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IRS Releases Guidance on Form W-2 Informational Reporting Requirement

April 4, 2011

On March 29, 2011, the Internal Revenue Service ("IRS") released Notice 2011-28, which provides guidance to employers on the requirement under the Affordable Care Act (the "Act") to report the cost of employer-sponsored health coverage on employees' annual Forms W-2. This new reporting requirement is informational only—to let employees know about the cost of their health coverage—and does not cause otherwise excludable employer-provided health coverage to become taxable. The guidance clarifies to whom the requirement applies, how information should be reported, what coverages are included, and how to determine the cost of the coverage. It also provides transition relief for smaller employers and others.

Previous Guidance

The Act requires employers to report the cost of employer-provided health coverage on Forms W-2 distributed annually to employees. On November 1, 2010, the IRS released Notice 2010-69, which made this requirement optional for all employers for the 2011 Forms W-2, which employers generally are required to furnish to employees in January 2012.

Current Guidance

In Notice 2011-28, the IRS mandates compliance with the reporting requirement beginning with 2012 forms (that is, for forms to be furnished to employees in January 2013). Employers may rely on this guidance if they voluntarily choose to report the cost of coverage on 2011 Forms W-2, even though such reporting is not required for 2011.

What Employers Are Subject to the New Reporting Requirements?

All employers that provide "applicable employer-sponsored coverage" during a calendar year are subject to the new reporting requirements. This includes federal, state and local government entities, churches and other religious organizations, and employers that are not subject to the COBRA continuation coverage requirements, to the extent such employers provide applicable employer-sponsored coverage under a group health plan.

Relief for Small Employers

Small employers (those that are required to file fewer than 250 Forms W-2 for the calendar year prior to the reporting year) will not be subject to the reporting requirement for 2012 Forms W-2, nor subsequent years, until further guidance is issued.

What Employer-sponsored Coverage Must Be Included on the Form W-2?

PPACA generally requires that the aggregate cost of "applicable employer-sponsored coverage" be reported on Forms W-2. "Applicable employer-sponsored coverage" means, with respect to any employee, coverage under any group health plan (including a self-insured plan) made available to the employee by an employer that is excludable from the employee's gross income under Section 106 of the Internal Revenue Code (the "Code"), or would be excludable if it were employer-provided coverage (within the meaning of such section), except that it does not include the following HIPAA-excepted benefits:

(1) long-term care;

(2) coverage only for accident, or disability income insurance, or any combination thereof; coverage issued as a supplement to liability insurance; liability insurance, workers' compensation, automobile medical payment insurance, credit-only insurance, and other similar coverage;

(3) nonintegrated vision and dental plans; and

(4) provided that such coverage is offered as an independent noncoordinated benefit, coverage only for a specified disease or illness and hospital indemnity or other fixed indemnity insurance.

What Is the Aggregate Reportable Cost and For Whom Is It Reported?

The aggregate cost of “applicable employer-sponsored coverage” is the total cost of coverage under all applicable employer-sponsored coverage, including both the portion of the cost paid by the employer and the portion of the cost paid by the employee, regardless of whether the employee paid for that cost through pre-tax or after-tax contributions. The aggregate reportable cost includes the cost of coverage under the employer-sponsored group health plan of the employee and any person covered by the plan because of a relationship to the employee, including any portion of the cost that is includible in an employee’s gross income, for example, the cost of coverage for a person other than the employee, the employee’s spouse, the employee’s dependent, or the employee’s child who will not have attained age 27 by the end of the taxable year. Thus, the aggregate reportable cost is not reduced by the amount of the cost of coverage included in the employee’s gross income.

Terminated Employees

An employer may apply any reasonable method of reporting the cost of coverage provided under a group health plan for an employee who terminated employment during the calendar year, provided that the method is used consistently for all employees receiving coverage under that plan who terminate employment during the plan year. The examples in the guidance illustrate that an employer may choose to report only the group health plan coverage employees received while performing services for the employer, or that coverage and COBRA continuation coverage, provided that the employer applies the method consistently for all employees receiving coverage under the plan who terminate employment during the plan year.

Regardless of the method of reporting used by the employer for other terminated employees, an employer is not required to report the aggregate reportable cost for an employee who has requested to receive a Form W-2 before the end of the calendar year during which the employee terminated employment.

Employees of Multiple Employers

Each employer providing employer-sponsored coverage must report the aggregate reportable cost of coverage it provides. However, if the employers are related employers and one such employer is a common paymaster for wages paid to the employee, the common paymaster must include the aggregate reportable cost of the coverage provided to that employee by all the employers for whom it serves as the common paymaster on the Form W-2 issued by the common paymaster.

