

Health Care Act W-2 Requirements: To Report or Not To Report—That is the Question

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The Patient Protection and Affordable Care Act amended the Internal Revenue Code (“Code”) to generally mandate that employers report on Form W-2 the aggregate cost of employer-sponsored health care coverage (the cost of coverage that is non-taxable under Code Section 106 or would be non-taxable if provided by an employer) for most types of plans with respect to 2012 and beyond.¹ The stated purpose of this reporting requirement is to provide employees with information on the value of employer-provided healthcare.² Recently issued interim IRS guidance (Notice 2011-28) clarifies the reporting requirements.³

In 2010, the IRS granted employers relief from this reporting requirement through the end of 2011,⁴ and the penalty provisions generally will apply to calendar years 2012 and beyond (*i.e.*, the first required reporting will be in January 2013 for the 2012 Forms W-2 issued then).⁵ Notice 2011-28 provides information for employers voluntarily choosing to report employer-sponsored health care coverage cost on 2011 Forms W-2 (normally issued in early 2012) and reiterates the free pass on penalties for 2011 non-reporting.⁶ Employers voluntarily reporting for 2011 “may rely” on Notice 2011-28.⁷

Notice 2011-28 further extends the reporting free pass for certain employers at least until calendar year 2013 (*i.e.*, these employers need not report health care coverage cost until they issue W-2s in early 2014, at the very earliest).

Speak Now or Hold Your Peace: Comment Submission Period

The IRS and Treasury Department are soliciting comments on all aspects of the interim guidance, including: implementation challenges; burdens of compliance; issues arising with respect to multiemployer plans, self-insured plans, small employers, and other plans; and how future guidance might abate or avoid such challenges. The comment deadline is Monday, June 27, 2011. Clients interested in submitting comments are welcome to contact us for assistance.

Form W-2 Reporting Requirement

Employers generally must provide their employees with a Form W-2 on or before January 31 of each year (with respect to the prior year). When cost of coverage reporting is required, employers will report the aggregate reportable cost (“ARC”) in box 12 of the Form W-2, using code DD.⁸

The PPACA W-2 reporting requirement is informational only, and failure to properly report will not cause coverage that is excludible from gross income under § 106 or any other Code provision to become taxable or to be reported in any other box on Form W-2.⁹

Note: Notice 2011-28 provides wide latitude for cost reporting with respect to individuals who terminate employment during a calendar year, as long as the employer uses the method of reporting consistently. For example, if an employee received \$350 worth of coverage for each of four months of employment then terminated employment and paid \$350 for each of six months (during the same calendar year) *after* employment, then the employer may report either \$1,400 or \$3,500 of coverage, as long as the employer is consistent in its reporting for all similarly-situated employees.¹⁰

What Types of Coverage Are Subject To Reporting?

Employers must report the cost of coverage under all “applicable employer-sponsored coverage.” Coverage under any group health plan¹¹ generally is “applicable employer-sponsored coverage” if:

- it is made available to an employee by an employer, and excludable from the employee’s gross income under Section 106; or
- it would be so excludable if it were employer-provided coverage.¹²

Items That Must Be Included In W-2 Reporting

Employers generally must report the full cost of coverage under *all* applicable employer-sponsored coverage,¹³ including:

- both the employer- and employee-paid costs (regardless of whether paid on a pre-tax or after-tax basis);¹⁴
- the cost of coverage for any person covered by the plan because of a relationship to the employee (*e.g.*, dependent coverage) even if the value of that coverage is included in the employee’s gross income;¹⁵
- employer contributions to health flexible spending arrangements (FSAs) other than contributions made via salary reduction elections;¹⁶
- if an employee elects a health FSA under a Section 125 cafeteria plan, the portion of the health FSA coverage, if any, that exceeds the amount of salary reduction (for all qualified benefits) elected by an employee;¹⁷
- the cost of coverage under dental or vision plans that do not qualify as stand-alone plans;¹⁸ and
- the cost of coverage under self-insured group health plans that are subject to federal continuation coverage requirements (such as COBRA, ERISA, the Public Health Service Act, and the temporary continuation coverage requirement of the Federal Employees Health Benefits Program).¹⁹

Reporting Exceptions

Employers need not report the following costs.

Permanent Exceptions

The following items are permanently excluded from Form W-2 cost reporting:

- the amount contributed to any Code Section 220(d) Archer MSA;
- the amount contributed to any Code Section 223(d) Health Savings Account (HSA);
- the amount of any salary reduction election contribution to Code Sections 106(c)(2) and 125 flexible spending arrangements (FSAs);
- the cost of insured coverage under stand-alone dental or vision plans;
- long-term care coverage;
- stand-alone coverage for a specified disease or illness (*e.g.*, cancer) or stand-alone coverage for most types of indemnity insurance to the extent the payment for which is not excludible from gross income and for which a deduction under Code Section 162(l) is not available;
- other coverage described in Code Section 9832(c)(1) (*e.g.*, accident and disability insurance, coverage supplemental to liability coverage, liability insurance, workers' compensation and similar insurance, automobile medical payment insurance, credit-only insurance, and other similar coverage under which medical care benefits are secondary or incidental to other insurance benefits), but reporting generally is required reporting for on-site medical clinics; and
- the cost of coverage with respect to an individual, if the employer is not otherwise required to issue a W-2 to that individual (*e.g.*, with respect to retirees or former employees receiving no compensation from the employer).²⁰

