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Updated Guidance on Form W-2 Reporting of Healthcare Coverage

Expanded guidance clarifies the types of plans and amounts that must be reported and requires employers to take additional steps to meet their Form W-2 reporting obligations.

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The Patient Protection and Affordable Care Act (Affordable Care Act) imposes on employers a new requirement to report the cost of employer-sponsored healthcare coverage. Notice 2012-9 (Notice), recently issued by the Internal Revenue Service, updates and expands prior guidance related to how employers must report such coverage. (See our July 7, 2011 LawFlash, "New Guidance Related to Form W-2 Reporting Requirements," available at http://www.morganlewis.com/pubs/EBLF_NewGuidanceRelatedToFormW2ReportingReqs_7july2011.pdf, for additional details on Form W-2 reporting requirements under the Affordable Care Act and related prior guidance.) This LawFlash discusses the changes made to the reporting requirements under the Notice.

Background

The Affordable Care Act generally requires annual reporting to employees of the "aggregate cost" of "applicable employer-sponsored coverage," as defined below. Such coverage is reported on Form W-2, Wage and Tax Statement, and is first required for the 2012 calendar year (for which Forms W-2 must be distributed by the end of January 2013), although employers may voluntarily report such coverage for the 2011 calendar year.

Definition of Applicable Employer-Sponsored Coverage

"Applicable employer-sponsored coverage" is coverage under any group health plan made available to an employee by an employer that is excludable from the employee's gross income under Internal Revenue Code (Code) section 106 (or would be excludable if it were employer-provided coverage under Code section 106). A group health plan generally means a plan of (or a plan contributed to by) an employer or employee organization to provide healthcare to employees and former employees or their families.

As provided under the statute and prior guidance, certain exceptions exist to this general definition of "applicable employer-sponsored coverage." For example, independent, noncoordinated coverage for a specified disease or illness (or for hospital indemnity or other fixed indemnity insurance) is not included

as applicable employer-sponsored coverage, where the payment for such coverage is not excludable from gross income and for which a deduction under Code section 162(l) is not permitted.

- The Notice clarifies that to the extent the employer only provides employees with the opportunity to purchase independent, noncoordinated coverage for a specified disease or illness (or for hospital indemnity or other fixed indemnity insurance), and for which employees pay the full amount of the premium on an after-tax basis, the cost of such coverage does not need to be reported on Form W-2. However, an employer is required to report the cost of coverage provided under hospital indemnity or other fixed indemnity insurance, or the cost of coverage only for a specified disease or illness, if the employer makes any contributions to the cost of coverage that are excludable from income under Code section 106 or if the employee pays for the coverage on a pre-tax basis under a Code section 125 cafeteria plan.

Definition of Aggregate Cost

"Aggregate cost" is the total cost of coverage under all applicable employer-sponsored coverages. Aggregate cost is determined according to the general rules used to determine the applicable premium for COBRA continuation coverage. It includes amounts paid by the employer and the employee, regardless of whether these amounts are paid through pre-tax or post-tax contributions. The aggregate cost also includes the cost of coverage that is taxable to the employee (such as coverage for a domestic partner or for a dependent who is older than 27 by the end of the taxable year).

Aggregate cost does not include amounts contributed to an Archer Medical Savings Account or a Health Savings Account for an employee or an employee's spouse. The Notice provides the following with respect to the determination of aggregate cost:

- The Notice clarifies that aggregate cost does not include the cost of coverage under a dental plan or vision plan that is considered an "excepted benefit" for purposes of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). The exclusion for these stand-alone dental and vision plans is a temporary exclusion.

- The Notice adds that the cost of coverage provided under an employee assistance program (EAP), wellness program, or on-site medical clinic is includible in aggregate cost only to the extent the coverage is provided under a group health plan (as defined under Code section 5000(b)(1)). Further, if the cost of coverage under an EAP, wellness program, or on-site medical clinic is otherwise includible in aggregate cost, but the employer does not charge a premium for COBRA or other federally required continuation coverage, then the employer is not required to report the cost of coverage for such programs. If, however, the employer charges a premium for COBRA coverage for these programs, then the cost of such coverage must be included in the aggregate cost. An employer that is not subject to COBRA or other federal continuation coverage requirements is not required to include the cost of coverage provided under such a program. Note that this is a temporary exclusion.

- In a change to prior guidance, the Notice provides that aggregate cost does not include excess reimbursements of highly compensated individuals that are part of gross income under Code section 105(h). In addition, the cost of coverage that is taken into income because an employee is a 2% shareholder-employee of an S corporation is not included in aggregate cost.

- The Notice also clarifies that the amount of a health flexible spending arrangement (FSA) must be included in aggregate cost only if the amount of the health FSA for the plan year exceeds the salary reduction elected by the employee for the plan year. The Notice also adds a new example, providing that if there are no employer flex credits under the Code section 125 cafeteria plan, then no reporting of the health FSA is required.

- An employer may include in aggregate cost the cost of coverage that is not required to be reported based on the temporary, interim relief described in the Notice—such as the cost of coverage under a health reimbursement account, multiemployer plan, EAP, wellness program, or on-site medical clinic—as long as such coverage is applicable employer-sponsored coverage.

