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TAX AND PERSONAL FINANCIAL PLANNING
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NEWSLETTER

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Hinckley, Allen & Snyder LLP, a regional law firm with offices in Boston, Providence, Hartford and Concord, NH, has been in New England since 1906.

THE IMPACT OF SAME-SEX MARRIAGE ON EMPLOYEE BENEFIT PLANS

Tracy A. Vitols, Esq.

Connecticut joins Massachusetts in recognizing same-sex marriage and as a result, there is much discussion regarding the impact on employee benefit plans. The purpose of this article is to inform you of some of the intended, and unintended, implications that the recognition of same-sex marriage will have on employer-sponsored employee benefit plans.

What is current Massachusetts and Connecticut state law? In 2003, the Massachusetts Superior Court decided that the Commonwealth of Massachusetts may not deny the protections, benefits and obligations of civil marriage to same-sex couples, effective May 17, 2004. Similarly, the Connecticut Supreme Court struck down the state law limiting marriage to heterosexual couples and the state civil union extending certain rights to same-sex couples. As of November 12, 2008, Connecticut recognizes same-sex marriage.

What is current Federal law? The Defense of Marriage Act (DOMA) was enacted in 1996 for the purpose of denying benefits to same-sex couples if they are married by a state. DOMA defines "marriage" as a legal union between one man and one woman and further defines "spouse" as a person of the opposite sex. DOMA also provides that these definitions will apply to any act of Congress, or any ruling, regulation, or interpretation of the various administrative bureaus and agencies in the United States. It is clear from the statute that only opposite-sex marriages will be recognized for federal purposes.

Most employee benefit plans are governed by the Employee Retirement Income Security Act of 1974, as amended (ERISA), and/or the Internal Revenue Code (the "Code"). If state law attempts to govern an ERISA-covered plan, the general rule is that the state law will be preempted by ERISA. The one exception to this general rule is that ERISA will not preempt state laws that govern insurance.

How are qualified retirement plans affected by same-sex marriages? A qualified retirement plan is a plan that is sponsored by an employer for the benefit of its employees and which provides or defers income until retirement. The term "qualified" means that the retirement plan will be afforded special tax treatment because it meets a number of requirements under the Code. Examples of qualified retirement plans include profit-sharing plans, 401(k) plans, money purchase pension plans, and defined benefit plans.

Since qualified retirement plans are governed by ERISA and the Code, the plans are subject to federal law and the principles of DOMA will apply. An employer may, but is not required to, recognize a same-sex marriage. However, for federal tax purposes, a same-sex spouse is not recognized.

Qualified retirement plan documents need to be carefully reviewed to determine how the term "spouse" is defined, if at all. If the

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THE IMPACT OF SAME-SEX MARRIAGE ON EMPLOYEE BENEFIT PLANS - CONTINUED FROM PAGE 1

definition of "spouse" is not clear, then the employer will need to revise the plan documents. Employers need to be aware that the terms of the plan document may inadvertently recognize a same-sex spouse even if this is not intended by the employer (i.e., if the definition of "spouse" is vague or is defined by reference to Massachusetts or Connecticut state law).

Is a same-sex spouse eligible for a QJSA? The required form of distribution under a defined benefit plan and a money purchase pension plan is a qualified joint and survivor annuity (QJSA), which is defined as an immediate annuity for the life of the participant, with a survivor annuity for the life of the participant's spouse. This automatic form of distribution may be waived with written spousal consent. Since a same-sex spouse is not recognized as a spouse under federal law, a participant married to a same-sex spouse would be treated as an unmarried participant for purposes of the QJSA requirements. An employer may extend the plan's definition of "spouse" to cover a same-sex spouse for this purpose; however, the spousal consent requirement to waive the QJSA, which is imposed by federal tax law, will not be required.

In the event of dissolution of a same-sex marriage, may a same-sex spouse obtain a QDRO? A qualified domestic relations order (QDRO) permits the assignment of all or a portion of the employee's retirement benefit pursuant to a court order to a spouse or former spouse of the employee. Although a same-sex spouse is not recognized under federal law, the QDRO rules depend upon state court orders issued under state domestic relations law. It is not clear whether the assignment of the participant's retirement benefit to a same-sex spouse pursuant to a court order would be recognized as a QDRO.

Since state insurance laws are not preempted by ERISA, then presumably a group health, dental or insurance contract that references a spouse under Massachusetts or Connecticut insurance law would be interpreted to include a same-sex spouse.

