

Employee Benefits Briefing

Reporting the Cost of Health Care Coverage: More for the W-2

On March 25, 2011, the Internal Revenue Service published Notice 2011-28, which provides guidance to large employers (defined as employers issuing more than 250 W-2s for calendar year 2011) on how to report the cost of group health coverage on employees' W-2s. Reporting is effective beginning for 2012 (i.e., for W-2s distributed in January 2013).

Background

The Patient Protection and Affordable Care Act of 2010 requires that employers report the cost of group health plan coverage to their employees annually on their W-2s. See Internal Revenue Code Section 6051(a)(14). Reporting was originally to begin with the 2011 W-2s (distributed in January 2012), but the IRS postponed the effective date in Notice 2010-69. Although this cost is included on the W-2 (in Box 12), it is informational only and is *not* included in taxable income.

Under Notice 2011-28, large employers (those issuing 250 or more W-2s for calendar year 2011) are required to start reporting the cost of group health plan coverage on the 2012 W-2s (distributed in January 2013).

Notice 2011-28 postpones this reporting requirement for smaller employers. Employers that are required to issue fewer than 250 W-2s for 2011 (distributed in January 2012) are not required to report the cost of group health plan coverage on the 2012 W-2s (distributed in January 2013). This exemption will continue to apply in later years as long as the employer meets the less than 250 W-2 prior-year limit, until the IRS issues further guidance.

Overview

Although Notice 2011-28 addresses a number of special situations that could apply to particular employers, for the vast majority of large employers, the following rules apply:

- *Timing:* The cost of coverage must be included on employee W-2s beginning in 2012 (i.e., W-2s distributed in January 2013).
- *How Reported:* The aggregate cost will be reported in Box 12 of the W-2 and will be identified by code DD.
- *Cost:* The cost of coverage will be equal to the COBRA rate (less any 2 percent administrative charge) for self-insured plans or the insurance premium rate for insured plans, in each case for the coverage tier (e.g., employee only, employee plus spouse, family, etc.) in which the employee participates.
- *Health FSAs:* Employee contributions to health FSAs are disregarded.

Additional Details

1. Plans Subject to Reporting

Reporting applies to all employer-sponsored group health plans. However, the following plans and amounts are not included:

- Long-term care plan
- Free-standing dental plan
- Free-standing vision plan

- Contributions to a multi-employer health plan
- Amounts contributed to any Archer MSA
- Amounts contributed to any Health Savings Account (HSA)
- Amounts contributed to a Health Reimbursement Arrangement (HRA)
- Employee salary-reduction contributions to a Health Flexible Spending Account (FSA) under a Section 125 cafeteria plan

2. Determining Aggregate Cost

The aggregate cost of coverage includes both the employee's premium and any employer subsidy. Cost reporting is done without regard to whether such amounts are pre-tax, post-tax or imputed as income to the employee.

For self-insured plans, the unsubsidized COBRA rate (excluding the 2 percent administrative fee) for the coverage tier (e.g., employee only, employee plus spouse, family, etc.) is the closest proxy to aggregate cost.

For insured plans, the premium charged by the insurance company for the coverage tier (e.g., employee only, employee plus spouse, family, etc.) is the aggregate cost.

3. Terminated Employees

For an employee whose employment terminates during the year, the employer may elect either (i) to report just the cost of active coverage through the termination date or (ii) the cost of coverage (active coverage, plus COBRA or other post-employment coverage) for the entire year. However, whichever method is chosen, the employer must be consistent for all employees whose employment terminates during the year.

Under long-standing IRS regulations, terminated employees may request a W-2 ahead of the normal January processing time (see Treasury Regulations § 31.6051-1(d)(1)(i)). However, for any former employee who asks for a mid-year W-2, the employer is *not* required to report the cost of health coverage on the employee's W-2.

In any case in which the employer is not required to file a W-2 for a former employee, the cost reporting rule does not otherwise create a requirement to file a W-2. For example, if an employee is receiving coverage under COBRA (or other post-employment coverage) in a year after the year of termination, and the employer does not issue a W-2 to the retiree/former employee (because no income is reported), the employer is *not* required to issue a W-2 to report the cost of their health coverage.

4. Health FSAs

As noted above, a health FSA may be disregarded when it consists solely of employee salary reduction contributions. However, if the employer matches the health FSA contributions (or otherwise contributes to the health FSA), the employer-provided portion of the benefit *may* be required to be included in the aggregate cost reported on the W-2.

For purposes of determining what, if any, health FSA amounts are to be reported on the W-2, the employer must compare the employee's total salary reductions for qualified benefits under the Section 125 cafeteria plan to what is allocated to his health FSA:

- If the salary reductions *equal or exceed* the amount allocated to the health FSA, *nothing* is reported. For example, assume the employee's total salary reductions under a Section 125 cafeteria plan are \$2,000 and the employer provides a \$1,000 flex credit. If the employee allocates \$1,500 to the health FSA, nothing attributable to the health FSA is reported, because \$2,000 is greater than \$1,500.
- If the salary reductions *are less* than the amount allocated to the health FSA, the difference is reported. For example, if an employee elects to contribute \$700 to a health FSA during the year and the employer matches the employee's contributions with an additional \$700, the employer must report the amount of the match (\$700) on the W-2.

5. Special Situations

Mid-Year Coverage Changes: If an employee changes coverage tiers mid-year (e.g., changes from employee-only coverage to family coverage), the employer is required to apply a reasonable and consistent methodology for calculating the pro rata portion of full-year aggregate cost attributable to each level of coverage. The same reasonable and consistent methodology should be used if an employee commences coverage or terminates coverage mid-year.

Transfers: If an employee transfers between employers that each provide employer-sponsored health insurance, each employer is responsible for reporting its aggregate cost on its W-2 for that year.

Common Paymaster: If a company utilizes a common paymaster for reporting compensation for

its various affiliates, that common paymaster is responsible for aggregating the aggregate cost information for the various affiliates.

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