HONIGMAN ALERT

Health Care Reform Alert **March 21, 2012**

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IRS Updates W-2 Reporting Obligations

On April 14, 2011, we issued a Health Care Reform Alert that discussed the obligations for employers to include the aggregate cost of the health care coverage they provide on the Form W-2 prepared for its employees (click to view alert). The IRS recently issued further guidance about this reporting obligation. This Health Care Reform Alert will focus on the changes provided by this recent guidance, though it also summarizes prior guidance where needed for clarity.

Form W-2 Reporting

Information about the "aggregate reportable cost" of the health care coverage provided to employees will be required to be reported on the 2012 Form W-2s – *i.e.*, those which are to be provided to employees in January of 2013.

- The aggregate reportable costs are to be reported on line 12 of Form W-2, using Code DD. This reporting is for informational purposes only and does not affect the taxability of these benefits.
- No reporting of group health plan coverage costs is needed for (i) employees to whom a W-2 would not otherwise have to be provided, (ii) employees who terminate mid-year and request a W-2 before the end of the calendar year during which they terminated employment.
- If a benefit plan provides both coverage that needs to be reported and coverage that doesn't (*e.g.*, a disability plan that also provides some medical coverage), any reasonable allocation method may be used to determine the reportable cost. If the medical coverage is only incidental, it may be ignored; if the medical coverage is significant and the other coverage is incidental, the cost of the medical coverage should be included.
- Third-party payers of sick pay that furnish Forms W-2 are not required to report any health care coverage costs, but the Form W-2 furnished by the employer must include the reportable costs, regardless of whether the employer's Form W-2 includes the sick pay or whether the third party sick-pay provider is furnishing a separate W-2.
- For mergers and acquisitions, the reportable costs may be allocated *pro-rata* between buyer and seller, or the acquiring company may elect to report the entire year's costs.

Which Employers Must Report?

This reporting obligation applies to all employers, including federal, state and local governments, churches and all other religious organizations, and small employers

who are not subject to COBRA. The IRS has, however, granted transitional relief (*i.e.*, relief until further guidance is issued), to the following:

- Employers who were required to file fewer than 250 Form W-2s for the preceding calendar year
- Federally recognized Indian tribal governments
- Tribally chartered corporations wholly owed by federally recognized tribal governments
- Multi-employer plans

What Costs Must be Reported?

"Aggregate reportable costs" include: (i) the reportable costs for each group health plan provided by the employer, and the cost of any coverage includable in the employee's gross income (but see below regarding excess reimbursements for § 105(h) violations); (ii) the share of the cost paid by both the employer and the employee, regardless of whether the employee's share was paid pre-tax or post-tax; and (iii) the cost of coverage for the employee's dependents.

"Aggregate reportable costs," however, *do not include*:

- Amounts contributed to an Archer MSA
- Amounts contributed to a health savings account (HSA)
- Salary reduction amounts contributed to a health care FSA, though any amounts available under an FSA in excess of the salary reduction amounts must be included
- Cost of coverage for (i) long term care insurance, (ii) accident or disability income insurance, (iii) supplementary liability insurance, (iv) automobile liability insurance, (v) workers' compensation or similar insurance, (vi) automobile medical insurance, (vii) credit-only insurance, (viii) specific disease insurance, and (ix) hospital indemnity or other fixed indemnity insurance; provided, however, that the cost of hospital indemnity or other fixed indemnity insurance and/or the cost of specific disease insurance must be reported if the employer makes any contribution to the cost of those coverages that is deductible under IRC § 106, or that the employee purchases on a pre-tax basis
- The 2% administrative cost for COBRA coverage
- The cost of "excess reimbursements" includable in the income of highly compensated individuals due to a violation of the IRC § 105(h) nondiscrimination rule; that is, the includable excess reimbursement is subtracted from the overall cost of that coverage in determining the aggregate reportable cost for that individual (this is a change from prior guidance)
- The cost of employer-provided coverage that is included in income because the employee is a 2% shareholder of an S Corp

And until further guidance is issued:

- Amounts contributed to health reimbursement arrangements (HRAs)
- The cost of limited scope dental and vision plans that are "excepted benefits" under HIPAA

- The cost of self-insured plans of employers not subject to COBRA continuation coverage or similar requirements
- The cost of employee assistance programs, on-site medical clinics, or wellness programs for which the employer does not charge a premium under COBRA

The IRS has provided a helpful chart that indicates the reporting obligation for a wide range of insurance coverages and other employer-provided health care arrangements. The chart can be found at: http://www.irs.gov/newsroom/article/0,,id=254321,00.html.

Note also that only employer-provided coverages need be reported so coverage available only through what are deemed to be payroll practices under ERISA need not be reported, but even where the employee pays for the entire cost of coverage, that coverage cost would need to be reported if coverage under the plan would not be available at the same cost to the employee if not for the employment-relationship.

If the costs of coverage increase or decrease during the calendar year, the change must be reflected in the aggregate reportable cost included on the Form W-2 for that year. The aggregate reportable cost must be determined on a calendar-year basis, based on the information available as of December 31. If a coverage period extends beyond December 31 (*e.g.*, a year-end payroll period that extends into the following year), the employer can choose to allocate the costs entirely in the first year, entirely in the second year, or can allocate them between the two years.

For employees terminating mid-year, the cost can be calculated based either on the cost of coverage while they were active employees, or on their active employee costs plus the cost of continuation coverage for the remainder of that calendar year, but whichever method is used, it must be applied uniformly to all employees terminating that year.

If there is a single coverage class under the plan (*i.e.*, all employees are charged the same rate no matter what their marital status or number of dependents) or if there is a distinct premium charged for different coverage classes (*i.e.*, single coverage, single plus one, family coverage, *etc.*), the reportable cost is the premium charged for each distinct coverage class, so long as this method is applied in the same manner to all coverage classes under the plan.

How May Reportable Costs Be Calculated?

There are three permissible methods for calculating aggregate reportable costs:

- The actuarial method for determining COBRA premiums, without including the 2% administrative charge
- If an employer subsidizes the cost of COBRA or bases COBRA premiums on the prior year's costs, it may determine its reportable costs based on a reasonable good faith estimate of the COBRA applicable premium for that period, using the same reasonable good faith estimate used to determine the applicable COBRA premium.
- For plans with insured benefits, the reportable costs are the premiums charged by the insurer.

Penalties for Noncompliance

The penalties for failing to file Forms W-2 with complete and correct information by the due date is a set dollar amount per W-2, subject to annual caps, but the specific dollar amount and the annual cap depends on when the correct information is provided. The IRS also has flexibility to waive some of these penalty amounts where the employer can show good faith and that the failure was due to reasonable cause. Failure to show reasonable cause may also subject the employer to an additional set of penalties. Without going into detail, suffice it to say that these penalties can be substantial – *i.e.*, up to $200 per W-2 with a $3 million cap. If, however, the employer fails to correct on account of intentional disregard, the penalty will be at least $250 per W-2 with no cap.

Action Steps

Although mandatory W-2 reporting is almost a year away, it requires employers to track their coverage costs for the entire 2012 calendar year. It is necessary, therefore, for employers to ensure that their payroll departments (or outside payroll providers) can track the necessary information, and responsibility should be assigned now for scheduling what information will be needed, who will provide it and who will coordinate the process for transmitting it in a form and timeframe for ensuring compliance with this new reporting requirement.

If you have questions about this reporting obligation, about any other aspect of complying with the Affordable Care Act, or any other employee benefits issue, please contact any of the Honigman attorneys listed on this Health Care Reform Alert.