

# W-2 Reporting Requirement

Revised January 2012

Notice 2012-9 provides guidance on W-2 reporting requirement

## IRS Issues New Guidance on Health Care Reform's W-2 Reporting Requirement

The Internal Revenue Service (IRS) recently issued IRS Notice 2012-9, which supersedes IRS Notice 2011-28 and replaces it with a modified and expanded explanation of the Patient Protection and Affordable Care Act's (PPACA) W-2 reporting mandate. The majority of the information in Notice 2012-9 is a restatement of the guidance provided in Notice 2011-28, meaning employers that have already started to prepare for compliance with the W-2 reporting requirement should not expect to significantly alter their plans in light of the new guidance. Specifically, Notice 2012-9 adds new Q&As 32-39, clarifies several Q&As in Notice 2011-28 and republishes the Q&As provided in Notice 2011-28 that remain unchanged.

This paper focuses on the background of the W-2 reporting requirement, the effective date of the requirement, the employers and plans subject to the requirement, the types of coverage that are reportable, the methods of calculating the cost of those coverages, and penalties relating to noncompliance. In addition, the paper includes frequently asked questions (FAQs) and additional resources relating to the reporting requirement that may be helpful to employers. Importantly, this paper also highlights the modifications and new guidance provided under Notice 2012-9.

## The W-2 Reporting Requirement

Under PPACA, employers are required to report the aggregate cost of applicable employer-sponsored group health plan coverage on each employee's Form W-2. The employer must report the cost of coverage on a calendar-year basis, regardless of the plan year used for the health plan. The reporting is intended for informational purposes for the employee (to provide employees with the cost of their health care coverage). The W-2 reporting requirement does not cause the cost of such coverage to be included in the employee's income or otherwise become subject to federal taxation.

## Employers Subject to the Requirement

Generally speaking, all employers, including private companies, governmental entities, church organizations and tax-exempt organizations, are required to provide informational reporting of the value of health benefits provided to employees. There is a small employer exception for employers who filed fewer than 250 Forms W-2 for 2011. Unless changed by future guidance, those employers who file fewer than 250 Forms W-2 for one calendar year will be exempted for the next calendar year. For this purpose, Notice 2012-9 clarified that the limit of 250 includes Forms W-2 filed by an employer's agent under Internal Revenue Code (IRC) § 3504. For example, if an employer would have filed 300 Forms W-2 in 2011 had it not used an agent, that employer would be subject to the reporting requirement for 2012 (Q&A-3).

Lastly, federally recognized Indian tribal governments are exempt from the reporting requirement. Notice 2012-9 expands this exemption to cover tribally chartered corporations wholly owned by federally recognized Indian tribal governments (Q&A-3).

## Effective Date

To provide more time for employers to make payroll administration and system changes to comply with the requirement, the IRS issued Notice 2010-69 last fall, which provided that for 2011, the W-2 reporting was voluntary.

Notice 2011-28 formally delayed implementation of the reporting requirement. According to that guidance, employers are not required to include the cost of coverage on any Form W-2 required to be issued before January 2013. Thus, the reporting requirement will first apply with respect to coverage provided in 2012. This means that most employers must begin reporting the costs of employees' health coverage for 2012 and report that value on the Form W-2, which generally will be provided to employees in January 2013. However, employers that file fewer than 250 Forms W-2 for one calendar year, self-insured plans that are not subject to the Consolidated Omnibus Budget Reconciliation Act (COBRA) (including church plans), and multiemployer plans will be exempted for 2012.

## Reportable Plan Information

Employers must report on Form W-2 the cost of "applicable employer-sponsored coverage," which is generally defined as any group health plan coverage provided by the employer to an employee that is excludable from the employee's income (usually under IRC § 106). Notice 2012-9 clarifies the definition of applicable employer-sponsored coverage, and describes the various contributions and coverages that are included in the definition, as outlined in the chart below.