Employees of a Successor Employer

If an individual transfers to a new employer that qualifies as a successor employer, both the predecessor and successor employers must report the aggregated reportable cost of coverage each provided, unless the successor employer follows the optional procedure under IRS rules and issues one Form W-2 reflecting wages paid to the employee during the calendar year by both employers. In that case, the successor employer must include the aggregate reportable cost of coverage provided by both employers, and the predecessor employer would not report the cost of coverage it provided.

Cost of Coverage Not Included in the Aggregate Reportable Cost

The cost of coverage in the aggregate reportable cost does not include the following: (1) the amount contributed to any Archer MSA, (2) the amount contributed to any Health Savings Account, (3) the amount of any salary reduction election to a flexible spending arrangement, (4) the cost of coverage under a Health Reimbursement Arrangement (HRA), or (5) the cost of coverage under a self-insured group health plan that is not subject to any federal continuation coverage requirements (*e.g.*, a church plan that is a self-insured group health plan). Nor does it include the cost of coverage provided by a state or the federal government.

Health FSAs

If the amount of salary reduction (for all qualified benefits) elected by an employee equals or exceeds the amount of the health flexible spending account (FSA) for the plan year, the employer does not include the amount of the health FSA for that employee in the aggregate reportable cost. However, if the amount of the health FSA for the plan year exceeds the salary reduction elected by the employee for the plan year (e.g., where an employer offers a match of an employee’s salary reduction contribution), then the amount of that employee’s health FSA minus the employee’s salary reduction election for the health FSA must be included in the aggregate reportable cost and reported.

Retirees, Independent Contractors

An employer is not required to issue a Form W-2 including the aggregate reportable cost to an individual for whom the employer is not otherwise required to issue a Form W-2.

Employees Provided Coverage Under a Multiemployer Plan

An employer that contributes to a multiemployer plan is not required to include the cost of coverage provided to an employee under that multiemployer plan in determining the aggregate reportable cost. If the only applicable employer-sponsored coverage provided to an employee is provided under a multiemployer plan, the employer is not required to report any amount for the aggregate reportable cost on the Form W-2 for that employee.

Excess Reimbursements of a Highly Compensated Individual

The cost of applicable employer-sponsored coverage is not modified because of excess reimbursements of highly compensated individuals that are included in gross income under Code Section 105(h); that is, an excess reimbursement that is included in income is neither added to the cost of coverage, nor subtracted from the cost of coverage, in determining the aggregate reportable cost.

Methods for Calculating the Reportable Cost

An employer may calculate the reportable cost under the plan using one of the following methods: (1) the COBRA applicable premium method; (2) the premium charged method if the employer is determining the cost of coverage for an employee covered by the employer's insured plan; or (3) the modified COBRA premium method if the employer subsidizes the cost of coverage or determines the cost of coverage for a year by applying the cost of coverage in a prior year. The guidance clarifies that an employer is not required to use the same method for every plan, but must use the same method with respect to a plan for every employee receiving coverage under that plan.

Similarly, an employer that charges a composite rate (e.g., single coverage class or single-only coverage and family coverage, or self-plus-one coverage and family coverage) may calculate and use the same reportable cost for a period for (1) the single class of coverage under the plan, or (2) all the different types of coverage under the plan for which the same premium is charged to employees, provided this method is applied to all types of coverage provided under the plan.

Reportable costs under a plan for a year must reflect any increases and decreases in the cost for the year. Likewise, if an employee changes coverage during the year, the reportable cost under the plan for the employee for the year must take into account the change in coverage by reflecting the different reportable costs for the coverage elected by the employee for the periods for which such coverage is elected. If the change in coverage occurs during a period (for example, in the middle of a month where costs are determined on a monthly basis), or an employee commences coverage or terminates coverage during a period, an employer may use any reasonable method to determine the reportable cost for such period, provided that the same method is used for all employees with coverage under that plan.

Transition Relief

As described above, the guidance provides transition relief for employers filing fewer than 250 Forms W-2; relief with respect to certain Forms W-2 furnished to terminated employees before the end of the year; relief with respect to multiemployer plans; relief for HRAs; relief with respect to certain dental and vision plans; relief with respect to self-insured plans of employers not subject to COBRA continuation coverage or similar requirements. The IRS has stated that 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 the 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). For example, in no event will reporting be required for 2012 Forms W-2 for any employer required to file fewer than 250 2011 Forms W-2.

As with other guidance, the IRS is soliciting comments on the Form W-2 reporting provisions.

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We will continue to update our clients on new developments in this rapidly changing area of the law. In the meantime, please feel free to contact your Proskauer attorney or any member of our Health Care Reform Task Force should you have questions regarding any aspect of health care reform.