If an employer sponsors an insured medical/dental plan, must a same-sex spouse be included? An employer that sponsors a medical plan, a dental plan, or health maintenance organization contract which provides a benefit to employees and their beneficiaries will likely be subject to state insurance laws. Since state insurance laws are not preempted by ERISA, then presumably a group health, dental or insurance contract that references a spouse under Massachusetts or Connecticut insurance law would be interpreted to include a same-sex spouse. Employers should confirm this treatment with insurers of health/dental plans.

If a same-sex spouse is included in a medical/dental plan, will the cost of coverage be excluded for federal income tax purposes? Federal tax law excludes the cost of coverage for a spouse or a dependent from the employee's gross income. Since a same-sex marriage is not recognized under federal law, the value of the cost of coverage provided to a same-sex spouse will be *included* in the employee's gross income for federal income tax purposes, unless the same-sex spouse qualifies as a dependent under the Code.

Is a same-sex spouse required to be included in a self-insured medical/dental plan? If the employer sponsors a self-insured plan (which is typically governed by federal law), then the employer would not be regulated by state insurance law and could either require or prohibit extending coverage to a same-sex spouse. Employers that sponsor self-insured plans will need to examine their plan documents to determine how "spouse" is defined. If it is determined that the definition of "spouse" is not clear

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EXECUTIVE COMPENSATION

FEDERAL ECONOMIC STIMULUS PROGRAMS LIMIT EXECUTIVE COMPENSATION

Frederick P. McClure, Esq.

Institutions that participate in federal programs to stimulate lending activity face additional limitations on executive compensation. Recently, the IRS published several Notices and the Economic Recovery Act itself includes new limitations which have recently been clarified by additional guidance from the Department of Treasury.

Public and private financial institutions that sell assets to the Treasury in excess of $300 million (and certain affiliates), including direct sales and sales through auctions, are subject to some or all of the following additional limitations on executive compensation:

- In most cases the limitations apply to the CEO, the CFO and the three other most highly compensated executives (we will call them senior executives).

- The Compensation Committee must act within 90 days to review compensation arrangements and certify their conclusions and actions to appropriate regulatory agencies.

- Any senior executive's bonus or incentive compensation that is paid while the Treasury holds a debt or equity position in the institutions must provide for a recovery or "claw back" of the payment if the payments were based on materially inaccurate financial statements or materially inaccurate performance metric criteria. This limitation is more restrictive than the provisions of Sarbanes-Oxley in several respects that we shall not describe here (but are available if you wish to contact the author).

- The financial institution must prohibit the payment of certain golden parachute payments to a senior executive during the period that the Treasury holds a debt or equity position acquired under a program of the Economic Stabilization Act of 2008. For the purpose of this rule the term parachute payment means a payment as a result of an involuntary termination (including in many cases a termination by the executive for good cause, or the failure of the institution to renew an employment contract, or in connection with a bankruptcy filing, insolvency or receivership of the institution or certain affiliated institutions).

- The provisions of the Internal Revenue Code that disallow an income tax deduction for non-performance based compensation has been reduced from $1 million to $500,000 for institutions that sell troubled assets to the Treasury.

If you are a financial institution that wishes to participate in any Treasury program under the Emergency Economic Stabilization Act of 2008, or if you are a senior executive of such an institution and you would like more information on the new limitations on executive compensation, please contact Frederick P. McClure or any other member of our Tax Group.

Public and private financial institutions that sell assets to the Treasury in excess of $300 million are subject to some or all of the limitations on executive compensation.

PERSONAL TAX & FINANCIAL PLANNING

TAX PROPOSALS OF THE NEW ADMINISTRATION

Roy W. Gillig, Esq.
Frederick P. McClure, Esq.

During the campaign President-elect Obama repeatedly pledged to increase tax rates on individuals who file separately and earn more than $200,000 per year and joint filers earning more than $250,000. Recent comments by his economic transition team indicate that tax increases may be delayed until after the economy has recovered.

Most long-term capital gains are presently subject to a 15% federal tax rate as are most dividends. The highest federal statutory marginal tax rate on ordinary income is now 35%. Under currently enacted law the capital gains rate is scheduled to increase after 2010 to 20%, the highest statutory marginal tax rate will return to 39.6%, and dividends will again be taxed at the ordinary tax rate instead of the capital gains rate.

