

# Form W-2 Information Reporting of Health Care Costs

The Patient Protection and Affordable Care Act (PPACA) made changes to reporting requirements on Form W-2 to include the aggregate cost of applicable employer-sponsored health coverage. *This information is intended to inform employees of the cost of their health care coverage, and does not cause coverage that is excludable from income to become taxable.*

Most employers are required to begin reporting the cost of employer-provided health coverage on Forms W-2 issued in January 2013 for the 2012 tax year. Reporting for 2011 is optional. Employers may now want to review that their payroll providers have taken appropriate steps to prepare for this new obligation. Failure to comply can result in a penalty of \$200 per Form W-2, up to a maximum of \$3 million.

The Internal Revenue Service (IRS) in Notice 2011-28 and Notice 2012-9 issued preliminary guidance on how employers should determine and report the cost of coverage. The guidance also offer some relief from reporting for certain employers. This summary provides a general overview of the new reporting requirement.

## Employers Required to Report

Generally, all employers that offer applicable employer-sponsored coverage, including federal, state and local government or tax-exempt entities and churches and other religious organizations, are required to provide informational reporting of the cost of that coverage to employees. The IRS has provided transitional relief from the reporting requirement for:

**Small Employers.** Employers that file fewer than 250 Forms W-2 for the previous year are not required to report for 2012 and later years unless and until the IRS issues future guidance.

**Tribal Governments.** Federally recognized Indian tribal governments are not subject to the reporting requirements.

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## Reporting Process

To comply with this new reporting requirement, an employer should determine the applicable employer-sponsored coverage for each employee, calculate the reportable cost of coverage, determine the aggregate cost for the employee, and then report that cost on the employee's Form W-2, in reportable Box 12, using Code DD.

### 1. Determine the Applicable Employer-Sponsored Health Coverage

Employers should first determine what applicable employer-sponsored health coverage is provided to each employee. "Applicable employer-sponsored coverage" generally means coverage under any group health plan made available to the employee by an employer, which is excludable from the employee's taxable income. This includes:

- Coverage under an insured or self-insured medical plan, including integrated dental or vision benefits;
- Coverage under a health flexible savings arrangement (FSA), i.e., an FSA that is a medical reimbursement arrangement, but see below for determining the reportable cost;
- Coverage under an employee assistance program (EAP), wellness program or health benefits provided at an employer's on-site medical clinic, to the extent that the coverage is provided under a program that constitutes a group health plan (i.e., the employer charges a COBRA premium for this coverage).

The following types of coverage are generally not considered "applicable employer sponsored coverage":

- Coverage for long-term care;
- Contributions to a health savings account (HSA) or Archer MSA;
- Coverage for HIPAA "excepted benefits" (except an on-site medical clinic), such as a stand alone dental or vision plan not otherwise integrated into a major medical plan, under which participants have the right not to elect the benefit and if they do elect the benefit they must pay an additional premium or contribution for that coverage;

- Coverage for a specific disease or illness or under a hospital indemnity or other fixed indemnity plan (unless the employer makes any contribution to the cost of coverage or the employee purchases the coverage on a pre-tax basis under a section 125 cafeteria plan). If the employer merely provides the opportunity for employees to purchase an independent, non-coordinated fixed indemnity policy and the employee pays the full amount of the premium with after-tax dollars, the cost is not required to be reported;
- Coverage under a self-insured group health plan not subject to federal continuation coverage requirements, such as a self-insured church plan;
- Coverage provided under a federal, state or local governmental plan that provides coverage primarily for members of the military and their families;
- Coverage under a health reimbursement arrangement (HRA); and
- Accident and disability coverage, liability insurance or workers' compensation insurance.

## II. Determine the Reportable Cost of Coverage

Once an employer has determined the applicable employer-sponsored coverage for each employee, the employer should calculate the cost of coverage (the "reportable cost"). The reportable cost for an employee equals the sum of the reportable cost for each period (e.g., a month) during the calendar year. The reportable cost includes both employer and employee contributions to the cost of coverage, whether made on a pre-tax or after-tax basis (except for the FSA rules described below). The reportable cost also includes contributions for all individuals covered (employee, spouse, and dependents).

All amounts reported as income as a result of coverage are included, such as the cost of coverage for a domestic partner or discriminatory coverage for a highly compensated employee. An employer that contributes to a multiemployer plan for union employees is not required to include the cost of health benefits under the multiemployer plan.

- **Methods of Calculating Cost.** The employer should choose one of the three following methods to calculate the reportable cost. Employers are not required to use the same method for every plan, but the employer must use the same method for every employee covered under a plan. Additionally, the IRS provides guidance for employers that charge a composite rate for coverage. For

example, if a plan charges one premium for single coverage and also charges one premium for family coverage regardless of the number of family members covered, the employer may report the same reportable cost for all the coverage in the single group and the same cost for all the coverage provided in the family group.

