MAYER·BROWN

Legal Update
January 23, 2012

IRS Issues Revised Guidance on Form W-2 Reporting Requirements for Costs of Employer Group Health Coverage

The Patient Protection and Affordable Care Act of 2010 (PPACA) requires employers to report the aggregate cost of "applicable employer-sponsored group health care coverage" (referred to herein as "Reportable Coverage") on employees' Forms W-2 in Box 12 using code DD. On October 12, 2010, the US Internal Revenue Service (IRS) issued Notice 2010-69, which waived the reporting requirements for Forms W-2 required to be issued for 2011, although employers could voluntarily elect to report for 2011. On March 29, 2011, the IRS issued Notice 2011-28, which provided interim guidance that was intended to address some of the issues relating to the reporting requirements and to assist employers in complying with the requirements.

On January 3, 2012, the IRS issued Notice 2012-9, which modifies and clarifies the earlier interim guidance and provides additional guidance on the reporting requirements. Under the new guidance, employers will be required to comply with the reporting requirements beginning in 2012 (with respect to Forms W-2 required to be provided in 2013). If an employer had voluntarily elected to report for 2011, the employer may rely on either the guidance issued in Notice 2011-28 or the new guidance set forth in Notice 2012-9.

Notice 2012-9 provides that if future guidance is issued that applies the reporting requirements more expansively, including with respect to additional employers, categories of employers, or types of coverage, the guidance will apply prospectively only and will not apply to any calendar year beginning within six months after the date that the more expansive guidance is issued.

While Notice 2012-9 indicates that the IRS is working to develop regulations, the IRS has not indicated when such regulations may be issued. The notice also states that the reporting is for employee informational purposes only and will not cause otherwise excludable coverage to become taxable. However, some commentators have speculated that the reporting may have indirect tax implications, such as providing a basis for the IRS to determine whether the so-called "Cadillac tax" applies and for governmental agencies to monitor whether an employer is providing affordable coverage to its employees. In addition, it is also possible that the IRS could use the information to try to determine whether an employer is properly including the value of discriminatory health coverage in employees' income. The IRS, however, has not indicated that it will use the information for any of these purposes.

The alert summarizes the reporting requirements as interpreted by the new guidance.

What Employers Are Subject to the Form W-2 Reporting Requirements?

Generally, all employers that provide Reportable Coverage during a calendar year are subject to

the reporting requirement. Federal, state and local governmental entities, churches and other religious organizations and employers that are exempt from the COBRA continuation coverage rules are generally subject to the reporting requirements other than with respect to any coverage provided under a self-insured group health plan that is not subject to any federal continuation coverage requirements. An employer is not subject to the reporting requirements for a calendar year if the employer was required to file fewer than 250 Forms W-2 for the preceding calendar year. The number of forms that an employer is required to file is determined without regard to the employer's use of an agent.

An employer is only required to report the cost of Reportable Coverage if the employer is otherwise required to issue a Form W-2 to the employee. Therefore, for example, if continuation coverage is provided to a former employee and the employer provides no compensation to the employee for which a Form W-2 is otherwise required, the employer is not required to issue a Form W-2 merely to reflect the cost of Reportable Coverage.

What is Reportable Coverage?

Reportable Coverage is defined generally as coverage under a group health plan that is made available to an employee by an employer and that is excludable from income under section 106 of the Internal Revenue Code (or would be excludable under section 106 if the coverage were employer-provided coverage). Reporting is generally required regardless of whether the employer or employee pays for the cost of coverage, subject to certain exceptions discussed below. A group health plan generally means a plan that is maintained or contributed to by an employer to provide health care to employees and former employees (and their eligible family members).

Generally, reporting is not required for coverage that provides (i) only dental or vision benefits under a separate policy or contract, (ii) long-term care coverage, and (iii) certain other coverage, including accident plans, disability plans, or worker's compensation. In some circumstances, coverage for a specified disease or illness is not required to be reported if the coverage is not excludible from gross income and is offered independently of other coverage.

An employer can elect to report coverage provided under a health reimbursement account (HRA), although such reporting is not required. Reporting coverage under an employee assistance plan (EAP), wellness program, or on-site medical clinic that is provided under a group health plan subject to COBRA, and for which the employer does not charge a separate COBRA premium, is also optional (although it is required if the employer does charge such a premium).

How is the Cost of Reportable Coverage to be Determined?

The aggregate cost of the Reportable Coverage that must be reported is the total cost of all Reportable Coverage (under all plans) that is provided to an employee for a calendar year. The cost is determined on an employee-by-employee basis.

Thus, for example, if an employee changes coverage during a year, or terminates or commences coverage, the cost for each coverage period is factored into the overall cost based on that employee's specific coverage options. The reportable cost must be determined on a calendar-year basis, even if the plan uses a different plan year. If a coverage period under a plan crosses over a calendar year (e.g., spans a payroll period that includes December 31), the employer may include the cost for that coverage period in either year or else apportion the costs between the two years.

