MEMORANDUM

HEALTH CARE REFORM FOR EMPLOYERS: IRS GUIDANCE ON NEW FORM W-2 REPORTING REQUIREMENT

May 14, 2012

One of the many new requirements in the Health Care Reform Law is a requirement that employers must report the value of the coverage that their employees receive under an employer-sponsored group health plan on an employee's Form W-2.

This requirement may sound simple. But, like most things associated with the Health Care Reform law – the law formally known as the Patient Protection and Affordable Care Act of 2010 ("PPACA") – it is not nearly as simple as it might seem.

In May 2011, the Internal Revenue Service ("IRS") issued formal guidance as to how this requirement would be implemented in the form of Notice 2011-28. That guidance addressed a number of different questions as to which employers and what types of coverage will be subject to the new reporting requirement. This guidance was summarized in our Memorandum dated November 2, 2011.

In January of this year, the IRS re-issued the May 2011 guidance in the form of Notice 2012-9. The new guidance does not change or "undo" the previous guidance, but it does answer some questions more clearly and directly than before and also addresses questions that were not previously addressed.

We have updated our Memorandum from last November to reflect the new IRS guidance and to address questions that our clients have been asking. As before, we have chosen to use a "question and answer" format as a way of making this Memorandum easier to read.

Q-1. ***Tax Treatment – Does the new reporting requirement change the tax treatment of employer-provided coverage?***

A-1. This is the first question the IRS addressed in its guidance. It is a question that we have been asked many times and it is undoubtedly a question that many other people have had.

The short answer to this question is this: The new reporting requirement does <u>not</u> change the current tax treatment of employer-provided coverage.

Here's what the IRS had to say about this in Notice 2012-9:

> This reporting to employees is for their information only. This reporting is intended to inform them of the cost of their health care coverage, and does not cause excludable employer-provided health care coverage to become taxable. Nothing in [PPACA] … causes or will cause otherwise excludable employer-provided health care coverage to become taxable.

If the value of employer-provided coverage was excludable before the new reporting requirement took effect, it will continue to be excludable after the new reporting requirement takes effect.

Q-2. ***Employers Subject to the New Reporting Requirement – Are there any employers who are <u>not</u> subject to the new reporting requirement?***

A-2. The new reporting requirement applies to any employer that provides coverage under a group health plan to its employees, with only a handful of exceptions. These exceptions are as follows:

(1) **Small Employer Exception.** The most important exception is for small employers. *If an employer was required to file fewer than 250 Form W-2s for the previous calendar year, it will not be subject to the new reporting requirement for the current calendar year.*

This exception is based on the rule that exempts employers from filing returns electronically if they file fewer than 250 returns. Thus, if an employer is not required to file its Form W-2s electronically, it will not be required to comply with the new reporting requirement.

For those employers who are close to the 250 return threshold, we would, however, note the following:

- The electronic filing exception is based on the total number of returns an employer is required to file, including both Form W-2s and other forms, such as Form 1099s.

- The small employer exception for the W-2 reporting requirement, on the other hand, is based only on the number of Form W-2s that an employer is required to file.

This has the following implications:

- If you are not required to file electronically for the previous calendar year, then you will not be required to comply with the new Form W-2 requirement.

- If you are required to file electronically for the previous calendar year, it is, however, possible that you will not be required to comply with the new W-2 requirement if you filed fewer than 250 Form W-2s for the previous year. In other words, if you were over the 250 threshold for electronic filing because you had to file other types of returns, but you had less than 250 W-2s, then you still would not be subject to the new W-2 requirement.

The small employer exception is part of the "transition relief" the IRS has provided. It is not necessarily permanent; however, the IRS has said that it will remain in effect until further guidance is issued.

(2) **Indian Tribal Governments.** In addition to the small employer exception, there is an exception for federally recognized Indian tribal governments. A federally recognized Indian tribal government is not required to comply with the new reporting requirement.

(3) **Employers Not Subject to Federal Continuation Coverage Requirements.** Finally, there is an exception for employers that are not required to offer continuation coverage under COBRA or other federal laws, *but only if the coverage is self-insured*. The most common example of this would be a self-insured church plan.

Because this exception applies on a plan by plan basis, it does not necessarily provide a complete exception to the reporting requirement. For example, if a church related employer maintained both a self-insured plan and a fully insured plan, it would not be required to report the value of coverage provided under its self-insured plan but it would be required to report the value of coverage provided under its fully insured plan (assuming, of course, that the fully insured plan does not fall under their own exception).

