



EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION

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July 12, 2011

Internal Revenue Service
CC:PA:LPD:RU (Notice 2011-28)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20224

Submitted Via Electronic Mail to Notice.Comments@irs.counsel.treas.gov

Re: Notice 2011-28

Dear Ladies and Gentlemen:

The Employers Council on Flexible Compensation (ECFC) appreciates the opportunity to offer comments on Notice 2011-28 (the "Notice"), which provides interim guidance on the informational reporting to employees of the cost of group health coverage pursuant to Code Section 6051(a)(14), as enacted by the Affordable Care Act (ACA) (the "W-2 reporting requirement"). ECFC is a membership association dedicated to maintaining and expanding employee benefit programs offered on a pre-tax basis, including health care, transportation, dependent/child care assistance and retirement plans. ECFC's more than 100 members include employers who provide these important benefits, as well as insurance, accounting, consulting, and actuarial companies that design or administer employee benefit plans throughout the nation. Together, ECFC companies design, offer, or administer flexible benefits for tens of millions of working Americans, a majority of whom have middle class incomes.

ECFC commends the IRS and Treasury Department for their efforts to provide guidance under the W-2 reporting requirement on a timely basis and appreciates the difficult issues that arise under the requirement, particularly given the interaction of the reporting requirement with other Code and ACA provisions for which guidance is not yet complete. The Notice provides helpful guidance in many areas, as well as providing important transition relief, including the exceptions for small employer plans and health reimbursement arrangements (HRAs).

Although the Notice does not include an explanation of why transition relief was provided in particular cases, the transition relief reflects a number of different factors, including administrative burdens imposed on employers, how useful information will be to employees, and the extent of applicable guidance. The current relief may be viewed as a balancing of these factors. ECFC believes that this type of balancing supports further relief, both for the reporting requirement as a whole, as well as for certain provisions. Thus, a number of the ECFC's comments focus on these issues. These comments also address the detailed rules regarding reporting with respect to health flexible spending arrangements (FSAs).

In summary, ECFC makes the following comments:

- A cost/benefit analysis supports delaying the reporting requirement until complete guidance is developed
- The reporting requirements should be delayed until comprehensive guidance on how to calculate the “applicable premium” under COBRA is issued
- Reporting should not be required for voluntary supplemental plans that are not group health plans under ERISA based on the level of employer involvement
- The exception for HRAs should be extended
- The small employer exception should be made permanent
- The FSA coverage provision should be simplified and clarified

Each of these points is discussed in detail below.

A. Delaying the Reporting Requirement until Complete Guidance Is Developed Seems Warranted If a Cost/Benefit Analysis Were Applied

Both the Administration and the Congress have recently focused on the negative effect that overly burdensome regulations can place on American businesses and job growth. Thus, as a first step, the President issued an Executive Order requiring all agencies to conduct a retrospective review of existing regulations.¹ The President’s Executive Order also articulates basic principles that agencies must adhere to in developing guidance in the future. According to the President, the regulatory system must promote economic growth, competitiveness, job creation and predictability, reduce uncertainty, and take into account benefits and costs.²

ECFC understands the difficult task faced by the IRS and Treasury Department in developing guidance with respect to the W-2 reporting requirement, in large part because the guidance necessitates the creation of rules that are not needed for any other purpose and because the statutory provisions creating the W-2 reporting requirement rely on other sections of the Code under which guidance is not complete. The Notice attempts to deal with these issues in the context of the W-2 reporting requirement and does provide helpful guidance in many areas, particularly by including transition rules.

However, the W-2 reporting guidance is not yet complete, and many questions with respect to how to report very common employer plan situations are still unanswered. For a variety of reasons, it is likely that future guidance will change the details of the W-2 reporting requirement, including the following reasons, to name a few:

¹ Executive Order 13563, 76 Fed Reg 3821 (Jan. 18, 2011).

