal government does not recognize domestic partners as legal "spouses." Thus, although employee and employee spouse/dependent health benefits are non-taxable, domestic partner benefits may be subject to federal taxation.

Legal considerations

The Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) are federal laws that are directly applicable to domestic partner benefits. ERISA governs voluntary, employer-sponsored, private sector employee welfare and pension benefit plans. ERISA generally preempts state laws that relate to employee benefit plans, but not state laws that regulate insurance. As such, state insurance law may require coverage of domestic partners in plans that are otherwise regulated by ERISA. However, a fully-insured health plan may be treated differently than a self-insured health plan. Public sector plans are generally exempt from ERISA, and the IRC regulates employee benefits provided through public sector health and retirement plans.

Employers must ensure compliance with their state's same-sex partner recognition and benefit regulations. Many cities have enacted equal benefit ordinances requiring contractors with the government entity to extend benefits to same-sex domestic partners. These laws generally require that contractors offering health insurance and other employee benefits to employees' spouses must offer the same benefits to employees' domestic partners.

In some cases, choosing not to extend domestic partner benefits may expose employers to potential lawsuits. State laws that ban discrimination on the basis of sexual orientation and marital status have been used to argue that employers are required to offer domestic partner benefits. However, these claims have been largely unsuccessful due to the rationale that unmarried heterosexual couples are also typically excluded.

Conclusion

Employers need to be aware of the complicated benefits, employment and tax issues that accompany domestic partner benefits. Before extending benefits to domestic partners, an employer should determine the status of the domestic partner rules in each state in which it operates. Understanding the needs and changing nature of your workforce will make it easier to decide whether to offer domestic partner benefits.