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IRS Guidance On Form W-2 Reporting of Group Health Plan Coverage

The IRS recently issued Notice 2012-9 (<http://www.irs.gov/pub/irs-drop/n-12-09.pdf>) that provides additional interim guidance on reporting the cost of employer provided health care coverage on Form W-2 (Code "DD" reporting). The Notice also modifies previously issued transition guidance (under Notice 2011-28).

Significantly, the Notice adds new Q&As 32-39, which may be helpful to plan sponsors and insurers in preparing their systems for the new reporting requirements in 2012. The Notice also clarifies several Q&As in Notice 2011-28 (and republishes the Q&As that were set forth in Notice 2011-28 and not changed).

The Notice will apply until further guidance is issued. Many of the new rules are characterized as "transitional relief" and the Notice states that these rules may change in future guidance. However, as with Notice 2011-28, any future guidance will be prospective only and will not be applicable earlier than January 1 of the calendar year beginning at least 6 months after the guidance is issued. The IRS will continue to consider comments submitted in response to Notice 2011-28 (and presumably Notice 2012-9) in drafting regulations.

The additional interim guidance and clarifications are summarized below.

New Guidance

- **Coverage under Employee Assistance Program (EAP) or Similar Program.** The Notice provides transition relief with respect to reporting the cost of coverage under an EAP, wellness program or on-site medical clinic for certain employers. Because many employers allow former employees to continue to access their EAP, wellness program or clinic during the COBRA period without charging for such access, the cost of such coverage is difficult to value. As a result, the Notice provides that if an employer does not charge a premium with respect to an EAP, wellness program or on-site medical clinic to qualifying beneficiaries receiving COBRA, then such coverage is not required to be included in the aggregate reportable cost *for any employee*. However, to the extent that an employer is following a formal COBRA process for these programs, and charges a COBRA premium, the employer must include that premium in the aggregate reportable cost on the Form W-2. An employer that is not subject to any federal continuation coverage requirements (i.e., ERISA, Public Health Service Act or the Federal Employees Health Benefits Program) is not required to include the cost of coverage under an EAP, wellness program or on-site medical clinic. (Q&A-32)

- **Third Party Sick Pay Provider.** The Notice provides welcome reporting relief for third party sick pay providers who may not have access to health plan information needed for reporting purposes. Under this relief, third party sick pay providers who furnish Forms W-2 to employees are not required to report the aggregate reportable cost of employer-sponsored group health plan coverage. 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)
- **Reporting Benefits Exempted Under Interim Relief.** An employer may include on Form W-2 the cost of coverage that is not required to be included in the aggregate reportable cost under applicable interim relief, including coverage under a Health Reimbursement Arrangement (HRA), a multiemployer plan, an EAP, wellness program, or on-site medical clinic, provided such coverage constitutes applicable employer-sponsored coverage and is calculated using a permissible method under the Notice. (Q&A-33)
- **Reporting Programs That Include Non-Covered Benefits.** For benefit programs that provide benefits that constitute applicable employer-sponsored coverage in conjunction with benefits that do not constitute applicable employer sponsored coverage (such as certain long-term disability programs), an employer may use any reasonable allocation method to determine the cost of the portion of the program providing applicable employer-sponsored coverage. The Notice further provides that if the portion of the program providing a benefit that is applicable employer coverage is incidental compared to the portion of the program providing other benefits, the employer is not required to include the cost of the program (including the portion that is applicable employer coverage) in the aggregate employer cost. Likewise, if the portion of the program providing a benefit that is not applicable employer-sponsored coverage is incidental, then the entire cost of the program may be reported. (Q&A-34)
- **Impact of Employee Status Changes After Year-End.** The Notice provides that the aggregate reportable cost for a calendar year may be based on information available to the employer as of December 31 of that year, without regard to any election or notification made after such date that retroactively affects coverage. For example, if an employee makes an election or provides notification of a status change (such as a divorce) in January 2013, which affects the cost of coverage in 2012, the changes in the cost of coverage need not be reflected in the aggregate reportable cost for 2012. The Notice also provides that a Form W-2c need not be furnished if a Form W-2 has already been provided for a calendar year, before the election or notification. (Q&A-35)
- **Coverage Periods Spanning Two Taxable Years.** If a coverage period includes December 31 but continues into the subsequent year, the employer may:
 - treat the coverage as provided under the calendar year that includes December 31;
 - treat the coverage as provided during the following calendar year; or
 - allocate the cost of coverage between each of the two years, using any reasonable allocation method (e.g., days of coverage).

