JONES WALKER

e*bulletin

EMPLOYEE BENEFITS, ERISA & EXECUTIVE COMPENSATION

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PATIENT PROTECTION AND AFFORDABLE CARE ACT PASSES CONSTITUTIONAL MUSTER; IRS ISSUES GUIDANCE ON W-2 REPORTING REQUIREMENT

On June 28, 2012, the U.S. Supreme Court surprised many observers by upholding, by a 5-4 margin, the constitutionality of the "individual mandate" (the requirement that most Americans purchase health insurance) contained within the Patient Protection and Affordable Care Act ("PPACA"). *National Federation of Independent Businesses et al. v. Sebelius, Secretary of Health and Human Services, et al.*, 132 S.Ct. 2566 (June 28, 2012)

A majority of the justices (including Chief Justice Roberts, who authored the opinion of the Court) opined that the individual mandate exceeded Congressional powers under the Commerce Clause, but a separate majority led by Chief Justice Roberts found that the individual mandate was a constitutional exercise of the power of Congress to levy taxes. As a result, the individual mandate and a majority of PPACA survived.

The only portions of the law that did not survive were those that would have penalized states that do not expand their Medicaid programs (struck down by a 7-2 margin). We will address how the Medicaid issues may affect employers of low-income employees in a future E*Bulletin. Meanwhile, employers should continue preparing to comply with the next wave of changes.

One such change affects Form W-2s that employers will issue for 2012 in January 2013. Earlier this year the IRS issued guidance for reporting the value of employer-provided health coverage on Form W-2, via revised and clarified Notice 2012-9 ("Notice").

General Requirements. Section 6051(a)(14) of PPACA requires employers to report the aggregate cost of employer-provided health coverage on Form W-2. The amounts are not reported on Form W-2 as taxable income, although this may change in 2018, when the "Cadillac Tax" on costly health plans is expected to be imposed.

Employers to Whom the Requirement Applies. The reporting requirement generally applies to all employers providing health coverage, including governmental entities, religious organizations, and employers that are not subject to COBRA, to the extent such employers provide "applicable employer-sponsored coverage" under a group health plan. Small employers (defined as employers required to file fewer than 250 W-2s for a given year) are exempt until at least 2014. No reporting is required in the case of retirees and other former employees, unless the employer is otherwise required to issue a W-2 to such individuals.

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Applicable Employer-Sponsored Coverage. This is defined as coverage under any group health plan made available to an employee that is excludable from the employee's gross income except:

1) long-term care;
2) employee assistance programs, wellness programs or on-site medical clinics (provided there is no premium charge under COBRA to qualified beneficiaries with respect to such coverage);
3) HIPAA excepted benefits (e.g., liability, accident or disability, worker's comp, etc.);
4) non-coordinated coverage for a specific illness or disease (e.g., cancer), hospital indemnity or other fixed indemnity arrangements when 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;
5) stand-alone dental and vision plans (when deemed excepted benefits under HIPAA);
6) multiemployer plan coverage;
7) self-insured plans otherwise not subject to COBRA (e.g., church plans); and
8) government-provided coverage for military members and their families.

Aggregate Reportable Cost. This includes both the employer and employee share of the coverage cost, regardless of whether coverage is on a pre-tax or after-tax basis. Aggregate reportable costs also include any portion of the cost of coverage that is subject to inclusion in the employee's gross income (e.g., domestic partner coverage).

Amounts contributed to account-based plans such as health savings accounts ("HSAs") and Archer medical savings accounts ("MSAs") are excluded. Reporting of coverage under a health reimbursement arrangement ("HRA") is optional. Amounts contributed to health flexible spending accounts ("FSAs") are included in the aggregate reportable cost, but only to the extent the contribution to the health FSA for the plan year exceeds the salary reduction (for all qualified benefits) elected by the employee for the plan year. For example, assume an employee elects $2,000 worth of benefits under a Section 125 plan, including a $1,500 health FSA contribution. The plan provides employer flex credits of $1,000. None of the health FSA amount is included in the aggregate reportable cost because the FSA amount ($1,500) does not exceed the employee's total salary reductions under the plan ($2,000).

Cost Calculation Methods. The IRS provided three ways to calculate the cost of coverage:

1) COBRA applicable premium method (excluding the otherwise-allowable 2% administrative fee) (generally for self-insured plans);
2) premium charged method (generally for fully-insured plans); and
3) modified COBRA premium method, under which the employer can either use a good faith estimate of the COBRA premium or use prior year COBRA premium costs as the current year's cost

(generally applicable when the employer subsidizes cost of coverage or when the actual premium charged to COBRA beneficiaries in the current year is equal to the COBRA premium for the prior year).

An employer need not use the same method for every plan. Regardless of the method used, an employer must report costs on a calendar year basis and make the calculations in good faith using a reasonable interpretation of the Internal Revenue Code.

Hybrid Coverage. The Notice clarifies that if an employer offers a program that includes both reportable and non-reportable coverage, e.g., a long term disability program providing specific limited health benefits), employers may use any reasonable method to allocate the health coverage portion. If the reportable portion is incidental in comparison to the non-reportable portion of coverage, then the employer is not required to report either coverage. Conversely, if the primary purpose of a program is medical coverage, and the non-reportable coverage is incidental, the employer may, but is not required to, include the non-reportable portion.

Employees Who Change Coverage or Terminate Employment Mid-Year. In determining the cost in such situations, the employer may apply any reasonable method of reporting the cost of coverage provided under the plan, provided such method is used consistently.

Employers are not required to report the cost of health coverage on W-2s of terminated employees who request a W-2 mid-year. Furthermore, employers are not required to report the cost of coverage provided to any individual unless they are otherwise required to file a W-2 for that individual.

How to Report. Amounts subject to reporting will be reported in box 12 of the W-2 and will be identified by code DD.

Additional Guidance under Notice 2012-9.

- Clarifies that when coverage extends over a payroll period including December 31, an employer may use any reasonable allocation method consistently applied to all employees to determine the applicable year for which to report.
- Clarifies that hospital indemnity or other fixed indemnity insurance is only reportable to the extent the employer contributes or offers the coverage on a pre-tax basis.
- Clarifies that third party payers are not required to include the reportable cost for health insurance on the W-2s they issue.

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Conclusion. While the notices provide much needed guidance, the IRS did not answer a fundamental issue: how to determine COBRA costs for self-insured plans. This issue will be more than a reporting issue in 2018 when, and if, the excise tax on high-cost health insurance benefits (the "Cadillac Tax") comes into effect.

Employers that are unsure whether a specific item of coverage is reportable should consult with their advisors. Employers should also ensure that their payroll systems or service providers are ready to handle this new reporting requirement.

If you have any questions regarding the new W-2 reporting requirements or PPACA in general, please contact one of the Jones Walker employee benefit attorneys listed below. More information on Form W-2 reporting requirements is provided in IRS FAQs, reproduced in our health care reform resource center: http://www.joneswalker.com/practices-118.html

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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