Employer Compliance Alert

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More IRS Guidance on W-2 Reporting of Health Coverage

Among the provisions contained in the 2010 Patient Protection and Affordable Care Act was a requirement that employers report, on each employee's IRS Form W-2, the value of any employer-provided health coverage. This reporting requirement is *optional* for 2011, but *mandatory* for 2012 (that is, for W-2s to be provided in January of 2013). The IRS issued an initial round guidance on this reporting requirement, but that Notice left many questions unanswered. A number of those questions have now been answered.

Overview of Reporting Requirement

Before addressing the recent guidance, it is worth noting some key points that have *not* changed. For instance, this reporting requirement remains optional for 2011, but then required for 2012.

Also preserved is a postponement of this requirement for "small" employers. Any employer that is required to issue fewer than 250 W-2s for 2011 (or that would have been required to issue fewer than 250 W-2s had it not engaged an agent to handle this reporting) qualifies for this postponement. The *soonest* such a small employer might be required to report the value of its employees' health coverage is January of 2014 (on the 2013 W-2).

Once this reporting requirement does apply, the value of employer-sponsored health coverage is to be reported in Box 12 of the W-2, using the code "DD." Finally, this latest Notice reemphasizes that nothing in this new reporting requirement will cause an employee to be taxed on any employer-provided health coverage.

Calculating the Cost of Coverage

Although the Notice addresses numerous questions, most employers will simply want to know how to calculate the cost of the coverage to be reported on each W-2. The amount to be reported should reflect both the employer and employee portions of that cost, with the *annual* amount equal to the sum of all *monthly* amounts (and under all plans sponsored by the same employer).

If a plan is *insured*, the amount to be reported should be the insurance premium charged for whatever level of coverage an employee received. If a plan is *self-funded*, the general rule is to use the "applicable premium" calculated for COBRA purposes. An example in the Notice makes clear that this does *not* include the additional 2% administrative fee allowed to be charged to COBRA beneficiaries.

Although these few rules should cover the vast majority of cases, the Notice does provide certain permissible alternatives. For instance, a "modified COBRA premium method" may be used if an employer subsidizes a plan's COBRA premiums. If an employer makes a good-faith estimate of the "applicable premium" - and then uses that estimate in calculating a subsidized COBRA premium - the employer may report the *estimated* amount as the cost of coverage on an employee's W-2.

Similarly, if an employer chose to continue charging a *prior-year* COBRA premium during the reporting year (and determines in good faith that the reporting year's cost of COBRA coverage was at least as large as the prior year's), the employer may use that prior-year COBRA premium (again, minus the 2% administrative fee) to satisfy this W-2 reporting mandate.

Finally, the Notice provides a number of permissible options if an employer charges a "composite" rate for active employees (such as the same amount for either employee-only or employee-plus-spouse coverage), but then calculates separate rates for COBRA purposes. Subject to certain limitations, such an employer may report either the composite rate or the COBRA rate (minus the 2% administrative charge).

Employers wishing to rely on any of these special rules should read the Notice carefully for additional restrictions and limitations.

<u>Recent Clarifications</u>

Among the recent clarifications contained in Notice 2012-9 are the following:

- There is no need to report any *employee* contributions to a flexible spending account ("FSA"). However, if an employee allocates any employer "flex credits" to a health FSA, those *employer* amounts must be reported.

- Whether the value of dental or vision coverage must be reported on a W-2 depends on whether that coverage constitutes an "excepted benefit" under the HIPAA portability and nondiscrimination rules. In general, this would be the case if either (1) the coverage is offered under a separate policy, certificate, or contract of insurance, or (2) participants have the right to *elect* the dental or vision coverage and must pay an additional premium if they do so. The value of such excepted benefits need not be reported.

- An employee assistance program ("EAP"), wellness program, or on-site medical clinic *may* be subject to this reporting requirement if it constitutes a "group health plan." However, the reporting of these benefits will be required only if the employer charges a separate premium for someone to receive COBRA coverage under these benefits.