With this uncertainty in rates, some taxpayers may decide that triggering gains at the current historically favorable tax rates is preferable to gambling that the low rates will be available in 2009 or thereafter. Although the rate increases probably do not justify triggering gains on assets that would not otherwise have been sold in the short-term, accelerating expected 2009 gains to 2008 may be advisable. There are a number of ways to trigger taxable income, and the methods generally depend on the nature of the asset from which income is to be recognized. Techniques range from simple to complex.

Taxpayers with losses caused by the general downturn in the economy should not despair, either. Deferring the recognition of losses until tax rates go up has the same effect as accelerating gains, assuming there is no other income next year against which loss can be offset.

Those who intend to shift assets from one generation to another at some time in the future should also consider whether the downturn in the economy, and generally lower asset valuations, make this an opportune time to transfer assets to minimize estate and gift taxes.

Something for everybody.

On January 1, 2009, the federal estate tax exemption rises to $3.5 million. While current law provides for additional dramatic changes in that exemption amount in 2010 and 2011, we believe that following the recent presidential election and the seating of Congress in 2009, a bipartisan bill will emerge fixing the exemption at roughly $3.5 million. Consequently, a single person will be able to leave up to $3.5 million to beneficiaries without any federal estate taxes. Married couples, with the appropriate planning, will be able to leave up to $7 million without any estate tax.

While the federal exemption will significantly increase in 2009, the same is not true with respect to State estate tax exemption amounts. In Rhode Island, that number is fixed at $675,000. In Massachusetts, the exemption is $1 million while in Connecticut, it is $2 million.

Unfortunately, this significant difference in the state exemption from the federal exemption could produce unnecessary and untimely estate taxes if your estate plans have not been updated in recent years. Also, this difference could result in estate distributions that do not conform to your estate planning objectives. Finally, the ability of a married couple to leave $7 million federal estate tax free makes it even more important for you to revisit your plans.

We strongly recommend that you have your estate plans reviewed to make sure that tax savings are maximized and that the ultimate distribution of your estates is consistent with your wishes and objectives. This is especially true for those of you who have not had your plans reviewed during the past five years.

Please call us for an appointment.

EMPLOYEE BENEFITS

THE HEROES EARNING ASSISTANCE AND RELIEF TAX ACT OF 2008

Donna M. Niles

On June 17, 2008, U.S. President George Bush signed into law the recently passed Heroes Earnings Assistance and Relief Tax Act of 2008 (the HEART Act). The HEART Act amends primarily the Internal Revenue Code of 1986 (the Code) to provide certain benefits for military personnel and their beneficiaries, including enhanced retirement and welfare benefits.

RETIREMENT BENEFITS

The following summarizes the provisions of the HEART Act that affect the administration of tax-qualified retirement plans. Unless otherwise provided, employers are required to (or may in the case of optional provisions) administer their plans to implement these changes effective January 1, 2007. However, plans do not need to be formally amended until the last day of the 2010 plan year.

SURVIVOR BENEFITS (REQUIRED)

If a tax-qualified retirement plan offers certain benefits to survivors of participants who die while actively employed, such as an incidental death benefit or accelerated vesting, the plan must offer these same benefits to survivors of participants who die while performing qualified military service.

The HEART Act requirement is effective retroactively for any military death during active duty that occurred on or after Jan. 1, 2007. Plan amendments must be adopted by the end of the first plan year that begins in 2010.

ADDITIONAL BENEFIT ACCRUALS (OPTIONAL)

Under the HEART Act, employers may amend their plans to credit a period of qualified military service to a participant who dies or becomes disabled during his/her military service for purposes of determining benefit accruals under the plan. Under this optional provision, the participant is treated as returning to work on the date preceding his/her death or disability and terminating employment on the actual date of his/her death or disability. By treating the deceased or disabled participant as returning to active employment prior to his/her date of death or disability, the participant may be credited with additional benefit accrual credit in much the same manner as a returning veteran under the Uniformed Services Employment and Reemployment Rights Act.

Additionally, under this optional provision, employers may contribute make-up contributions under defined contribution plans and make-up accruals under contributory defined benefit plans for contributions missed while deceased or disabled participants are engaged in qualified military service. For this purpose, employers may treat these individuals as having contributed or deferred under the plan at the average of their participant contributions or deferrals for the 12-month period before their qualified military service or their actual period of service if less than 12 months.

The additional benefit accruals provided under these optional rules must be credited on a reasonably equivalent basis to all employees performing qualified military service who otherwise meet the conditions for receiving the additional accruals.

Plans are permitted to implement these rules for deaths or disabilities that occur on or after Jan. 1, 2007.

