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New Guidance Issued for Reporting the Cost of Health Coverage on Forms W-2

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In March of 2011, the Internal Revenue Service (“Service”) issued Notice 2011-28 which provided interim guidance regarding the informational reporting to employees of their employer-sponsored group health plan coverage (the “2011 Notice”). The Service has now issued Notice 2012-09 (the “2012 Notice”) which supersedes the 2011 Notice and makes certain changes to the guidance provided in the 2011 Notice. This Legal Alert summarizes the new 2012 Notice and updates the information provided in our previous Legal Alert on this issue.

The informational reporting requirement was added to the Internal Revenue Code of 1986 (“Code”) by the Affordable Care Act. Under this new requirement, employers must provide to each employee who is receiving coverage from a group health plan sponsored by the employer information regarding the cost of such coverage. Employers are required to comply with the informational reporting requirement beginning with 2012 Forms W-2 (i.e., forms required for the 2012 calendar year that employers must furnish to employees in January 2013).

Perhaps the change made by this 2012 Notice that will be of greatest interest to many employers is that certain costs no longer have to be reported (i.e., EAPs, wellness programs and on-site medical clinics), but only if the employer does not charge COBRA or other premiums based on federal continuation coverage requirements.

General Requirements

Code Section 6051(a)(14) requires the aggregate cost of applicable employer-sponsored coverage to be reported on a Form W-2. The amount is reported in Box 12, using Code DD. This dollar amount is for informational purposes only, and the amount reported does not affect the existing general rules regarding whether the coverage is excludable from gross income (employers should be prepared to respond to this question from employees). Beginning with the 2012 calendar year, all employers that provide applicable employer-sponsored coverage to their employees in an applicable calendar year are required to comply with the informational reporting requirement. However, an exception exists for small employers.

Until further guidance is issued (and at least for 2012), an employer is not required to comply with the informational reporting requirement for a calendar year, if the employer was required to file less than 250 Forms W-2 for the preceding calendar year. For this purpose, the number of Forms W-2 required to be filed is determined without taking into account the use of an agent under Code Section 3504 (that is, if over 250 Forms would have been required if no agent was used, the exception does not apply). In addition, exceptions exist for self-insured plans that are not subject to federal COBRA continuation

coverage laws and plans maintained primarily for military members and their families. The 2012 Notice also provides that until further guidance is issued, employers that are tribally chartered corporations wholly-owned by a Federally-recognized Indian tribal government are exempt from the reporting requirements.

Employers must only report the aggregate cost of applicable employer-sponsored coverage to an individual for whom the employer is otherwise required to issue a Form W-2. This means that employers are not required to send a Form W-2 to individuals who are enrolled in employer-sponsored health coverage, but who do not otherwise receive a Form W-2 for the applicable year. This may include retirees, surviving spouses and dependents, COBRA participants and other terminated employees with continuation coverage.

The 2012 Notice also continues an exception for employees who terminate employment during a calendar year. Under this exception, for the year of termination, an employer may voluntarily report the cost of coverage after termination of employment, as long as this rule is consistently applied. Some employers hoped that this rule would be extended beyond the year of termination. However, the 2012 Notice did not change the fundamentals of this exception. Thus, based on the 2012 Notice, if an individual has compensation to report on a Form W-2 for a year after the year of termination, then the employer must report the aggregate cost of employer-sponsored coverage for that year. For example, if an individual terminates employment on July 1, 2012 and receives 12 months of severance pay along with continuation of health coverage, the special exception discussed above applies to the year of termination (i.e., 2012). However, the special exception would not apply for future years. Thus, for 2013 the individual would receive a Form W-2 for the remaining six months of severance pay and the employer would also have to report the cost of coverage during this same period, whether or not it is COBRA coverage or continuation of active employee coverage. This same process would also apply in other situations, such as retirees who receive Form W-2s due to nonqualified deferred compensation payments.

If two related employers (within the meaning of Code Section 3121(s)) concurrently employ an employee, and one employer is a common paymaster for wages, the common paymaster must include the aggregate cost of employer-sponsored coverage by all the employers for whom it serves as the common paymaster. If the related employers do not use a common paymaster, the related employers may either report the entire aggregate cost on one of the Forms W-2 provided to the employee or may allocate (using a reasonable method) the aggregate cost among the employers concurrently employing the employee. A special rule is provided for individuals who transfer employment to a successor employer.

Applicable Employer-Sponsored Coverage

Applicable employer-sponsored coverage (“Employer Coverage”) is coverage under any group health plan that is excludable from the employee’s gross income or would be excludable if it were Employer Coverage. This is a broad definition that includes many types of Employer Coverage, such as major medical coverage (both self-insured and insured), mini-med coverage, on-site medical clinic coverage and employer flex credits to a health flexible spending arrangement (FSA). However, the Notice provides for a number of exceptions to the reporting requirements.

