



Guidance on New W-2 Reporting Requirement for Health Coverage Cost

In our recent client alert, “2012 On The Horizon – Employee Benefit Action Items,” dated October 28, 2011, we noted that employers will need to begin reporting the cost of each employee’s group health plan coverage on Form W-2. The cost of health coverage is reportable on the Form W-2 solely for informational purposes and does not affect the typical exclusion of coverage from an employee’s taxable income.

Subject to certain exceptions, reporting is first required for 2012 with respect to Forms W-2 issued in January of 2013. This month, the Internal Revenue Service (“IRS”) issued additional guidance¹ on this requirement, including permissible methods of calculating the reportable cost. Employers will need to make a number of decisions in complying with the requirement and are strongly encouraged to implement mechanisms now to properly capture this year’s cost. The following are some key considerations raised by the IRS’s new guidance.

Methods of Calculating Cost

An employer may calculate the reportable cost by using one of the following three methods:

- **COBRA Applicable Premium Method:** The reportable cost for the period may be equal to the premium applicable to the coverage determined in accordance with the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (“COBRA”).
- **Premium Charged Method:** For insured group health plans, the reportable cost for the period may be equal to the premium charged by the insurer for the employee’s coverage.
- **Modified COBRA Premium Method:** If the employer subsidizes the cost of COBRA, then the reportable cost can be based on a reasonable good faith estimate of the unsubsidized applicable COBRA premium for the period. In addition, if the actual premium charged by an employer to qualified beneficiaries for the period is based on the COBRA cost determined for a prior year, then that prior year’s COBRA applicable premium can be used as the reportable cost.

¹ Notice 2012-9, 2012-4 I.R.B. (1/3/2012). This guidance amends and restates the IRS’s prior guidance on the Form W-2 reporting requirement for health care costs contained in Notice 2011-28, 2011-16 I.R.B. 656 (3/18/2011).

General Exclusions

Employers are not required to include the cost of coverage for the following benefits:

- **Employee Assistance Programs (“EAP”), Wellness Programs and On-Site Medical Clinics:** Excludable if the employer does not charge a premium for these benefits when they are extended to a qualified beneficiary through continuation coverage under COBRA.
- **Health Flexible Spending Accounts (“FSAs”):** Excludable if only employee salary reduction contributions are made to the FSA.
- **Dental and Vision Plans:** Excludable in the case of a limited-scope dental or vision benefit which is not subject to the rules under the Health Insurance Portability and Accountability Act of 1996, as amended (“HIPAA”).
- **Fixed Indemnity Insurance (e.g., Disease-Specific Policies):** Excludable if the employer offers employees the opportunity to purchase the policy on an after-tax basis and the policy is not coordinated with other employer-offered health coverage.

Small Employers

Until further guidance is issued by the IRS, employers who filed fewer than 250 Forms W-2 for the preceding calendar year are exempt from the reporting requirement.

Other Considerations

Programs Combining Health Coverage and Other Benefits

An employer is permitted to use any reasonable allocation method to identify the cost of coverage to report for a benefit program that includes both health coverage and other benefits. If the health coverage is incidental to the program, then the employer is not required to report the cost of that health coverage. On the other hand, if the non-health benefits are incidental to the program, then the employer may report the full cost of the program.

Retroactive Changes in Family Status

The cost reported on Form W-2 should be based on the information that is available to the employer as of December 31 of the reporting year. Accordingly, if an employee reports a change in family status after the close of the year that occurred in the reporting year, such as a divorce in the previous year, the employer may disregard that change.

Treatment of Terminated Employees

Employers may use any reasonable method of reporting the cost of coverage of an employee who terminates employment during the reporting year, as long as it does so consistently. For example, the employer may report the cost of coverage only during the period of active employment or, alternatively, it may also include the cost of coverage during any period of COBRA continuation coverage. Also, employers need not report the cost of coverage at all if the terminated employee requests his or her Form W-2 prior to the end of the calendar year.

Successor Employers

Under preexisting IRS guidance, when employees transfer to an employer during the middle of a year as a result of the employer’s acquisition of assets from a seller, the employer is permitted, but not required, to file consolidated Forms W-2 for the transferred employees that reflect the wages paid by both the buyer and the seller. Because these consolidated Forms W-2 will now be required to include the combined cost of health coverage provided by both the

buyer and the seller, many buyers may decide not to adopt the consolidated Form W-2 reporting following an acquisition.

This summary does not contain an exhaustive discussion of the Form W-2 reporting requirement described above. If you have any questions regarding the requirements or this summary, please contact your regular Sidley Austin contact or any other member of the Firm's Employee Benefits Group for more information.

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