² *Id.*

- The cost that is required to be reported is based upon COBRA cost as determined under Section 4980B, for which there is not any guidance other than the statute;
- It is unclear how to value certain types of common employer arrangements, including on-site health clinics which are not generally considered to constitute health plans for other purposes under the Code and HRAs or FSAs;
- The cost that is required to be reported relates to information that will be needed in order to implement the high cost plan tax under Section 4980I, for which even preliminary guidance has not yet been issued, and which is not effective until 2018.

While some of these issues might not be of great concern for a requirement that is designed only to provide consumer information, resolution of these issues may have a much greater impact in the context of the high cost plan tax. For example, the methods that an employer may choose to determine cost under the Notice may produce very different values. When the high cost plan tax is effective, these differences may become very significant. For example, whether the high cost plan tax is imposed may depend on the particular valuation method used, even if two plans have the same fair market values. These cost issues are not easy to resolve, as evidenced by the fact that COBRA cost regulations have been in the developmental stage for a long time.

These uncertainties translate into higher costs and confusion for employers. Implementing the reporting requirement requires employers (or their payroll processors and agents) to update payroll reporting systems to maintain, collect, manipulate and report data that is not currently required for other purposes. This is clearly not without cost. Further, because the guidance with respect to the reporting requirement is not yet final or complete, it is likely that payroll systems will need to be modified again (and possibly more than once) when guidance is completed with respect to the high cost plan tax.

The burdens of the W-2 reporting requirement should also be viewed in the context of the overall burdens that are placed on employers under ACA. Employers have been working to comply with the first round of health care reforms that are already effective, as well as planning for further reforms as they come into effect and the exchanges become operational in 2014. Looking just at reporting requirements alone, ACA places substantial paperwork burdens on employers, including new requirements for notices of adverse benefit determinations, notices regarding grandfather plan status, notices regarding automatic enrollment, reporting requirements relating to minimum essential coverage, uniform benefit summaries and notices regarding quality of care initiatives and wellness programs, again, just to name a few. Further, even though the W-2 reporting requirement is not relevant for any tax administration purpose, employers may be subject to significant penalties for failures to comply.

In this context, the benefits of this reporting requirement should be carefully scrutinized to be sure that they outweigh the additional burdens the requirement will place on employers. On the benefit side of the ledger, the reporting requirement is not relevant for tax administration purposes. Rather, the purpose of the requirement as stated in the Notice is to provide useful comparative information to employees regarding health coverage. Given the lack of complete

guidance, we question whether the requirement as currently proposed to be implemented will have the desired effect or may rather serve to confuse employees, because the information will not allow a clear comparison of the cost of major medical coverage.

We believe that if a cost benefit analysis as described in the President's Executive Order were applied, the costs currently involved will outweigh the benefits and that requiring reporting at this time is premature. The Treasury Department has noted in other areas under ACA, such as the new nondiscrimination rules imposed on self-insured plans, that lack of complete guidance is a sufficient reason for delay. We believe a further delay is appropriate here to allow issuance of complete guidance and to provide a single set of rules that is consistent with the high cost plan tax.

B. The Reporting Requirements Should Be Delayed Until Comprehensive Guidance On How To Calculate The "Applicable Premium" Under COBRA is Issued

Q&A-25 of the Notice³ relies on the COBRA applicable premium as a method for determining reportable cost. Q&A-27 allows employers to use a modified COBRA premium method in some circumstances. If an employer uses the method described in Q&A-25, the employer must calculate the COBRA applicable premium in a manner that satisfies the requirements under Code Section 4980B(f)(4). In the absence of regulations regarding how to calculate the applicable premium, the Notice relies on Treasury Regulation Section 54.4980-1, Q&A 2, to provide that the COBRA applicable premium calculation will meet the requirements of Code Section 4980B(f)(4) if the employer makes the calculation "in good faith compliance with a reasonable interpretation of the statutory requirements under § 4980B."

