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Changes for Your Health Plan:
Do you want the good news or the bad news first?

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The good news: IRS has delayed one of the thornier provisions of federal health reform that would affect all employers: changes to W-2 reporting requirements.

The bad news: Employers may well have to change the way they offer and pay for health insurance to their officers, executives, and owners – including through provisions in their employment or severance agreements, rather than through their health plans - in the next few months.

W-2 Reporting Change Delay

The federal health care reform law contains a provision that requires employers to include the cost of the employer-paid portion of health insurance on their employees' 2011 W-2s. The change in reporting does not change how employer-provided health benefits are taxed, but instead is intended to show employees the value of health insurance as an employee benefit. While this is a worthwhile goal, changing W-2 reporting is an administratively difficult and potentially costly change to payroll processing.

Recently, the IRS announced that it will waive the new W-2 reporting requirement for one year. Now, health care cost information will have to be reported beginning with the 2012 W-2s, which are issued in 2013.

Expanded Nondiscrimination Rules

Many employers offer/pay for different benefits to different groups of employees. For example, owners or officers or senior management may have access to one policy while rank-and-file employees have access to a less generous policy. In other instances, employers may offer one policy to all employees, but contribute one amount for owners/officers/senior management and a lower amount for other employees. Also, it is very common for executive employment contracts, severance arrangements, and similar contracts to contain a provision offering continued health insurance coverage to the executive after retirement or separation, paid for in whole or in part by the employer, in addition to what is required by COBRA. All of those types of arrangements most likely are now prohibited.

For many years, self-funded medical plans (i.e. plans that the employer funds without an insurance policy) have not been permitted to discriminate in favor of highly compensated individuals. Under the new federal health care reform law, these nondiscrimination rules will apply to insured plans as well, effective with the first plan year on or after 9/23/2010.

For this purpose, "highly compensated individuals" include the 5 highest paid officers, anyone that owns (directly or indirectly) 10% or more of the company, and anyone in the highest paid 25% of employees (other than 10% owners). Therefore, the rules apply generally to owners, officers, executives, and senior management.

For this purpose, "discriminate" includes defining coverage groups in a way that favors highly compensated individuals, as well as providing benefits to highly compensated individuals that are not provided to everyone else. Essentially, this rule prohibits owner plans, officer plans, senior management plans, special executive retirement and separation plans, and separate contribution tiers that benefit those individuals.

If a plan does discriminate, the plan could be subject to an excise tax equal to $100 per day per individual discriminated against (i.e. each non-highly compensated individual), in addition to other penalties.

The other good news: There are ways to provide executive benefits without violating the nondiscrimination rules. Employers need to determine if they need that type of workaround. Therefore, we recommend that all employers take this opportunity to evaluate their group health plans and other benefit arrangements – including employment and severance arrangements - to determine if there are any nondiscrimination compliance issues. To avoid a violation (and the associated penalties), the review (and any correction required) should be completed before the beginning of the next plan year of the employer's health plan.