1. The COBRA Applicable Premium Method. Under this method, the reportable cost for a period is equal to the COBRA applicable premium for coverage for that same period (without the 2% administrative fee). Employers that choose this method must make the calculations in good faith compliance with a reasonable interpretation of the statutory requirements under Code section 4980B (the COBRA rules).
  2. The Premium Charged Method. Employers who have insured group health plans may use the Premium Charged Method. Under this method, the reportable cost for a period is equal to the premium charged by the insurer for that employee's coverage (and any dependents) for that same period.
  3. The Modified COBRA Premium Method. Employers that subsidize the cost of COBRA or charge an actual COBRA premium equal to the COBRA applicable premium from a prior year may use a Modified COBRA Premium Method. Under this method, the reportable cost is generally based on the prior year's premium (minus the 2% fee) or a good faith estimate of the full COBRA premium for subsidized premiums.
- **Changes in Cost or Coverage.** The employer should account for the following changes in cost or coverage and incorporate this in the reportable cost:
    - Changes in Cost of Coverage. If the cost of coverage increases or decreases in any period, the employer should include the change when calculating the reportable cost.
    - Changes in an Employee's Coverage. If an employee commences, terminates, or changes coverage during the year, the employer should take into account the change in coverage when calculating the reportable cost. If the change occurs during a period (e.g., the middle of a month), the employer may use any reasonable method to calculate the reported cost, provided that the same method is used for all employees with coverage under the plan.
    - Coverage Provided to an Employee Who Terminates Employment During the

Calendar Year. If an employee elects to continue coverage after termination of employment, the employer can either report only the cost of coverage for the period during which the individual was an active employee, or the cost of coverage for both the period as an active employee, plus the period of continued coverage after employment terminated. However, the employer must use that method consistently for all employees who terminate during the calendar year.

- **Reportable Cost of a Health FSA.** If the employer sponsors a health FSA, the employer is not required to include the amount of an employee's salary reduction in the reportable cost. Accordingly, the employer should determine the reportable cost for the FSA in the following manner:
  - Determine the amount of the FSA by adding the amount of salary reduction elected by the employee for the year and the amount of any optional employer flex credits that the employee elects to apply to the health FSA.
  - Reduce the amount of the FSA by the employee's salary reduction election, but not below zero, to determine the reportable cost. If the amount of salary reduction for all qualified benefits equals or exceeds the amount of the FSA, the employer does not include the amount of the health FSA in the aggregate reportable cost. If the amount of health FSA exceeds the salary reduction, then the FSA minus the employee's salary reduction election for the health FSA is included in the aggregate reportable cost.
  - Example. An employer offers a Code section 125 plan that offers taxable and nontaxable benefits, including a health FSA. The employer offers an employer flex credit in the form of an employer match of the employee's salary reduction election. The employee makes a \$700 salary reduction election for the FSA and the employer matches that amount. Accordingly, the amount of the employee's health FSA equals \$1,400. In this instance, the amount of health FSA exceeds the salary reduction election. Therefore, the reportable cost equals \$700 ( $\$1,400 - \$700 = \$700$ ).

### III. Determine the Aggregate Reportable Cost

The employer should then add together the reportable costs for each plan in which an employee participates to calculate the "aggregate reportable cost" for that employee (e.g., the reportable cost of the health plan plus the reportable cost of the FSA). The aggregate reportable cost also includes any coverage includable



in an employee's gross income, such as coverage provided to a dependent child over age 26. The aggregate reportable cost should be based on information available to the employer as of December 31 of the reporting year. Therefore, any election or notification made or provided in the next calendar year that has a retroactive effect on coverage in the earlier year, is not required to be included in calculating the aggregate reportable cost.

If the coverage period includes December 31 but extends into the next calendar year, the employer may (1) treat the coverage as provided during the calendar year that includes December 31, (2) treat the coverage as provided in the immediately subsequent calendar year, or (3) allocate the cost between the two years under any reasonable allocation method, which generally should relate to the number of days in the coverage period that fall within each of the two calendar years. The method must be applied consistently to all employees.

#### **IV. Report the Cost of Coverage**

Employers should report the aggregate reportable cost of an employee's coverage on the Form W-2, Wage and Tax Statement, in box 12 using Code DD. Employers are not required to report any amount in box 12, Code DD for an employee who requests a Form W-2 before the end of the calendar year during which the employee terminated employment.

Additionally, employers are not required to issue Forms W-2 reporting the aggregate cost of coverage to former employees who do not receive any compensation from the employer reportable on a Form W-2 (e.g., retirees). Also, employers are not required to report the total aggregate reportable costs attributable to the employer's employees on Form W-3, Transmittal of Wage and Tax Statement.

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