Employers with plans that are subject to COBRA have been operating under this "good faith" compliance standard for some time. With respect to the W-2 reporting requirement, reference to the good faith standard is helpful in that it provides flexibility to employers. However, there are many questions that need to be resolved with respect to determining the COBRA premium, particularly in the case of self-insured plans and certain arrangements like HRAs where there is no definitive rule. More pressure will be placed on the calculation of the premium when the high cost plan tax becomes effective. If further guidance is not provided, then the amount of the high cost plan tax could vary significantly based on how an employer calculates cost. In addition, some plans are not subject to COBRA, such as employer clinics, so that employers do not currently calculate cost for such plans for any purpose.

Given that these issues will need to be addressed in more detail for the high cost plan tax, it is likely that practices an employer adopts for W-2 reporting will need to change when rules for the high cost plan tax are developed. Thus, employers may have to update systems more than once. In order to avoid the imposition of unnecessary and wasteful administrative costs, if the preceding request is not adopted, the W-2 reporting requirement should be delayed until further guidance on the COBRA applicable premium calculation is provided. Waiting for further

³ All references to Qs&As are to the Notice, unless otherwise indicated.

guidance is also likely to provide more useful information for employees, as there are likely to be fewer changes in the amount reported due merely to changes in valuation methods.

C. Reporting Should Not Be Required For Voluntary Supplemental Plans that Are Not Group Health Plans Under ERISA Based on the Level of Employer Involvement

Q&A-13 defines a “group health plan” for purposes of the W-2 reporting requirement as a plan (including a self-insured plan) of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated with the employer in a business relationship or their families. For purposes of identifying whether a specific arrangements in a group health plan, Q&A-13 provides that employers may rely on a good faith application of a reasonable interpretation of the statutory provisions and applicable guidance, including Treasury Regulation Section 54.4980B-2, Q&A-1.

There are many arrangements where employees may purchase their own insurance coverage, and request that, as a convenience to them, their employer submit the coverage premiums by payroll deduction. Under such voluntary supplemental arrangements the coverage is neither sponsored nor funded by the employer. In such cases, the remoteness of the employer involvement with the arrangement means that the coverage would not be treated as a group health plan for purposes of ERISA or COBRA.

ECFC requests that the Notice clarify that voluntary supplemental arrangements, such as those providing fixed indemnity insurance or other excepted benefits, be excluded from the definition of group health plan for purposes of the W-2 requirement if the arrangement is not a group health plan under ERISA because the employer involvement with the plan is minimal. Applicable guidance that could be relied upon for this purpose would be the “safe harbor” provided in ERISA regulations.⁴ Under the safe harbor, an arrangement is not a “welfare plan” and thus not a “group health plan” for purposes of ERISA if (1) no contributions are made by an employer or employee organization; (2) participation in the program is completely voluntary for employees or members; (3) the sole functions of the employer or employee organization with respect to the program are, without endorsing the program, to permit the insurer to publicize the program to employees or members, to collect premiums through payroll deductions or dues checkoffs, and to remit them to the insurer; and (4) the employer or employee organization receives no consideration in connection with the programs, other than reasonable compensation for administrative services actually rendered in connection with payroll deductions or dues checkoffs. Under these circumstances, such arrangements also should not be considered to be group health plans as defined under the Code for COBRA purposes. There are no employer contributions, only employee contributions, the employee is purchasing individual coverage, and the cost of the coverage to the employee is not affected by the fact that the employer facilitates payment through payroll or salary reduction. Thus, such arrangements are not group health plans under Treasury Regulation Section 54.4980B-2, Q&A-1.

⁴ 29 CFR § 2510.3-1(j).

