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April 2011

The IRS has released guidance relating to employer obligations under PPACA to report certain healthcare costs on employee W-2s. The guidance also provides temporary relief from compliance for small employers.

## IRS Issues Guidance on Form W-2 Reporting for Costs of Employer-Provided Coverage

By Steven Friedman and Sean Brown

On March 29, 2011, the IRS issued Notice 2011-28, which provides greater clarity to employers in connection with how to administer new Form W-2 reporting requirements for costs of employer-provided health coverage. This reporting is required under Section 6051(a)(14) of the Internal Revenue Code (“Code”), which was added by Section 9002 of the Patient Protection and Affordable Care Act (“PPACA”). The IRS has requested comments on the Notice, which will be due 90 days after the Notice is officially published in the Federal Register.

The reporting requirement was scheduled to become effective for the 2011 tax year, but the IRS issued Notice 2010-69 last October, which delayed enforcement of the requirement until the 2012 tax year (*i.e.*, for Forms W-2 required to be issued by end of January 2013). Notice 2011-28 provides further transitional relief for certain employers as described below.

It is important for employers to begin working with their health care and payroll providers now to ensure that any needed system changes are in place by January 1, 2012. In part, this is because, unlike Notice 2010-69, Notice 2011-28 does not provide any penalty relief for failure to comply with the new reporting requirements. The penalty for such a failure is \$200 per Form W-2, up to a maximum of \$3 million.

Key provisions from the Notice are summarized below.

### Employers Subject to the Reporting Requirement

Except as provided in the Notice’s transitional relief described below, virtually all employers that provide “applicable employer-sponsored coverage” under a group health plan must comply with the new reporting requirement. This includes federal, state and local government entities, churches and other religious organizations, and employers that are not subject to the COBRA continuation requirements.

Additionally, the Notice provides transitional relief for employers filing fewer than 250 Forms W-2 in the previous calendar year. Under the transitional relief, these small employers will not be required to report until the IRS issues further guidance.

## Categories of Coverage for Which Reporting is Required

Employers must report the cost of all “applicable employer-sponsored coverage,” which includes any group health plan coverage that is excludable under Section 106 of the Code, or would be excludable if it were employer-sponsored coverage. The Notice makes clear that employer contributions to an Archer MSA or Health Savings Account, as well as an employee’s salary reduction contributions to a health flexible spending account (“Health FSA”), do not need to be reported. Any employer flex credits contributed to a Health FSA, however, would need to be reported. The Notice provides that the following types of coverage are specifically excluded from the reporting requirement:

- Stand-alone dental or vision coverage
- Coverage provided by a federal or state government, or agency of such government, primarily for members of the military and their families
- Coverage for long-term care
- Coverage for HIPAA-excepted benefits (except for on-site medical clinics)
- Hospital or fixed indemnity coverage or insurance for a specified disease or illness, but only if the coverage is a HIPAA-excepted benefit and is paid for by the employee on an after-tax basis

Additionally, reporting for the following types of coverage will not be required until the IRS issues further guidance:

- The cost of coverage under a Health Reimbursement Arrangement
- Coverage provided under a multiemployer group health plan
- Coverage provided by a self-insured group health plan that is not subject to any federal coverage continuation requirements (e.g., COBRA)

## Calculating the Cost of Coverage

The Notice makes clear that the cost of coverage includes both the employer’s and the employee’s share of the cost of coverage. Additionally, the reportable cost includes any amount that is required to be included in an employee’s taxable income, such as imputed income for coverage of certain individuals (e.g., domestic partners or adult children over the age of 27), or amounts includible as excess reimbursements under Code Section 105(h). In determining aggregate cost, the employer may choose to include the cost of any continuation coverage, as long as it applies the same methodology for all plan participants for the applicable calendar year.

The Notice provides three methods that an employer may use to calculate the cost of coverage. The employer is not required to use the same method for each of its plans, but it must use the same method with respect to each employee receiving coverage under each respective plan.

- 1. COBRA Applicable Premium Method** – Under this method, the reportable cost equals the COBRA applicable premium for coverage for the period based on a calculation made in good faith compliance with the requirements of Code Section 4980B.
- 2. Premium Charged Method** – For fully insured plans, the employer may use the actual premium charged by the insurer to calculate the cost of coverage.
- 3. Modified COBRA Premium Method** – If the employer subsidizes the cost of COBRA, then the employer may utilize a good faith estimate of the COBRA applicable premium to determine the reportable cost. Additionally, if the actual COBRA premium charged by the employer for each period in the current year is equal to the premiums charged for each period in a prior year, the employer may use the COBRA applicable premium for the prior year to determine the reportable costs for the current year.

## Special Considerations for Calculating the Cost of Coverage

**Changes in Coverage.** If an employee changes coverage during the year, the amount reported on Form W-2 must take into account the change in coverage. If the change occurs during a period, such as in the middle of a month, the employer may use any reasonable method to determine the reportable cost for such period. The Notice provides that using the reportable cost at the beginning of the month or the end of the month, or averaging or prorating the reportable costs are all reasonable methods.

**Changes in Cost of Coverage.** The employer must also take into account changes in the cost of coverage that occur during the course of a plan year.

**Employers Charging Blended or Composite Rate.** The Notice provides that, if an employer charges the same rate for all employees under the plan, regardless of the scope of coverage, the employer can report the same amount for all employees for the period. Similarly, if the plan has different tiers of coverage (e.g., employee-only, family, etc.), and employees in each tier pay the same premium, the employer may report the same amount for each coverage group for the period.

**Determination Period Not the Calendar Year.** If the employer uses a 12-month determination period that is not the calendar year for purposes of calculating the COBRA applicable premium under the plan, the employer cannot use such determination period when calculating the cost of coverage. The reportable cost must be determined on a calendar year basis. In order to convert the COBRA-applicable premium to a calendar year amount, the employer will need to apply rules similar to the rules for calculating the cost of coverage when an employee has a change in coverage during the year, or when the cost of coverage changes during the year.

## Other Key Points from the Guidance

The Notice clarifies several other important items, as summarized below:

- The cost of coverage is to be reported in Box 12 of Form W-2, using Code “DD.”
- The reporting is for informational purposes only and will not affect the taxability of any such coverage.
- If an employee terminates employment mid-year and requests a Form W-2 at termination, the employer is not required to report any amount for such employee.

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