| APPLICABLE EMPLOYER-SPONSORED COVERAGE  |  |
|---|--|
| Included  | Not Included   |
| Major medical coverage  | Employee FSA contributions (through salary reductions)   |
| Executive medical plan coverage   | HRA coverage <sup>1</sup>  |
| Combined medical/dental/vision plan   | HSA and Archer MSA contributions   |
| Employee assistance program (EAP) (only included if a COBRA premium is charged for continued coverage under the EAP) <sup>1,2</sup> | Noncoordinated coverage for specific illness or disease (i.e., cancer coverage)  |
| Employer contributions to health FSA (including employer flex credits)  | Notice 2012-9 clarified that the amount of a health FSA is not required to be included if the amount of the health FSA is funded only through employee salary contributions (Q&A-19).<br>Notice 2012-9 also clarified prior guidance providing that coverage under a HIPAA-excepted benefit, including a stand-alone vision or dental plan, is not included (Q&A-20). <sup>3</sup> |
| On-site medical clinics (only included if a COBRA premium is charged for continued coverage) <sup>1,2</sup>                         | Coverage for long-term care  |
| Prescription drug coverage  | Multiemployer plans <sup>1</sup>   |
|   | Self-insured group health plans not subject to COBRA (e.g., plans sponsored by church organizations) <sup>1</sup>  |
|   | Coverage provided under a government plan that provides coverage primarily for members of the military and their families  |

1. Subject to transition rules (discussed below).
2. Notice 2012-9 provides that the cost of coverage provided under an EAP, wellness program or on-site medical clinic is only includible in the aggregate reportable cost if a COBRA premium is charged. If the employer does not charge a COBRA premium for continued coverage under the EAP, wellness program or on-site medical clinic, the employer is not required to report the value of such coverage on the employee's Form W-2. An employer not subject to any federal continuation coverage requirements is not required to include the cost of coverage under an EAP, wellness program or on-site medical clinic (Q&A-32).
3. Generally, in order to be a HIPAA-excepted benefit, dental or vision benefits must be offered under a separate policy, certificate or contract of insurance or participants must have the right not to elect the dental or vision benefits, and if they do elect the dental or vision benefits, they must pay an additional premium or contribution for that coverage.

Importantly, coverage under a health reimbursement arrangement (HRA), EAP, wellness program or on-site medical clinic, multiemployer plan, and self-insured group health plans not subject to COBRA is subject to transitional rules under Notice 2012-9, meaning that the IRS may limit the applicability of those provisions in future guidance. That said, any change will be prospective only and will not apply earlier than Jan. 1 of the calendar year beginning at least six months after the date of issuance of any change. In addition, an employer is required to report the aggregate cost of applicable employer-sponsored coverage, including amounts paid by the employer and the employee, regardless of whether the employee's contributions are made on a pre- or post-tax basis. This would also include all contributions for covered individuals, including the employee's spouse and dependents, and all amounts reported as income as a result of coverage (including the cost of coverage for an adult dependent over age 26 or for a domestic partner).

## Permissible Reportable Cost Calculation Methods

Notice 2012-9 provides three methods that an employer can use to determine the reportable cost.

- **COBRA Applicable Coverage Method:** Under this method, the cost equals the COBRA applicable premium for the period. A good-faith estimate of the COBRA premium may be used.
- **Premium Charged Method:** The employer reports the cost of coverage by using the premium charged by the insurer for the employee's coverage (and any dependents). Only employers with fully insured plans may use this method.
- **Modified COBRA Premium Method:** If the employer subsidizes the COBRA cost, then the employer may report a reasonable good-faith estimate of the full cost. This approach recognizes situations where an employer with a self-insured plan subsidizes the cost of COBRA by underestimating the actual cost of health benefits.

Regardless of the method used to calculate the aggregate reportable cost, all plans must be reported on a calendar-year basis, regardless of the employer's plan year. In addition, if an employee begins, changes or terminates coverage during the year, the reported costs must reflect the actual periods of coverage.

Notice 2012-9 clarifies that, for a program in which an employee receives benefits that constitute applicable employer-sponsored coverage, as well as benefits that do not constitute applicable employer-sponsored coverage (such as long-term disability), an employer may use any reasonable method to determine the cost of the portion of the program providing applicable employer-sponsored coverage (Q&A-34). Employers should track actual coverage for each employee over the course of the entire calendar year and report accordingly, using one of the above methods and in accordance with the above rules.

## Special Considerations for Calculating the Cost of Coverage

Notice 2012-9 provides special rules for different situations, including changes in coverage and cost of coverage, employers charging blended or composite rates, and non-calendar-year plans.