The reportable cost includes the portion of the cost of coverage paid by the employer as well as the portion paid by the employee (whether paid on a pre-tax or after-tax basis). In addition, the

reportable cost is not limited to amounts that are excluded from income; for example, the cost of coverage for a dependent which is includable in the employee's gross income is included in the reportable cost. Although the reportable cost generally includes both after-tax and pre-tax employee contributions, salary reduction contributions to a health flexible spending account, and contributions to a health savings account or an Archer medical savings account are not included.

The aggregate cost may be determined in one of the following three ways:

- **COBRA Applicable Premium Method.** The cost may be determined under rules that are similar to those used to determine the applicable premium for purposes of COBRA continuation coverage. Under this method, the reportable cost is equal to the applicable premium costs for that coverage for the applicable period. An employer using this methodology must make such calculations in good faith compliance with a reasonable interpretation of the statutory COBRA requirements.
- **Premium Charged Method.** If the plan is insured, an employer may determine the cost based on the premium charged. Under this method, the reportable cost is the premium charged by the insurer for the applicable employee's coverage (e.g., self-only or family coverage) for the applicable period.
- **Modified COBRA Premium Method.** If an employer subsidizes the cost of COBRA coverage, the employer may determine the reportable cost using a reasonable good faith estimate of the applicable COBRA premium for the relevant period, as long as that basis is used to determine the subsidized COBRA premium. For example, if an employer reasonably determines that the applicable COBRA premium is $300 per month, but the employer subsidizes 50 percent of the cost of COBRA coverage, it may use $300 as the reportable cost per month for purposes of the Form W-2 reporting requirements. If the COBRA premium charged for one year equals the applicable COBRA premium for each period in the prior year, the employer may use the applicable COBRA premium in each period in a prior year as the reportable cost for each applicable period in the current year. For example, if an employer charged $306 per month for COBRA coverage in 2011 ($300 as a premium cost plus a 2 percent administrative fee) and determined that it was going to charge the same COBRA premium for 2012, the employer may use $306 for the reportable cost for each period in 2012.

The total reportable cost is the sum of the costs for each coverage period during the year (e.g., each payroll period or each month) using the method determined by the employer. An employer is not required to use the same method for each plan but must use the same method under a given plan for all employees receiving coverage under that plan.

In the case of amounts that are includable in a highly compensated employee's income as an excess reimbursement under a discriminatory self-insured health plan, the amount of the excess reimbursement is subtracted from the cost of the coverage in determining the reportable costs. For example, if a highly compensated employee receives a taxable excess reimbursement in the amount of $20,000 from a group health plan, and the cost of plan coverage is otherwise $50,000, the reportable cost is $30,000. Special rules also apply in the case of shareholder-employees of an S-corporation and in situations where an employer charges a composite rate for coverage under a plan where there is a single coverage level or where there are multiple coverage levels and employees are charged the same premium for each level.

If a plan provides benefits that constitute Reportable Coverage and benefits that do not constitute Reportable Coverage, the employer can use any reasonable allocation method to determine the cost of coverage.

Are There Special Rules for Terminated Employees?

An employer generally may apply any reasonable method of reporting the cost of Reportable Coverage for an employee who terminates employment during a calendar year, as long as the method is used consistently for all employees receiving coverage under the applicable plan who terminate employment during the year and continue or otherwise receive coverage after termination of employment. Regardless of the method used, however, an employer is not required to report any amount pursuant to the reporting requirements (i.e., in Box 12 using Code DD) for an employee who requests to receive a Form W-2 before the end of the calendar year in which the employee terminates employment.

How Do the Reporting Rules Apply to Related Employers and Successor Employers?

If an employee is concurrently employed by more than one related employer, and one of the employers is a common paymaster for the employee, the common paymaster-employer must include on the Form W-2 that it issues the aggregate cost for the Reportable Coverage provided to that employee by all of the employers for whom it serves as the common paymaster. The employers that are related and use the common paymaster may not report the cost of coverage that they provide. Related employers that do not compensate the employee who is concurrently employed by a common paymaster may either report the entire cost of the Reportable Coverage or allocate the aggregate cost among the employers that concurrently employ the employee using any reasonable method of allocation.

If an employee transfers to a new employer that is a successor employer for purposes of the FICA rules, both the predecessor and successor-employers must report the aggregate reportable cost of Reportable Coverage that each provided to the employee. This rule applies unless the successor-employer follows the optional reporting procedures of Revenue Procedure 2004-53, which permits the successor to issue only one Form W-2 for both the predecessor and successor. If the optional reporting procedure is followed, the Form W-2 will need to reflect the cost of the Reportable Coverage provided by both the predecessor and the successor employer.

Special rules apply for employers that participate in a multiemployer healthcare plan.

For more information about the issues raised in this Legal Update, please contact the member ofour Employment & Benefits practice who regularly advises you, or one of the lawyers listed below.

Debra B. Hoffman
+1 312 701 7219
dhoffman@mayerbrown.com

Christine S. Matott
+1 312 701 8571
cmatott@mayerbrown.com