The following are not reported on a Form W-2 as Employer Coverage –

- Long term care coverage or insurance
- Stand alone dental and vision coverage, if it satisfies the requirements for being a HIPAA-excepted benefit
- Coverage under an EAP, wellness program or on-site medical clinic, if (1) it is not a group health plan under Code Section 5000(b)(1), or (2) if the employer does not charge a premium for such coverage when it is provided under federal continuation coverage requirements, such as COBRA
- HIPAA-excepted insurance for a specified disease or illness, but only if it is paid on an after-tax basis and only if the employer makes no contribution to the cost of coverage
- Any amount contributed to a Health Savings Account (HSA) or Archer MSA
- Any salary reduction amount contributed to a health FSA by an employee (however, employer flex credits or other employer contributions to a health FSA must be reported as noted above)
- Health Reimbursement Arrangement (HRA) coverage
- Other HIPAA-excepted coverage, such as AD&D and disability

Nevertheless, an employer could voluntarily include the cost of Employer Coverage that is not required to be included, such as the cost of coverage under an HRA, an EAP or an on-site medical clinic. Special rules also exist for multiemployer plans.

Aggregate Cost of Employer Coverage

The total cost of all Employer Coverage must be included in the aggregate reportable cost (subject to the exceptions noted above). This means that all types of Employer Coverage are added together and reported on the Form W-2 as one amount. For example, if the employee has both major medical and on-site medical clinic coverage (that does not fall within the exception described above), both coverages are aggregated and reported on the Form W-2. Further, the Notice provides that the aggregate reportable cost includes the following –

- Both the employee and employer portions of the Employer Coverage, regardless of whether the employee pays for the coverage on a pre-tax or after-tax basis.
- The cost of Employer Coverage for all individuals covered by the group health plan because of the employee (e.g., spouse, domestic partner, children and other individuals).
 - Note that the aggregate reportable cost is not reduced by the amount of the Employer Coverage that is imputed as additional wages for individuals who are not Federal income tax dependents.

The aggregate reportable cost reported on Form W-2 may be based on the information available to the employer as of December 31. This means that any election or notice provided to the employer in the following year that has a retroactive effect on coverage does not affect the amount that is required to be reported.

If a pay period crosses two calendar years, the employer can choose to treat the coverage as provided (on a consistent basis for all employees) during the calendar year that includes that December 31, during the

following calendar year, or allocate the cost between the two years using a reasonable method that should relate to the number of days in the period.

The Notice provides that the employer may calculate the reportable cost under a group health plan using one of the following four methods –

- COBRA Applicable Premium Method: Under this method, the reportable cost for a period equals the COBRA applicable premium under Code Section 4980B(f)(4) for that coverage for that period. The employer is required to follow the generally applicable requirements of COBRA used in establishing COBRA continuation coverage rates.
- COBRA Premium Charged Method: Fully insured plans may use the premium charged method, which equals the total premiums charged by the insurer for that employee's coverage.
- Modified COBRA Premium Method: Employers may also use the modified COBRA premium method with respect to a plan, if it subsidizes the cost of COBRA or if the actual premium charged by the employer to COBRA participants for each period in the current year is equal to the premium calculated under the COBRA applicable premium method for each period in the prior year.
- Composite Rates: Special rules exist for employers who charge a single composite rate for all coverage tiers or if there is only one coverage tier for the group health plan. If a composite rate is used for active employees but not for determining COBRA rates, the employer may use either the composite rate or the applicable COBRA premium, but it must use the same method consistently for all active employees and for all COBRA qualifying beneficiaries.

Because the COBRA rules themselves are not entirely clear on how to calculate COBRA rates, employers appear to have some flexibility in determining the aggregate cost of Employer Coverage, as long as the employer follows a good faith interpretation of the rules. Further, if an employee commences, changes or terminates Employer Coverage during the year, the reportable cost for the employee for that year must take into account the change in coverage. For example, if an employee is enrolled in an HMO and changes to a PPO mid-year or adds a spouse and dependent to the employee's coverage, those changes must be reflected in the aggregate reportable cost. If the change in coverage occurs during a period (for example, in the middle of a month where costs are determined on a monthly basis), an employer may use any reasonable method to determine the reportable cost for such period, such as using the reportable cost at the beginning of the period or at the end of the period, or averaging or prorating the reportable costs, provided that the same method is used for all employees with coverage under that plan. Last, if an employee commences coverage or terminates coverage during a period, an employer may use any reasonable method to calculate the reportable cost for that period, provided that the same method is used for all employees with coverage under the plan.

If a program provides both Employer Coverage and other benefits, such as a long-term disability program that also provides certain health benefits, an employer may use any reasonable allocation method to determine the cost of the portion of the program providing Employer Coverage. If the portion of the program that is Employer Coverage is only incidental in comparison to the other (non-health) benefits provided, the employer is not required to report the cost of the Employer Coverage. If the portion of the program providing a benefit that is not Employer Coverage is only incidental, the employer may (but is not required) to report the cost of the entire program.

Further guidance may limit the availability of some of the relief provided in the 2012 Notice. However, any future guidance will be prospective only and will not limit the relief provided in the 2012 Notice for the 2012 Forms W-2 (that is, the forms generally provided in January 2013 for the 2012 calendar year).

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