EXTENSION OF EXEMPTION FROM EARLY WITHDRAWAL PENALTY (REQUIRED)

Individuals called to active duty after September 11, 2001 and prior to December 31, 2007 for a period of at least 180 days were exempt from the 10 percent penalty tax on early withdrawals from qualified retirement plans. Individuals who took an early withdrawal also had the option to repay the distribution within the two-year period after the end of active duty. The HEART Act indefinitely extends both the penalty exemption and the repayment option to individuals called to active duty after December 31, 2007.

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FEDERAL & STATE LEGISLATION

RECENT FEDERAL AND STATE ACTION

Frederick P. McClure, Esq.

HIGH DEDUCTIBLE HEALTH CARE PLANS USING HEALTH SAVINGS ACCOUNTS

The IRS has issued detailed written guidance on a range of issues relating to the high deductible health care plans using health savings accounts. We anticipate that this additional guidance together with increased focus on health care costs and issues will stimulate the adoption of high deductible plans by employers as a means of reducing costs and increasing the flexibility for employees. Until recently there were just too many unresolved issues for many employers who were considering this alternative health care arrangement. If you would like more information on high deductible health care plans and health savings accounts please contact Tracy Vitols.

FINAL REMINDER

Amendments to deferred compensation arrangements to comply with Section 409A of the Internal Revenue Code must be adopted by December 31, 2008.

2009 BENEFIT PLAN LIMITATIONS

The annual limit on elective contributions under 401K plans and eligible deferred compensation plans (Section 457) will increase from $15,500 to $16,500 and the so-called catch-up contribution...

The amount of compensation that may be taken into account in calculating contributions and benefits under pension and 401K plans increases from $230,000 to $245,000.

The compensation amount that defines a "highly compensated employee" increases from $105,000 to $110,000 for 2009.

We anticipate that this additional guidance together with increased focus on health care costs and issues will stimulate the adoption of high deductible plans by employers as a means of reducing costs and increasing the flexibility for employees.

NEW TAX ON DEFERRED COMPENSATION FROM CERTAIN FOREIGN BASED BUSINESSES

The Emergency Economic Stabilization Act of 2008 (the "bailout bill") includes an amendment to the deferred compensation provisions of the Internal Revenue Code. Section 457A will apply beginning January 1, 2009 to any US taxpayer who receives an award of deferred compensation from any partnership whose income is not subject to a comprehensive foreign income tax (its income is not subject to tax in another country), or a foreign corporation whose income is not effectively connected with the conduct of a trade or business in the US (its income is subject to tax in the US), or whose income is not subject to a comprehensive foreign income tax (its income is not subject to tax in another country).

The deferred compensation will be includible in the income of the US taxpayer in the year that the deferred compensation is no longer conditioned on the future performance of substantial services, unless it is paid within 12 months of the end of that year or the compensation is determined solely by reference to the gain on the sale of a single investment asset (other than an investment fund) and substantially all of the gain is allocated to investors in the entity.

The targets for this one are those who are operating hedge funds or private equity funds that are effectively domiciled to avoid any comprehensive income tax structure.

NEW LIMITS ON EXECUTIVE COMPENSATION

See the article on page 3.

THE HEROES EARNING ASSISTANCE AND RELIEF TAX ACT OF 2008 — CONTINUED FROM PAGE 5

DIFFERENTIAL WAGE PAYMENTS (REQUIRED)

Any payments made by an employer after December 31, 2008 to an employee on active duty for a period of more than 30 days will be treated as "differential wage payments" to the extent the payments represent all or a portion of the wages the individual would have received from the employer absent being called to active military service. Any such payments will be subject to federal withholding rules and will be reportable as W-2 wages (currently differential wage payments are treated as benefits reportable on IRS Form 1099). Moreover, in the retirement plan context, participants receiving differential wage payments must be treated as active employees and the payments treated as compensation for purposes of determining plan benefits.

A participant on active duty who is treated as an employee due to receipt of differential wage payments is still entitled to take advantage of the rule allowing for distributions from a qualified plan, 403(b) plan or 457 plan upon commencement of military leave lasting at least 30 days (because, in this unique context, leave with differential wage payments is still treated as a seperation from service). If a participant receiving differential wage payments takes a distribution, he/she may not make elective deferrals or contributions to the plan for six months following the date of distribution.