- Even if an employer is not *required* to report the value of certain types of health coverage - either the types listed immediately above, or coverage received under a health reimbursement arrangement ("HRA"), as noted in the prior guidance - the employer may *choose* to report these amounts. For some employers, this approach may be more consistent with the systems in place to track the value of the various types of coverage provided to each employee.

- Pre-existing rules require an employer to provide a W-2 within 30 days of a request received from an employee who terminates during the calendar year. Under this recent Notice, however, such a W-2 need not report the cost of any health coverage received by that employee.

- Moreover, if an employer waits until year-end to supply W-2s to terminated employees (the

more usual case), those W-2s may report *either* the value of the coverage received only while an active employee *or* the value of the coverage received through the end of the year (thereby including the value of any COBRA coverage). The employer must be consistent, however, in selecting one of these two approaches.

- In a bit of welcome news, the Notice provides that an employer need not report the value of health coverage received by any individuals who are not otherwise entitled to receive a W-2. These might include COBRA beneficiaries, retirees, non-employee directors, or independent contractors.

- The IRS Form W-3 (which is used to transmit employee W-2 data to the IRS) need not report the cost of any health coverage.

- In general, this W-2 reporting requirement applies even to the value of any health coverage that must be included in an employee's taxable income. This might include the value of coverage provided to an employee's domestic partner, or to a non-dependent child over age 27. Contrary to the earlier guidance, however, it is *not* necessary to report the value of coverage that is taxable only because (1) a self-funded plan discriminates in favor of highly compensated individuals (in violation of Section 105(h) of the Tax Code), or (2) an employee is a 2% or more shareholder in a Subchapter S corporation.

- If a single plan provides both *health* coverage and *non*-health coverage (such as disability or life insurance), an employer may use any reasonable method to allocate the total cost of coverage between the two categories - and then report only the cost of the health coverage. Alternatively, if either the health coverage or the non-health coverage is merely "incidental" to the other type of coverage, the employer may treat the plan as though it provided only the primary type of coverage.

- The value of the coverage provided to an employee may be determined on the basis of the facts known to the employer on December 31 of the reporting year. Accordingly, any information learned after that date may be disregarded, even if that information results in the employee's coverage during the reporting year either increasing or decreasing in value. The value might *increase*, for example, if an employee was allowed to retroactively add coverage for a newborn child who was born during the reporting year. It could *decrease* if an employee retroactively dropped coverage for a former spouse in connection with a divorce.

- If the final pay period in a calendar year laps over into the following year, an employer may allocate the value of any health coverage received during that pay period between the two calendar years, based on a reasonable allocation of the days falling within each year. Alternatively, so long as it is done consistently, the employer may allocate that entire pay period to *either* of the two calendar years.

- Although prior guidance suggested that both hospital indemnity insurance and coverage for a specific disease or illness were *entirely* exempt from this W-2 reporting requirement, the most recent Notice limits this exemption to plans under which an employee pays the full premium for that coverage on an *after-tax* basis. If an employer pays any portion of the premium - or if an employee pays any portion of the premium on a *pre-tax* basis - the entire value of the coverage must be reported. As a result, even some "voluntary insurance arrangements" (which are exempt from most requirements of ERISA) must be reported on a W-2 - that is, if employees pay their premiums on a pre-tax basis.

Although the first W-2s on which the value of health coverage must be reported are not due until January 31, 2013, employers will want to ensure that they are able to capture all the data they will need in order to comply with this reporting requirement. For instance, they will need to know the

type and level of coverage received by each employee during each month (or pay period) during 2012. This may require that payroll software be reprogrammed in the very near term to preserve a record of these coverage levels.

The IRS expects to issue still further guidance on this reporting requirement. According to Notice 2012-09, however, any such guidance will be prospectively effective only. Moreover, it will apply only to calendar years beginning at least six months after that additional guidance is issued. For this reason, employers who are subject to this W-2 reporting requirement in 2012 should assume that this is the final guidance they will receive before reaching their compliance deadline.

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