### Changes in Coverage and Cost of Coverage

If an employee enrolls in, terminates or changes coverage during the year, the amount reported on Form W-2 must take into account that change. This includes moving from one coverage tier to another. For changes during a period (such as in the middle of a month), Notice 2012-9 provides that employers may use any reasonable method to determine the reportable cost for that period, so long as the employer uses the same method for all employees it covers under the plan. Reasonable methods would include prorating or averaging the reportable costs for the month, or using the reportable cost at the beginning or end of the month. The employer must also take into account a change in coverage or cost in coverage during the course of a plan year and report coverage accordingly.

Further, Notice 2012-9 contains new guidance providing that the aggregate reportable cost for a calendar year may be based on information available to the employer as of Dec. 31 of that year, without regard to any election or notification made after such date that retroactively affects coverage. Therefore, any election or notification that is made or provided in the subsequent calendar year that has a retroactive effect on coverage in the earlier year is not required to be included in the calculation of the aggregate reportable cost for the calendar year. In practice, this means that if an employee were to make a change of status election in January 2013, affecting the cost of coverage in 2012, the changes in the cost of coverage would not need to be reflected in the aggregate reportable cost for 2012. Additionally, Notice 2012-9 provides that an employer is not required to furnish a Form W-2c if a Form W-2 has already been provided for a calendar year before the election or notification (Q&A-35).

For midyear terminations, the employer has flexibility to report only the cost of coverage received prior to termination or to report the cost of COBRA coverage. In addition, if an employee terminates employment and requests a Form W-2 prior to the end of the 2012 calendar year, the employer is not required to report any amount for coverage on Form W-2. This is a transitional rule, meaning that the IRS may in the future limit the applicability of the rule.

### Charging Blended or Composite Rates

If an employer charges the same rate for all employees under the plan, regardless of the scope of coverage, the employer may report the same amount for all employees for that period. If the plan has different tiers of coverage (i.e., employee-only, employee plus one, employee plus family), and employees in each tier pay the same premium, the employer may report the same amount for each coverage group for that period.

Notice 2012-9 clarifies the guidance for employers that charge a “composite rate.” For employers that charge a composite rate for active employees but do not use a composite rate for determining applicable COBRA premiums for qualifying beneficiaries, the employer may use the composite rate or the applicable COBRA premium to determine the aggregate cost of coverage reported on the Form W-2, provided the same method is used consistently for all active employees and for all qualifying beneficiaries (Q&A 28).

### Non-calendar-year Plans

The reportable cost must be determined on a calendar-year basis. Thus, the employer cannot use a non-calendar 12-month determination period for purposes of calculating the applicable COBRA premium under the plan when calculating the cost of coverage. Instead, the employer must apply rules similar to the rules for calculating the cost of coverage when an employee has a change in coverage during the year.

New guidance is provided in Notice 2012-9 concerning how to report the cost of coverage that spans two taxable years. Where a coverage period extends beyond Dec. 31 of a reporting year, the employer has the option to:

- Treat the coverage as provided under the calendar year that includes Dec. 31;
- Treat the coverage as provided during the calendar year immediately subsequent to the calendar year that includes Dec. 31; or
- Allocate the cost of coverage for the coverage period between each of the two calendar years under any reasonable allocation method, which generally should relate to the number of days in the period of coverage that fall within each of the two calendar years.

Whichever method the employer decides to use must be applied consistently to all employees (Q&A-36).

### Multiple Employers

Notice 2011-28 provided that if an employee has multiple employers during a calendar year, each employer must report the cost of coverage. If, however, the employee has a common paymaster (i.e., related employers) among the multiple employers, then only the common paymaster must report the cost of the coverage. If the employee transfers from a predecessor to a successor employer, the successor employer can report the cost of coverage for both employers. Notice 2012-9 builds on this guidance by clarifying that if related employers employ the same employee, but do not use a common paymaster, the employers may either report the total aggregate on a single W-2 or allocate the cost between the employers and report the divided cost on separate Forms W-2 (Q&A-7).

### Where to Report the Cost of Coverage

According to Notice 2012-9, employers must report the aggregate cost of applicable employer-sponsored group health plan coverage on Forms W-2 for 2012. The employer reports the amount in Box 12 of the Form W-2 using code DD. The IRS released a sample Form W-2. (See Web address under “Additional Resource” below.)

## Penalties for Noncompliance

Failure to properly report the cost of employer-sponsored health coverage on Form W-2 may result in penalties. Specifically, the penalty for such a failure is \$200 per Form W-2, up to a maximum of \$3 million. In addition, Notice 2012-9 does not provide any penalty relief for failure to comply with the W-2 reporting requirements.