Temporary Exceptions

The IRS granted further non-reporting relief for the following types of plans (employers will not have a reporting requirement with respect to these types of plans for any calendar year that starts within six months of any future IRS guidance (but in no event will they be required to report for any tax years before 2013)):

- all plans of smaller employers that filed fewer than 250 Forms W-2 for the previous calendar year;²¹
- multiemployer plans;²²
- Health Reimbursement Arrangements;²³
- stand-alone self-insured dental and vision plans;²⁴
- self-insured plans not subject to COBRA continuation or similar requirements;
- employers furnishing Forms W-2 to employees who terminate before the end of a calendar year and request a Form W-2 before the end of that year;²⁵
- the cost of coverage under a self-insured group health plan not subject to any federal continuation coverage requirements (*e.g.*, self-insured religious plans; self-insured small employer plans, etc.); and
- the cost of coverage provided by the federal government, the government of any state or political subdivision, or any agency or instrumentality of such government under a plan maintained primarily for military members and their families.

Who Must Report?

Generally, all employers that provide applicable employer-sponsored coverage²⁶ must comply with the reporting requirements.

Notice 2011-28 provides special reporting rules with respect to employees who transfer to a Code Section 3121(a)(1) "successor employer" and with respect to related employers with a common paymaster.

Successor Employer Rule

If an employee transfers to a new employer that qualifies as a "successor employer" under Code Section 3121(a)(1), both the predecessor and successor employers must report the cost of coverage provided by each, unless parties take advantage of the optional consolidated wage reporting rules described in Revenue Procedure 2004-53, 2004-2 C.B. 320, in which case the successor employer will issue one Form W-2 reflecting the total cost of coverage and wages paid during the relevant calendar year by both the predecessor and successor employers and the predecessor employer will not report either.²⁷

Common Paymaster Rule

If an employee works for one or more related employers and has a common paymaster that issues a single Form W-2 for each employer, only that common paymaster will report the cost of coverage on its Form W-2.²⁸

Methods for Calculating the Cost of Coverage

Cost generally is the same as the applicable COBRA premium without the 2% administrative load. The aggregate reportable cost of coverage is the sum of the reportable costs for each period during the year as determined under the employer's selected method (three methods are available). The employer *must* determine the reportable cost on a calendar year basis, even if the employer uses a non-calendar year 12-month determination period for the purposes of applying the COBRA applicable premium under a plan.²⁹ Employers need not use the same method for every plan, but *within* a plan the same method must apply for every employee receiving coverage under the plan. The cost reported must reasonably reflect changes in coverage, as well as commencement or termination of coverage, that occur during the calendar year.³⁰

The COBRA Applicable Premium Method. Under this method, "the reportable cost for a period is equal to the COBRA applicable premium for that coverage for that period."³¹ This premium must be calculated in good faith using a reasonable interpretation of COBRA's statutory requirements.

The Premium Charged Method. This method may only be used to determine the reportable cost of an employee covered by an employer's insured group health plan. The reportable cost for a period is equal to the premium charged each period by the insurer for that employee's coverage.

The Modified COBRA Premium Method. This method may be used where (a) an employer subsidizes the cost of COBRA, or (b) the employer charges an actual premium to COBRA qualified beneficiaries for each period in the current year that is equal to the COBRA applicable premium for each period in the prior year. In scenario (a), the reportable cost may be based on a "reasonable, good faith estimate" of the COBRA applicable premium for the period, but the employer must use the same estimate to determine the subsidized COBRA premium. In scenario (b), the reportable cost for each period in the current year may be based on the COBRA applicable premium for each period in the prior year.

Revisiting the Question: Why Suffer the Slings and Arrows of Voluntary Reporting?

In light of Notice 2011-28, employers need to decide whether to report aggregate costs on 2011 Forms W-2. After all, planning and implementation efforts will not be without cost, and employers might be inclined to wait out the trial period and adopt the practices of industry peers once reporting becomes mandatory. It is unclear, but employers may be subject to penalties for reporting the wrong amount on erroneous 2011 Forms W-2, even though reporting is voluntary.

Nevertheless, we note a few potential advantages to voluntary reporting in 2011 (or attempting it):

- Employers will have the opportunity to test their reporting system to make sure that it works. This test may expose unanticipated obstacles for each employer that will take time to solve, and may help employers avoid penalties for filing erroneous W-2 statements.³²
- Voluntarily reporting employers also may uncover reporting issues that the IRS should address before reporting becomes mandatory for 2012.
- Should employers encounter significant problems in implementation, those problems might generate support for repealing the medical cost reporting requirement.
- Employers may be able to use the reported data to educate employees about health care costs.