ROLLOVERS TO ROTH IRAS

Recipients of a military death gratuity are eligible to roll this amount over to a Roth IRA or a Coverdell education savings account so long as the rollover is completed within the year following receipt of the gratuity payment. The traditional limitations on rollovers to Roth IRAs do not apply. This change applies to any gratuity payments made with respect to a death that occurs after June 17, 2008. If the gratuity payment was made with respect to a death that occurred after October 7, 2001 and before June 17, 2008, recipients can still take advantage of this rule so long as the rollover is completed by June 17, 2009. This change should not affect an employer's administration of its plans, but employers should be aware of this option.

WELFARE BENEFITS

FLEXIBLE SPENDING ACCOUNTS (OPTIONAL)

Employers are *permitted* to add "qualified reservist distributions" to their cafeteria plans. An employer may amend its health flexible spending arrangement (FSA) to allow reservists called to active duty to withdraw all or a portion of the balance in their account. This distribution will be taxable to the employee. In order to take advantage of this option, the individual must be called to active duty for at least 180 days (or indefinitely) and the distribution must be made on or after the day the individual is called to active duty and on or before the last date on which employees can submit claims for reimbursement under the FSA for the year in which the individual is called to active duty. This optional change allows employers to prevent the active duty employee from forfeiting his/her unused account balance and may be implemented immediately following the enactment of the HEART Act. Employers will have to amend their FSA plans accordingly.

EXTENSION OF MENTAL HEALTH PARITY REQUIREMENTS (REQUIRED)

The HEART Act amends the Code, the Employee Retirement Income Security Act of 1974 (ERISA), and the Public Health Services Act to extend the mental health parity requirements applicable to group health plans through the end of 2008.

PLAN AMENDMENTS REQUIRED

Compliance with the HEART Act will require plan amendments to many retirement plans by December 31, 2010 (for calendar year plans). In addition, any employer that wants to add qualified reservist distributions to a cafeteria plan must amend the plan and distribute a revised summary plan description or summary of material modification by the appropriate deadlines for the effective date the employer chooses for implementation of the change.

THE IMPACT OF SAME-SEX MARRIAGE ON EMPLOYEE BENEFIT PLANS — CONTINUED FROM PAGE 2

with respect to including or excluding a same-sex spouse, then the employer will need to revise the plan documents accordingly.

If an employer is subject to federal COBRA, will the employer be required to offer COBRA continuation coverage to a same-sex spouse? The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) is a federal law that requires employers to offer continuation of health benefits to certain individuals who would otherwise lose coverage. Federal COBRA applies to an employer that maintains a group health plan for its employees or their families provided that the employer employs at least 20 employees.

COBRA continuation coverage is required to be offered to a "qualified beneficiary" who is defined as any employee, spouse of an employee, or dependent child of an employee that is covered under the group health plan on the day before the event that causes the individual to lose his or her coverage. In accordance with the principles of federal law, "spouse" would not include a same-sex spouse. Thus, federal COBRA continuation coverage is not required to be offered to a same-sex spouse. If, however, an employer wishes to extend continuation coverage to a same-sex spouse, the employer should first consult with the insurer.

What if the employer provides employee benefits to domestic partners? Similar to a same-sex spouse, a domestic partner is not recognized under federal law and will be subject to the same treatment described above. One notable difference is that a domestic partner will not benefit from Massachusetts or Connecticut insurance laws, which recognize a same-sex spouse.

Employers that offer domestic partner benefits will need to consider whether to continue offering domestic partner benefits in their plans. In the past, an employer typically offered domestic partner benefits only to same-sex couples in order to provide a benefit that would not have otherwise been available (i.e., a same-sex domestic partner did not have the option of marriage). Employers that wish to continue domestic partner benefits in their plans may need to revise their domestic partner provisions to include opposite-sex domestic partners so as to avoid any potential state law discrimination issues.

What steps should an employer take with regard to Massachusetts and Connecticut state law? Given the fact that the employer has some discretion to determine whether a particular employee benefit plan will cover a same-sex spouse, it is prudent for the employer to take a position with regard to extending such coverage. For any employee benefit plans involving insurance, the employer needs to follow-up with the insurer as to the treatment of a same-sex spouse.

The employer needs to review its employee benefit plans for the definition of spouse and determine whether this definition is consistent with the employer's position. If the plan's definition of spouse is not clear or is ambiguous, then the employer will need to revise the documents (including plan communications) for purposes of clarification and to reduce the potential for later disputes.

If you have any additional questions regarding this Newsletter or have any other Tax and Personal Financial Planning needs, please contact any member of the Tax and Personal Financial Planning Law Group.

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