Q-3. ***Controlled Groups and the Small Employer Exception. How does the small employer exemption apply when the employer is part of a controlled group?***

A-3. When two or more employers are under common ownership or are otherwise part of a "controlled group," the Internal Revenue Code ("Code") requires them to be treated as if they were a single employer, *but only for certain purposes.* For example, a parent and a subsidiary must generally be treated as if they were a single employer for purposes of the employee benefit provisions of the Code. The Code does not, however, require the controlled group rules to be applied for purposes of the electronic filing requirements for Form W-2 reporting. So, if an employer has its own employees and issues Form W-2s to its employees using its own EIN, the employer will not be subject to the new Form W-2 reporting requirement unless it was required to file at least 250 Form W-2s for its own employees for the previous calendar year. Whether it is above or below the 250 Form W-2 threshold is determined based solely on the Form W-2s that it was required to file for its own employees. It is not aggregated for this purpose with any other employers within its "controlled group."

Q-4. ***Coverage That Must Be Reported – Does the new reporting requirement apply to all of the group health plan coverage that an employer provides?***

A-4. The new reporting requirement requires employers to report the value of most types of employer-provided coverage under a group health plan, but there are exceptions. The value of the following types of coverage is not required to be reported:

(1) Dental coverage and/or vision coverage, *if* the coverage is provided under a separate "dental only" or "vision only" plan;

(2) Coverage in which benefits for medical care are secondary or incidental to other insurance benefits, such as medical benefits provided under an automobile liability policy;

(3) Coverage for a specified disease (such as cancer insurance) or hospital insurance or other types of "fixed indemnity" coverage, but *only if* the entire cost of the coverage is being paid for by the employee using after-tax dollars. This exception does not apply if any part of the cost of the coverage is being paid for by the employer or by the employee using pre-tax dollars through a Section 125 cafeteria plan;

(4) Most contributions to a Health Flexible Spending Account ("Health FSA"), as discussed in more detail below;

(5) Contributions to a Health Savings Account or an Archer MSA; and

(6) Coverage for long-term care (to the extent that such coverage might otherwise constitute a group health plan).

We would note that additional rules may apply if an employer has an on-site medical clinic. These additional rules are beyond the scope of this Memorandum.

Q-5. ***EAPs, Wellness Programs & Onsite Clinics – Are employers required to report the cost of employee assistance programs (EAPs), wellness programs, and on-site clinics qualifying as group health plans?***

A-5. If the employer does not charge a COBRA premium for continuation of these benefits, then the employer is not required to report the cost. However, if the employer does charge a COBRA premium, the cost of coverage must be reported. The safest option for employers is to report the cost regardless. There is no penalty for doing this.

Q-6. ***Health FSAs – What are the special reporting rules for Health FSAs?***

A-6. The special reporting rules for Health FSAs may be summarized as follows:

(1) If the *only* contributions to an employee's Health FSA are the employee's own pre-tax salary reductions, no reporting will be required.

(2) If the employer contributes to an employee's Health FSA, no reporting will be required *if* the total dollar amount that is available under the Health FSA for the year does not exceed the total dollar amount of the employee's pre-tax salary reductions for *all* pre-tax benefits for that year.

(3) However, *if* the employer contributions to an employee's Health FSA *and* the dollar amount that is available under the Health FSA for the year is more than the total dollar amount of the employee's pre-tax salary reductions for the year, *then the difference between the Health FSA dollar amount and the employee's pre-tax salary reductions must be reported*.

Q-7. ***Health FSAs – Did the IRS provide examples of how the special reporting rules for Health FSAs are supposed to work?***

A-7. Yes. The IRS provided two examples:

(1) **Reporting Not Required.** In the first IRS example, the facts are as follows:

(a) An employee elects $1,500 for his/her Health FSA. The employee also elects several other pre-tax benefits. The total cost of all of these pre-tax benefits, including the Health FSA, is $3,000 for the year.

(b) The employer will provide a $1,000 credit toward the cost of these benefits. The remaining $2,000 will be paid by the employee by making pre-tax salary reductions.

In this example, *no reporting is required* because the $1,500 annual election for the Health FSA is less than the $2,000 in pre-tax salary reductions that the employee will make for the year.