Action Items and Next Steps

Employers should decide whether to undertake voluntary reporting for 2011, and should determine when and how they will implement PPACA-compliant payroll practices for 2012 Forms W-2 and beyond.

For additional Paul Hastings Client Alerts on PPACA issues, please see [Health Care "Reform" Provides No Relief for Employers](#) (general information on PPACA) and [DOL Grants Certain Group Health Plans Relief By Extending Non-Enforcement Period for Internal Claims and Appeals Requirements](#).



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- 1 I.R.C. § 6051(a)(14), 26 U.S.C. § 6051(a)(14).
- 2 Patient Protection and Affordable Care Act ("PPACA"), P.L. 111-148, Section 9002 (amending 26 U.S.C. § 6051(a)(14)); I.R.C. § 6051(a)(14), 26 U.S.C. § 6051(a)(14).
- 3 I.R.S. Notice 2011-28, -- C.B. -- (Mar. 29, 2011), <http://www.irs.gov/pub/irs-drop/n-11-28.pdf> [hereinafter "Notice 2011-28"]. Notice 2011-28 applies solely for the purposes of Code § 6051(a)(14), and "no inference should be drawn concerning any other provision of the Code." *Id.* at *5.
- 4 See Notice 2010-69, 2010-44 I.R.B. 576 (Oct. 12, 2010), <http://www.irs.gov/pub/irs-irbs/irb10-44.pdf> (indicating that the "Treasury Department and the IRS have determined that this relief is appropriate to provide employers with additional time to make any necessary changes to their payroll systems or procedures in preparation for compliance with the reporting requirement") [hereinafter "Notice 2010-69"].
- 5 Notice 2011-28 at *2. Any future guidance that applies reporting requirement more expansively will apply prospectively only, and will not apply to any calendar year beginning within six months of the date the guidance is issued. *Id.*
- 6 Notice 2010-69.
- 7 Notice 2011-28 at *5.
- 8 Notice 2011-28, Q&A-5. Employees are not required to report this information on Form W-3, Transmittal of Wage and Tax Statements. Notice 2011-28, Q&A-10.
- 9 Notice 2011-28, Q&A-2.
- 10 Notice 2011-28, Q&A-6.
- 11 A "group health plan" is a plan of the employer or an employee organization (or receiving contributions from the employer or an employee organization) to provide health care to employees, former employees, the employer, others associated with the employer in a business relationship, or their families. Notice 2011-28, Q&A-13. Employers "may rely on a good faith application of a reasonable interpretation of the statutory provisions and applicable guidance" in determining whether an arrangement is a group health plan. *Id.*
- 12 Notice 2011-28, Q&A-12.
- 13 Excess reimbursements of highly compensated individuals that are included in gross income under Section 105(h) do not factor into the ARC determination. Notice 2011-28, Q&A-23.
- 14 Notice 2011-28, Q&A-14.
- 15 Notice 2011-28, Q&A-15.
- 16 Notice 2011-28, Q&A-19, Example 2.
- 17 Notice 2011-28, Q&A-19.
- 18 Notice 2011-28, Q&A-20.
- 19 Notice 2011-28, Q&A-21.
- 20 Notice 2011-28, Q&A-9.
- 21 Notice 2011-28, Q&A 3.
- 22 See note 28, *infra*.
- 23 Employer-Provided Health Coverage Informational Reporting Requirements: Frequently Asked Questions, IRS.Gov (Mar. 29, 2011), <http://www.irs.gov/newsroom/article/0,,id=237894,00.html>; see also Notice 2011-28, Q&A-18.
- 24 Notice 2011-28, Q&A 20.

25 Notice 2011-28, Q&A-6.

26 "Applicable employer-sponsored coverage" has the same meaning as in Code Section 4980I(d)(1). Notice 2011-28 at *3. There, with respect to any employee, the term refers to coverage under any group health plan made available to the employee which is excludable from the employee's gross income under § 106, or would be so excludable if it were employer-provided coverage within the meaning of § 106. *Id.*

27 Notice 2011-28, Q&A-8.

28 Where employers are Code Section 3121(s) related employers and one employer is a Section 3121(s) common paymaster, then the common paymaster must report the ARC of coverage provided to that employee by all employers for whom it serves as common paymaster, on the Form W-2 issued by the common paymaster; however, the related employers need not report the cost of coverage they provide. Notice 2011-28, Q&A-7, Q&A-17.

29 Notice 2011-28, Q&A-31.

30 Notice 2011-28, Q&A-29 and Q&A-30.

31 Notice 2011-28, Q&A-25.

32 See *2011 Instructions for Forms W-2 and W-3: Wage and Tax Statement and Transmittal of Wage and Tax Statements*, Department of Treasury and Internal Revenue Service, 7 (2011), <http://www.irs.gov/pub/irs-pdf/iw2w3.pdf> (describing penalties for failure to file correct W-2 information returns that range from \$30 to \$250 per W-2 (up to a yearly maximum of \$1,500,000) and listing exceptions to penalties).