



The “Who, What, When & How” to Group Health Plan Form W-2 Reporting

One of the many new challenges imposed on employers due to the passage of the Patient Protection and Affordable Care Act on March 23, 2010 (“Health Care Reform”) is the requirement to report the “aggregate cost of employer-sponsored coverage” on their employees’ Forms W-2. The types of coverage required to be reported and the method to calculate the “aggregate cost” of such coverage were, until recently, unclear.

This Health Care Reform reporting provision, now set forth within Internal Revenue Code section 6051(a)(14), was scheduled to become effective for taxable years beginning after December 31, 2010. The IRS thereafter issued Notice 2010-69, suspending the reporting requirement until 2012.¹ This was welcome relief to Employers as the technicalities of reporting group health plan coverage were still a bit of a mystery.

However, on March 29, 2011, the long-anticipated guidance on Form W-2 reporting was released in IRS Notice 2011-28.² While future guidance is still expected, employers now have a much clearer picture of how to comply with this new Health Care Reform requirement. We summarize this guidance below.

Who Must Comply:

All employers are subject to this reporting requirement.

Except for the transition relief provided below, all private and public employers, federal, state and local government entities, churches and other religious organizations, and other employers not subject to COBRA’s continuation requirements, must comply to the extent they provide applicable employer-sponsored coverage under a group health plan. The only exception is for federally recognized Indian tribal governments.

¹ Notice 2010-69 explained the extension would provide employers additional time to make any necessary changes to their payroll systems or procedures in preparation for compliance with the reporting requirement. While the IRS did also issue a draft Form W-2 (which included the requisite boxes for health benefit reporting), such reporting was optional for 2011. The IRS did confirm that any amounts reported remain nontaxable to the employee.

² Notice 2011-28 indicates it only provides “interim guidance” for the 2012 Forms W-2 reporting. To the extent that future guidance expands these reporting requirements, or causes them to apply to additional categories of coverage or employers, the guidance will apply prospectively only and will not apply to any calendar year beginning within six months after the guidance is issued.

Transition Relief for Smaller Employers:³ Notice 2011-28 provides transition relief for at least another year for employers who were required to file less than 250 Forms W-2 in the preceding calendar year.

When the Reporting Requirement is Effective:

Notice 2011-28 confirmed that reporting will begin for the 2012 calendar year. This means that employers must collect information on the aggregate cost of employer-sponsored coverage provided in year 2012 and must include such information within the Forms W-2 issued in January 1, 2013.

Because this reporting requirement becomes effective in eight (8) months, employers should begin working with their payroll systems to set up procedures and the necessary infrastructure to report the cost of health care provided in calendar year 2012.

What Coverage Must Be Reported:

The total cost of coverage under all “applicable employer-sponsored coverage” provided to the employee for the calendar year must be reported on that employee’s Form W-2.⁴

“Applicable employer-sponsored coverage” is group health plan coverage that is non-taxable to the employee (i.e., excludable from an employee’s gross income under Code section 106).⁵

Exceptions:

Applicable employer-sponsored coverage specifically does **not** include:

- Any coverage described in Code section 9832(c)(1) (i.e., HIPAA excepted benefits) other than coverage for on-site medical clinics, meaning that coverage for such clinics is reportable;⁶

³ This transition relief currently has no expiration date but it is clear that W-2 reporting will not be required prior to January 2014 (for coverage provided in calendar year 2013). Notice 2011-28 states: “Future guidance may limit the availability of some or all of this transition relief; however, such guidance will be prospective only and will not be applicable earlier than January 1 of the calendar year beginning at least six months after its date of issuance. In no case will such guidance limit the availability of this transition relief for the 2012 Forms W-2 (meaning Forms W-2 for the calendar year 2012 that employers generally are required to furnish to employees in January 2013 and then file with the [Social Security Administration]).” See IRS Notice 2011-28, page 18.

⁴ As with previous guidance, Notice 2011-28 emphasizes that although the cost of applicable employer-sponsored coverage must be reported on Form W-2, it does not have any impact on the taxability of such coverage and is for informational purposes only.