## Additional Clarifications/New Guidance on Notice 2012-9

In addition to the changes discussed above, Notice 2012-9 clarifies several other topics from the previous guidance, including:

**105(h) Clarification and S Corporations:** Notice 2012-9 modifies the guidance on excess reimbursements to clarify that the aggregate reportable cost does not include excess reimbursements of highly compensated individuals that are included in income because a self-funded plan violates the nondiscrimination rules in IRC § 105(h). In addition, a similar rule applies to coverage provided to 2 percent shareholder-employees of S corporations (Q&A-23).

**Reporting Benefits Exempted Under Interim Relief:** An employer may include in the aggregate reportable cost the cost of coverage that is not required to be included in the aggregate reportable cost under applicable interim relief, including coverage under an HRA, multiemployer plan, EAP, wellness program, or on-site medical clinic, provided such coverage is calculated using a permissible method as outlined in Notice 2012-9, and is applicable employer-sponsored coverage (Q&A-33).

**Hospital Indemnity/Other Fixed Indemnity Insurance:** Under transition relief provided in the notice, the exclusion from “applicable employer-sponsored coverage” for hospital indemnity plans, fixed-indemnity insurance and coverage for a specific disease does not apply if the employer makes any contribution to the cost of coverage that is excludable from income, or if the employee purchases the policy on a pre-tax basis under a cafeteria plan; such contributions must be reported. However, the cost of hospital indemnity, other fixed-indemnity insurance, or coverage only for a specified disease or illness is not required to be included in the aggregate reportable cost if the benefit is offered as an independent, noncoordinated benefit and is paid for with after-tax dollars or is includible in gross income (Q&A-37, 38).

**Third-party Sick Pay Providers:** Generally, a third-party provider that makes payments of sick pay to employees on the employer’s behalf has no responsibility for reporting such payments on a W-2. However, a Form W-2 furnished by an employer must include the aggregate reportable cost even if that Form W-2 includes sick pay or if a third-party provider is furnishing a separate Form W-2 reporting the sick pay (Q&A-39).

In summary, Notice 2012-9 provides more concrete rules relating to the Form W-2 reporting requirement. In order to avoid penalties, employers should continue to prepare for compliance with the reporting requirement for the 2012 tax year by working with payroll administrators to determine their level of preparedness to administer the new reporting requirement, as well as determining which of their benefit arrangements must be reported.

## FAQs

**Q. Does the reporting requirement cause the cost of coverage to become taxable to the employee?**

**A.** No. The reporting is for informational purposes only and will not affect the taxability of any such coverage.

**Q. When does the W-2 cost of coverage reporting begin?**

**A.** While optional for 2011, most employers must begin reporting the costs of employees’ health coverage for 2012 and report that value on the Form W-2 that generally will be provided to employees in January 2013. However, employers who file fewer than 250 Forms W-2 for one calendar year, plans not subject to COBRA (including church plans), and multiemployer plans will be exempted for 2012.

**Q. How do employers report the cost of coverage for terminated employees?**

**A.** If an employee terminates employment prior to the end of the year, the employer may use any reasonable method of reporting the cost of coverage, provided that method is used for all employees in the plan. If a terminated employee requests a W-2 prior to the end of the calendar year in which they were terminated, the employer does not have to report the cost of coverage on that employee’s W-2, and does not need to issue a separate W-2 solely for purposes of satisfying the PPACA W-2 reporting requirement.

**Q. How do employers report the cost of coverage for retirees and other former employees?**

**A.** According to Notice 2012-9, coverage amounts do not need to be reported if a former employee receives health benefits but would not receive a Form W-2 except for the reporting requirement. In other words, if a retiree or former employee that is receiving health benefits (such as COBRA or retiree benefits) does not receive any compensation from the employer that would require a Form W-2, then the employer does not need to issue a Form W-2 to the retiree or former employee.

**Q. How do employers report the cost of coverage for union employees?**

**A.** An employer that contributes to a multiemployer plan is not required to include the cost of health benefits under a multiemployer plan.

## Additional Resources

**Notice 2012-9:** <http://www.irs.gov/pub/irs-drop/n-12-09.pdf>

**Sample Form W-2:** <http://www.irs.gov/pub/irs-pdf/fw2.pdf>

**Form W-2 Instructions:** <http://www.irs.gov/pub/irs-pdf/iw2w3.pdf>

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