As noted, certain plans and costs are temporarily excluded from the reporting requirements. Future guidance may be issued that would revise or eliminate these temporary exceptions, but such guidance will be prospective only and will not apply earlier than January 1 of the calendar year beginning at least six months after the date the guidance is issued.

Employers Subject to the Reporting Requirement

The new Form W-2 reporting requirement generally applies to all employers that provide applicable employer-sponsored coverage during a calendar year, including federal, state, and local government entities and churches and other religious organizations. Certain employers are excluded from the reporting requirement, namely (1) employers that are required to file fewer than 250 Forms W-2 in the preceding calendar year, corresponding with the W-2 electronic filing rules (this is a temporary exception); and (2) federally recognized Indian tribal governments.

- The Notice clarifies that the determination of whether an employer is required to file fewer than 250 Forms W-2 for a calendar year is determined based on the Forms W-2 that the employer would have been required to file without regard to the employer's use of an agent under Code section 3504 (where an agent generally is one who controls or pays the wages of an employee or group of employees employed by one or more employers).

- The Notice also provides a temporary exception from the reporting requirements for employers that are tribally chartered corporations wholly owned by a federally recognized Indian tribal government.

Methods of Calculating the Cost of Coverage

There are different methods by which an employer can calculate the cost of coverage for Form W-2 reporting. An employer may use (1) the COBRA applicable premium method (which is based on the established method of calculating COBRA, less the 2% administrative charge), (2) the premium charged method (which can be used by insured plans, using the premiums charged by the insurer), or (3) the modified COBRA premium method (which can be used when the employer subsidizes the cost of COBRA or when the premiums charged by the employer in the current period equal the prior year's COBRA rates).

- The Notice addresses the reportable cost when the employer charges employees a composite rate (i.e., if there is a single coverage class or if employees are charged the same premium for each type of coverage under the plan). If an employer uses a composite rate for active employees, but does not use a composite rate when determining applicable COBRA premiums for qualified beneficiaries, either the composite rate or the applicable COBRA premium can be used for calculating the reportable cost. However, the method chosen must be used consistently for all active employees and must be used consistently for all COBRA qualifying beneficiaries.

Method of Reporting on Form W-2

The aggregate cost of applicable employer-sponsored coverage is reported in box 12 of Form W-2, using Code DD. With respect to an individual who is an employee of multiple employers, each employer must report the cost on a Form W-2, although a common paymaster of related employers must report the aggregate cost for all employers for whom it is the common paymaster.

- The Notice clarifies that if the related employers do not compensate an employee who is concurrently employed using a common paymaster, then the related employers may either report the entire aggregate cost on just one of the Forms W-2 provided to the employee or may allocate such cost among the employers that concurrently employ the individual using any reasonable allocation method.

- The Notice adds that if a program provides a benefit that constitutes applicable employer-sponsored coverage and the same program provides another benefit that does not constitute applicable employer-sponsored coverage (such as a long-term disability plan that also provides healthcare benefits), the employer may use any reasonable allocation method to determine the cost of coverage for the applicable employer-sponsored coverage. Further, if the portion of the program that constitutes applicable employer-sponsored coverage is only incidental to the other benefits provided under the program, the employer is not required to report the cost of either benefit under the program. Conversely, if the portion of the program providing a benefit that is not applicable employer-sponsored coverage is only incidental to the applicable employer-sponsored coverage, the employer is permitted, but not required, to include the benefit that is not applicable employer-sponsored coverage in determining the reportable cost.

- The Notice provides that aggregate reportable cost for a calendar year may be based on information available to the employer as of December 31 of the calendar year. Therefore, aggregate cost for a calendar year does not need to reflect any election or notification made or provided in a subsequent calendar year that retroactively affects the prior year coverage (such as the addition of a new dependent). Further, no Form W-2c is needed to report the subsequent change in coverage.

- The Notice also provides that an employer can address a coverage period that continues into a subsequent calendar year (such as a final payroll period of the reporting calendar year that includes December 31 but that continues into the next year) by (1) treating the coverage as provided during the reporting calendar year, (2) treating the coverage as provided during the subsequent calendar year, or (3) allocating the cost of coverage between the two years using a reasonable allocation method. The same approach must be used for all employees.

- Finally, the Notice adds that the aggregate reportable cost is not required to be reported on a Form W-2 provided by a third-party sick pay provider. However, a Form W-2 furnished by an employer to the employee must include the aggregate reportable cost regardless of whether the Form W-2 includes sick pay, or whether a third-party sick pay provider provides a separate Form W-2 reporting the sick pay.

Conclusion

The Affordable Care Act requires employers to take steps to capture the cost of coverage for applicable employer-sponsored coverage. While prior guidance, including Notice 2011-28, provided employers with answers to many questions related to implementing the statute's requirements, this new Notice clarifies various items and addresses certain other aspects of the reporting rules. Employers should review their benefit plans to determine which plans meet the definition of "applicable employer-sponsored coverage." For example, employers should consider whether their EAPs, wellness programs, or on-site medical clinics would be considered group health plans and, further, whether they should report such coverage (consideration also should be made as to whether COBRA should be offered for such programs). Employers also should determine which costs should be excluded from the determination of aggregate cost and should modify their payroll systems and/or data collection procedures to correctly capture the data needed for Form W-2.

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