The method selected must be applied consistently between all employees. (Q&A-36)

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- **Hospital Indemnity/ Specified Disease or Illness Insurance.** The Notice provides transitional relief and guidance for coverage provided under hospital indemnity or other fixed indemnity insurance.
 - Pre-tax coverage. The cost of hospital indemnity or other fixed indemnity insurance, or coverage only for a specified disease or illness must be included in the aggregate reportable cost on Form W-2 if the employer makes any contribution to the cost of coverage that is excluded from the employee's income or if the employee purchases the policy on a pre-tax basis under a cafeteria plan. Note that employers often allow employees to pay the cost for these types of benefits on a pre-tax basis, based on IRS guidance allowing that approach. See IRS Technical Advice Memorandum 199936046, FN 1. However, if an employer structures the benefit in this way (i.e., does not require the employee to pay for this coverage on an after-tax basis or does not include the value of this coverage in an employee's income), the employer must include the cost in the aggregate reportable cost on Form W-2. (Q&A 37).
 - After-tax coverage. 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 (or, in the case of a self-employed individual, is a payment for which a deduction under Code section 162(l) is allowable). (Q&A-38)

Clarifications to Prior Guidance

- **Dental and Vision Plan Reporting.** The Notice clarifies prior guidance and provides that the cost of coverage under a dental plan or vision plan is not included in the aggregate reportable cost if the plan satisfies the requirements for being excepted benefits under HIPAA. Generally, to be excepted benefits under HIPAA, the dental or vision benefits must:
 - be offered under a separate policy, certificate or insurance contract, or
 - permit participants not to elect the dental or vision benefits and if they do elect them, they must pay an additional premium or contribution for that coverage. (Q&A-20)
- **Exempted Employers.** The Notice expands and clarifies the employers who are exempt from the employer-sponsored health care reporting requirements.
 - Small Employers. Employers that are required to file fewer than 250 Forms W-2 for the preceding plan year are exempt from the reporting requirement for 2012 Forms W-2. These employers are also exempt from reporting for later years until further guidance is issued. However, for this purpose, the Notice clarified that the 250 limit includes Forms W-2 filed by an employer's agent under Code section 3504. (Q&A-3)
 - Indian Tribes. The notice expands the exemption for Federally recognized Indian tribal governments to cover employers that are tribally chartered corporations wholly owned by a Federally recognized Indian tribal government, until further guidance is issued. (Q&A-3)

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- **Health FSA Reporting.** The Notice clarifies that the amount of a health FSA is not required to be included in the aggregate reportable cost reported on Form W-2 if the amount of the health FSA is funded only through employee salary reduction contributions. (Q&A-19)
- **105(h) Clarification and S Corporations.** The Notice 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 Code section 105(h). In addition, a similar rule applies to coverage provided to 2% shareholder-employees of S corporations. (Q&A-23)
- **Use of Composite Rate.** The Notice clarifies the guidance for employers that charge a "composite rate," where all employees are charged the same premium for coverage under the plan, regardless of scope of the coverage, or if there are different types of coverage (e.g., employee and family) and employees are charged the same premium for each type of coverage. 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)
- **Work for Multiple Employers.** The Notice clarifies guidance for employees who work for multiple employers. If the employee works for multiple related employers but the employers do not share a common paymaster, then the employers may:
 - report the entire aggregate reportable cost on one of the Forms W-2 issued to the employee; or
 - allocate the aggregate reportable cost among the employers using any reasonable allocation method. (Q&A-7)

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