(2) **Reporting Is Required.** In the second IRS example, the facts are as follows:

(a) An employee elects $1,400 for his/her Health FSA. The employee does not elect any other pre-tax benefits.

(b) The employer will provide a $700 credit toward the cost of the Health FSA election made by the employee. The remaining $700 will be paid by the employee by making pre-tax salary reductions.

In this example, *reporting is required* because the $1,400 annual election for the Health FSA is more than the $700 in pre-tax salary reductions that the employee will make for the year.

Q-8. ***Dollar Amounts – How Is An Employer Required to Calculate the Cost of Coverage?***

A-8. The IRS guidance provides the following alternatives for calculating the cost of coverage:

(1) **COBRA Premium.** An employer may calculate the reportable cost of coverage by using the premium that would have been charged if the employee had been receiving that coverage under COBRA. If the COBRA premium is used, the 2% administrative fee is *not* included and any subsidies the employer might provide toward the cost of COBRA coverage should be ignored.

(2) **Premiums Charged for Fully Insured Coverage.** If coverage is fully insured, an employer may choose to use the premiums that were charged by the insurance company for that coverage.

Additionally, as noted above, there are special rules that apply if coverage under a Health FSA is required to be reported.

Q-9. ***Retroactive Changes – How should employers treat retroactive changes that affect the cost of coverage?***

A-9. In some situations, a change in coverage might take place on a retroactive basis after the end of a calendar year. For example, if a child is born to an employee in December, the employee would have the right under the HIPAA special enrollment rules to add that child to the employee's coverage effective as of the date of birth, but the deadline for doing so would not be until sometime in January. The IRS has clarified that an employer is not required to take these types of retroactive changes into account when it calculates the cost of coverage for the previous year. The amount reported on the W-2 may be based on the information available to the employer on December 31 of the reporting year and the employer is not required to change its W-2 reporting if that information later changes.

Q-10. ***Former Employees and Retirees – Are there special rules for former employees and retirees?***

A-10. The IRS guidance provides the following special rules for former employees and retirees:

(1) If the employer is not otherwise required to issue a Form W-2 to a retiree or other former employee, no reporting is required. Thus, for example, if a former employee is continuing to receive coverage but did not have any reportable compensation, no reporting is required.

(2) If a former employee requests the issuance of a Form W-2 *before* the end of the calendar year in which the former employee's employment was terminated, no reporting is required.

(3) If neither of these two exceptions applies, the employer "may apply any reasonable method of reporting the cost of coverage provided" under a group health plan for an employee who terminated employment during a calendar year, as long as the same method is consistently used for all employees who terminated employment during that calendar year.

For example, if an employee terminates employment and elects COBRA continuation coverage, the employer could choose to report the value of coverage (a) only for the period that the employee was covered as an active employee, or (b) for the entire period that the employee was covered, including coverage both as an active employee and under COBRA.

Q-11. ***Effective Date – When does the new reporting requirement take effect?***

A-11. The new reporting requirement was originally scheduled to take effect in 2011. As a result, the Form W-2s that were issued in January 2012 for compensation paid in 2011 would have been affected by the new reporting requirement.

However, the IRS formally delayed the effective date in late 2010. As a result, compliance with the new reporting requirement was *optional* with respect to Form W-2s that were issued to report compensation paid in 2011. Compliance is *mandatory* with respect to compensation paid in 2012. This means that Form W-2s that will be issued in January 2013 reporting 2012 compensation will be required to comply with the new reporting requirement.

Q-12. ***Completing the Form W-2 – What box and code will be used to report the value of employer-provided group health plan coverage?***

A-12. The instructions for completing the Form W-2 state that the value of employer-provided group health plan coverage should be reported in Box 12 using Code DD.

Q-13. ***Consequences of Non-Compliance – What are the consequences for not complying with the new Form W-2 reporting requirement?***

A-13. Under the Internal Revenue Code, an employer is subject to a penalty if it fails to include "all of the information required to be shown" on a Form W-2 or if it includes "incorrect information." The penalty is $100 for each Form W-2 with incomplete or incorrect information that is filed with the IRS, up to a maximum penalty of $1.5 million. The same penalty also applies for each Form W-2 with incomplete or incorrect information that is given to an individual.

If you have any questions regarding the impact of health care reform on employers, please feel free to call Steven Smith, Eric Namee, or Brad Schlozman at (316) 267-2000.