Executive Compensation
& Benefits

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# Health Care Reform Update: How to Report Health Care Costs on Form W-2

by Mark C. Jones

*On March 29, 2011, the Internal Revenue Service released much-needed interim guidance on W-2 reporting of employee health care costs. The notice gives commonsense answers to frequently asked questions on the calculation of reportable costs and extends transition relief to certain small and mid-size employers, as well as employers that contribute to multiemployer plans or maintain certain self-insured plans.*

Health care reform, as enacted by the Pension Protection and Affordable Care Act of 2010 ("PPACA"), requires employers to disclose the cost of group health plan coverage on each employee's Form W-2. Originally intended to take effect for the 2011 tax year, the reporting requirement was made optional until the 2012 tax year pursuant to IRS enforcement relief announced last year. (For information on this relief, see our client alert dated October 19, 2010.)

According to the IRS, the sole purpose of including health care costs on Form W-2 is to provide comparable information to employees on the cost of their health care coverage. However, a number of the answers in the new notice cross-reference the rules on the calculation of the excise tax on high-cost "Cadillac" health care plans. Therefore, it appears possible that the health care costs disclosed on Form W-2 will become a basis for the assessment of the Cadillac tax when the tax becomes effective in 2018.

In general, the requirement to report health care costs extends to all employers, including federal, state and local governmental entities and churches and other religious organizations. The only exceptions are for Indian tribal governments and, until further guidance is released, employers that were required to file fewer than 250 Forms W-2 for the preceding calendar year.

Employers must take into account both the employer-paid portion and the employee-paid portion of their group health care expenses, except that, in general, only employer contributions to health flexible spending accounts (such as flex credits) must be included. Employers must also include coverage under a group health plan of an employee's spouse, dependents or children, including any portion of the cost that may not be deductible under federal or state tax law, such as coverage of a domestic partner or an adult child who is older than age 27.

If an employee's health care benefits are provided under an insured group health plan, then the employer may report on the W-2 the actual premium charged by the insurer for the employee's coverage. Otherwise, employers may use the same methodology they would use to determine the applicable premium for "COBRA" continuation coverage. (COBRA requires a reasonable, good-faith effort to determine the cost of covering similarly situated beneficiaries for the same period.) If an employer subsidizes the cost of COBRA, it may report the reasonable estimate of the premium that it uses for determining the amount of the COBRA subsidy. If it charges COBRA beneficiaries a premium that is based on the actual cost for similarly situated beneficiaries in a prior year, it may report the prior year's premium as the cost for the current year.

In determining the reportable cost, employers must aggregate the cost of health care provided under all employer-provided plans, except for salary reduction contributions to flexible spending accounts and all contributions to Archer medical savings accounts and health savings accounts. Notice 2011-28 adds to the list of permitted exclusions those benefits that would not be taken into account for purposes of determining the excise tax on "Cadillac" plans, such as coverage for long-term care, dental and vision coverage provided under a separate insurance policy, coverage provided under disability, accident, liability or similar insurance under which medical care is incidental to other benefits (although coverage for on-site medical clinics must be included) and nondeductible coverage under certain stand-alone fixed indemnity plans and certain stand-alone plans that cover treatment for a specified disease or illness.

The transition relief under Notice 2011-28 allows employers to exclude the cost of coverage under a multiemployer plan, a health reimbursement account, a self-insured plan that is not subject to COBRA (such as a church plan) or a governmental plan maintained primarily for members of the military or their families. All transition relief, including the relief given to smaller employers, will be effective until the issuance of further guidance. Any such guidance is to be effective only prospectively and no earlier than a calendar year beginning at least six months after the date on which the new guidance is issued.

Employers whose benefits are not subject to transition relief should work with their health plans and payroll service providers to develop a system of gathering the data necessary to comply with the new reporting requirements. We recommend that companies take advantage of the voluntary reporting period for 2011 to test their payroll systems before the penalties for reporting failures apply in 2012.

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If you have any questions about the new guidance or the reporting of health care costs, please contact the Pillsbury attorney with whom you usually work or one of the members of our Executive Compensation & Benefits practice section.


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