EMPLOYEE BENEFITS

IRS PROVIDES GUIDANCE AND RELIEF ON PPACA W-2 REPORTING REQUIREMENTS

by Cynthia A. Moore
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In Notice 2011-28, the IRS has provided guidance and transition relief to employers on how to report the cost of employer-provided health care coverage on Form W-2, as required by the Patient Protection and Affordable Care Act ("PPACA"). The reporting requirement, set forth in Section 6051(a)(14) of the Internal Revenue Code (the "Code"), was scheduled to take effect in 2011. Previously, in Notice 2010-69, the IRS delayed the effective date until 2012 to give employers time to make changes to their payroll systems. Notice 2011-28 (the "Notice") now provides helpful guidance on the reporting requirement in question and answer format.

Information Only; Effective Date

The Notice emphasizes that the Form W-2 reporting requirement is for information only - the cost of employer-provided health coverage is not taxable income to employees. The purpose of the reporting is to "provide useful and comparable consumer information to employees on the cost of their health care coverage." Q&A 2. The cost will be reported on Form W-2 in box 12, using code DD. The reporting requirement will initially apply to Form W-2 for the 2012 calendar year, generally furnished to employees in January 2013.

Which Employers are Subject to the Reporting Requirement?

In general, all employers are subject to the reporting requirement. However, small employers who file fewer than 250 Forms W-2 for calendar year 2011 will not be required to report the cost of employer-sponsored coverage on Form W-2 for 2012. This rule provides welcome relief for small employers.

Which Health Plans are Subject to the Reporting Requirement?

The cost of employer-sponsored health coverage includes the employer and employee share of the cost for all group health plans excludable from employee income, except:

- coverage for long-term care;
- any "excepted benefits" under Code Section 9832(c)(1), such as worker's compensation or disability insurance, other than coverage for on site medical clinics;
- any separate policy providing vision or dental coverage;
- amounts contributed to an Archer MSA or a health savings account;
- salary reduction contributions to a health flexible spending account;
- the cost of coverage under a multiemployer plan;
- the cost of coverage under a health reimbursement account;
- a dental plan or a vision plan that is not integrated into a group health plan providing additional health care coverage;
- the cost of coverage under a self-insured group health plan not subject to federal continuation coverage requirements (such as a church plan); and
- a government-sponsored plan providing coverage primarily for members of the military and their families.

How is the Cost of Coverage Determined?

An employer can determine the cost of coverage under one of three methods:

1. the COBRA applicable premium method;
2. the premium charged method for an insured plan; or
3. the modified COBRA premium method if an employer subsidizes the cost of COBRA coverage or uses prior year cost to determine its COBRA rate.

The cost for each employee is calculated by adding the monthly cost of coverage provided to the employee and his or her covered dependents. An employer can use different methods for different plans, but must use the same method with respect to a plan for every employee receiving coverage under that plan. For example, an employer could use the "COBRA applicable premium method" for its self-insured PPO plan and the "premium changed method" for its insured HMO plan.

The "COBRA applicable premium method" is the COBRA premium as determined under the COBRA rules. There are no regulations on determining the COBRA premium, so an employer can follow its normal good faith procedure in determining the COBRA applicable premium.

The "premium charged method" is the premium charged by the insurer for coverage for a month.

The "modified COBRA premium method" can be used only if one of the following applies. First, if the employer subsidizes the cost of COBRA, it can use a reasonable good faith estimate of the COBRA premium, if the employer subsidy is based on that premium. Second, if the current year COBRA premium is equal to a prior year COBRA rate, the prior year COBRA rate can be used to report the cost of coverage in the current year.

Other Reporting Guidelines

Mid-Year Cost Changes. The cost of coverage is determined on a calendar year basis. So if the employer uses the COBRA applicable premium method and the COBRA premium is based on a plan year that is not a calendar year, the cost of coverage must be adjusted mid year for an employee who is covered for the entire calendar year.

Example: The COBRA premium is determined for the plan year April 1-March 31. The single premium for April 1, 2011 - March 31, 2012 is $600 and for April 1, 2012 - March 31, 2013 is $650. The cost of coverage reported on the 2012 Form W-2 issued in January 2013 for an employee with self-only coverage is ($600 x 3) + ($650 x 9) = $1800 + $5850 = $7650.

Mid-Year Coverage Changes. If an employee commences, terminates or changes coverage during the calendar year, such changes must be taken into consideration in calculating the cost of coverage. For example, if an employee drops or adds a dependent during the year, such coverage changes will affect the calculation of the reportable cost of coverage. This means that an employer cannot simply look at its list of covered employees as of December 31 and use the coverage option in effect on that date as a good faith estimate of the cost of coverage. The employer will need to monitor enrollments, disenrollments, mid-year plan changes and dependent changes in order to accurately report the cost of coverage. This will result in precise reporting to employees, but is an administrative headache for employers. These requirements may lead employers to (a) change the plan year for a group health plan to the calendar year and (b) limit the changes that can be made to a health plan coverage election to the HIPAA special enrollment rights.

Mid-Year Termination of Employment. In a very helpful rule, if an employee terminates coverage mid-year and loses coverage under a group health plan, the employer can use any reasonable method of determining the cost of coverage. The Notice describes the following two methods that are reasonable:

- the cost of coverage during the period when the employee was actively employed, or
- the cost of coverage during the period when the employee was actively employed plus any period of COBRA coverage during the calendar year.

The method that is elected should be used consistently for all employees receiving coverage under that health plan during the year. In more welcome relief, the cost of coverage need not be reported on Form W-2 to a terminated employee who asks to receive his or her Form W-2 before the end of the year.

Retirees. An employer is not required to issue a Form W-2 reporting the cost of coverage to a covered person who does not otherwise receive a W-2, such as a retiree.

Although the Notice provides welcome relief in many areas, the W-2 reporting requirement still gives employers yet another administrative burden. It is not too soon to begin discussing the changes with the payroll provider and begin developing procedures to monitor mid-year changes.

If you have any questions about the Form W-2 reporting requirement, please contact:

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