⁵ This also includes coverage that *would* be excludable from gross income under Code section 106 if it were employer-provided coverage.

- Long-term care coverage;
- Coverage under a separate policy, certificate or contract of insurance that provides benefits, substantially all of which are for treatment of the mouth (including any organ or structure within the mouth) or for treatment of the eye; or
- Any coverage described within Code section 9832(c)(3) that is not excludable from gross income and for which a Code section 162(l) deduction is not allowed. This is coverage offered as independent, non-coordinated benefits, i.e.:
 - coverage only for a specified disease or illness; or
 - hospital indemnity or other fixed indemnity insurance.

Furthermore, the reporting requirements of Code section 6051(a)(14) do not apply to:

- Amounts contributed to Archer MSAs, health savings accounts (HSAs), employee salary reduction contributions to flexible spending arrangements (FSAs);⁷ or
- Costs of coverage provided by the government (local, state or federal) that are maintained primarily for member of the military or members of the military and their families.

*Additional Exceptions - Transition Relief:*⁸ The IRS guidance provides transition relief from the reporting requirement for at least an additional year for the following plans:

- Cost of coverage under a Health Reimbursement Arrangement (HRA);
- Contributions by an employer to a multiemployer plan;

⁶ The types of coverage under Code 9832(c)(1), commonly referred to as HIPAA excepted benefits, which are not subject to the new Form W-2 reporting requirement are:

- accident or disability income insurance;
- supplement coverage to liability insurance;
- liability insurance (including general liability or automobile liability);
- workers' compensation or similar coverage;
- automobile medical payment insurance;
- credit-only insurance; and
- other similar insurance, as specified in the regulations, where benefits for medical care are secondary or incidental to other covered benefits of such insurance.

⁷ However, if the employer also contributes to the health FSA and if the total amount of the health FSA for the plan year exceeds the total salary reduction amount (for all benefits) elected by the employee for that year, then the amount of the employee's health FSA minus the employee's salary reduction election for the health FSA is the amount required to be reported.

⁸ This transitional relief currently has no expiration date but it is clear that W-2 reporting will not be required prior to January 2014 (for coverage provided in calendar year 2013). Notice 2011-28 states: "Future guidance may limit the availability of some or all of this transition relief; however, such guidance will be prospective only and will not be applicable earlier than January 1 of the calendar year beginning at least six months after its date of issuance. In no case will such guidance limit the availability of this transition relief for the 2012 Forms W-2 (meaning Forms W-2 for the calendar year 2012 that employers generally are required to furnish to employees in January 2013 and then file with the [Social Security Administration])." See IRS Notice 2011-28, page 18.

- Stand-alone dental plans or vision plans which are not integrated into a group health plan; and
- Cost of coverage in connection with self-funded group health plans that are not subject to any federal continuation coverage requirements (i.e., self-funded church plans).

How to Report:

Employers must report the amount calculated below in box 12 of Form W-2, using code “DD.”

How to Calculate the Reportable Cost:

Significantly, the total cost of coverage provided is reportable, without regard to (1) whether contributions were made by the employer or employee contributions or whether contributions were made on a pre-tax or after-tax basis; (2) the scope of coverage provided (i.e., employee, spouse or dependent); or (3) any imputed income to employees resulting from a discriminatory plan or taxable coverage provided (i.e., for domestic partners).⁹

Notice 2011-28 sets forth the following methods of calculating the reportable cost:

- Applicable Premium: Employers may use the COBRA applicable premium method for calculating the amount to report. (The applicable premium does not include the 2% COBRA administration fee). This will be the method most likely chosen for self-funded plans.
- Premium Charged: Fully insured plans may use the premium charged by the insurance carrier.
- Modified Premium: Employers subsidizing the cost of coverage or who determine the current year’s cost by using the COBRA applicable premium of coverage for the previous plan year may use the modified COBRA premium method. For subsidized costs, the employer may base its reportable cost on a reasonable good faith estimate of the COBRA applicable premium, if that same reasonable good faith estimate was also used as the basis for determining the subsidized COBRA premium. For employers using the previous year’s applicable premium, they may use that previous year’s COBRA applicable premium for the reportable cost.

The flexibility provided in this Notice for determining the reportable amount will likely be well received. However, while the guidance provides that the same method of calculation is not required for each plan, it also requires that once a method is chosen for

⁹ Therefore, the cost of coverage to be reported is not increased or reduced by any amount that must be included in the employee’s gross income.

one plan, the same method must be used for every employee receiving coverage under that plan.

The IRS also addressed specific scenarios likely to arise with regard to calculating the cost of coverage:

- Composite Rate: A simplified approach is used for employers who charge a composite rate. For example, if the employer charges the same rate for all employees under the plan, regardless of the category of coverage elected (single, two-person, family), the employer can report the same amount for each of the employees' Form W-2, using one of the methods described above. Similarly, if the employer charges the same amount for all employees per category of coverage elected (single, two-person, family) and the employees in each separate coverage category pay the same amount, then each category can have the same amount reported for the period, again, using one of the methods above.
- Mid-year Coverage or Cost Changes: If cost changes during the reportable period or coverage changes during the year (due to beginning, terminating or switching coverage), the amount reported must reflect the increase or decrease in cost for the relevant period.

The Notice provides that a reasonable method to determine the reportable cost for such coverage is permissible as long as such method is used consistently for all employees making mid-year changes. For example, if the change in coverage occurs mid-month, the employer may use a reasonable method to determine the cost, such as using the cost at the beginning of the month, the end of the month, or prorating or averaging the reportable costs, just as long as this same method is used for all employees with coverage under the plan.

- Retirees and Former Employees: Employers are not required to issue W-2s for those individuals who otherwise would not be receiving a W-2 due to cessation of employment or retirement, even if the former employees are still receiving group health plan coverage.

For employees terminating mid-calendar year, the employer may use a reasonable method of reporting the cost of coverage provided under a group health plan for that calendar year, as long as the same method is used consistently for all employees receiving coverage under that plan and who terminate employment during that year. For example, if an employee has coverage from January through mid-April in which he terminates, and then elects COBRA for an additional six months, the employer may report the first four full months of coverage, or may instead report the ten months of coverage (including COBRA), as long as the employer does so consistently with other terminated employees.

Transition Relief for Terminated Employees:¹⁰ If a terminated employee requests his/her Form W-2 to be issued prior to the end of the calendar year in which s/he was terminated, the employer is not required to include the cost of coverage on that W-2.

Penalties

Penalties imposed for not timely complying with the reporting requirements are steep (currently up to \$100 per Form W-2 and capped at \$1.5 million per large employer). Therefore, employers should pay prompt attention to this Notice and take swift action to implement an effective procedure for reporting the aggregate cost of applicable employer-sponsored coverage.

IRS Circular 230 Disclosure

Unless expressly stated otherwise, this document is not intended or written to function as a covered opinion under Department of Treasury regulations. Any federal tax advice within this document is not intended or written to be used, and cannot be used, for the purpose of: (1) avoiding penalties that may be imposed, or (2) promoting, marketing or recommending to another party any transaction or matter addressed herein.

Note about the Author:

Elizabeth H. Latchana is a shareholder with Fraser Trebilcock specializing in health and welfare employee benefits.

¹⁰ This transitional relief currently has no expiration date but it is clear that W-2 reporting will not be required prior to January 2014 (for coverage provided in calendar year 2013). Notice 2011-28 states: "Future guidance may limit the availability of some or all of this transition relief; however, such guidance will be prospective only and will not be applicable earlier than January 1 of the calendar year beginning at least six months after its date of issuance. In no case will such guidance limit the availability of this transition relief for the 2012 Forms W-2 (meaning Forms W-2 for the calendar year 2012 that employers generally are required to furnish to employees in January 2013 and then file with the [Social Security Administration])." See IRS Notice 2011-28, page 18.