ECFC believes that subjecting such arrangements to reporting requirements is unnecessarily burdensome and does not serve the intended purpose of the reporting requirement, which is to inform employees of the true cost of their employer sponsored health care. Employees are already aware of the cost of supplemental coverage that falls under the ERISA “safe harbor,” because they pay the full cost of the premiums for this coverage – regardless of whether they pay such premiums on a before- or after-tax basis. Including such coverage in the aggregate may also be confusing to employees who are trying to make comparisons with respect to their major medical coverage. Including such coverage also complicates the calculations that must be made for each employee during each pay cycle; for example, an employer will have to track separately certain excepted benefits for reporting purposes and exclude others – for each employee. This will be a daunting task for many employers. Imposing such burdens, when there is no offsetting benefit makes little sense, particularly in these difficult economic times when employers are simply trying to maintain their current workforce and keep their doors open. It makes more sense to implement this requirement when the data will actually be used by the IRS to calculate the high cost plan tax.

D. The Exception for HRAs Should Be Extended

ECFC supports the relief from the reporting requirement provided for HRAs in the Notice and requests that this relief be extended. Determining COBRA cost for HRAs is one of the areas where there is not yet full guidance.⁵ ECFC understands that the Treasury Department, together with the Departments of Health and Human Services and Labor, is considering the extent to which various requirements apply to HRAs under ACA. The Notice does not state the reasons why the exception for HRAs was provided, but ECFC believes that the lack of complete guidance on these issues is a strong reason supporting the exception. Further, because HRAs provide a specific dollar amount of coverage, W-2 reporting is not needed to inform employees of the value of this coverage. Thus, the exception for HRAs should be extended or made permanent.

E. The Small Employer Exception Should Be Made Permanent

Notice 2011-28 provides transition relief from the reporting requirement for “small employers,” defined in Q&A-3 as employers required to file fewer than 250 Forms W-2 for the preceding calendar year. Under the transition relief, small employers are exempt from the reporting requirement at least through 2013 Forms W-2 (i.e., such employers will not have to report health coverage costs on any Forms W-2 require to be furnished before January 2014). This relief continues until the issuance of further guidance.

The costs of complying with administrative requirements often fall hardest on small employers, particularly in times of economic uncertainty. Such costs may in some cases be prohibitively large for small employers and dissuade small employers from offering a full range of health coverage to employees. The small employer exception in the Notice recognizes the special concerns of small employers, and the transition relief is welcome. However, many small

⁵ See 2002-45.

employers remain concerned that they may need to comply in the future. In order to avoid small businesses from incurring costs in anticipation of having to comply and to provide the predictability that the President seeks in regulations, the small employer exception should be made permanent.

F. The FSA Coverage Provision Should Be Simplified and Clarified

The statutory provisions in Section 6051 provide that salary reduction contributions to a health FSA are not subject to the W-2 reporting requirement. Q&A-19 provides guidance with respect to this exception in circumstances where the employer provides optional employer flex credits. There is no legislative history that explains the rationale for exempting salary reduction contributions, however, a fairly obvious rationale is that employees do not need to be informed of such amounts because the employee has affirmatively elected how much to contribute to the FSA. Further, FSA contributions are generally supplemental to other health coverage. [As noted above, these two reasons favor a permanent exception for voluntary supplemental coverage as well]. ECFC has two concerns with respect to the proposed treatment of employer flex credits. First, the rule in the Q&A is complex to administer. Second, ECFC is concerned that Q&A-19 is an indication that the Treasury Department may be considering treating employer flex credits as salary reduction contributions for purposes of the \$2,500 cap on salary reduction contributions under Section 125(i) which is effective for taxable years beginning after December 31, 2012. These concerns are discussed in turn below.

An alternative approach to the rule in Q&A-19 that would reduce complexity for almost all FSAs is to exempt health FSAs from reporting requirements if the FSA qualifies as an excepted benefit.⁶ While this approach may in some cases provide a broader exemption from reporting than the rule in Q&A-19, it will be simpler because it relies on existing rules that are familiar to most plan sponsors that currently maintain health FSAs. For the limited number of situations where an FSA is not an excepted benefit, then reporting would be required under the proposed rule in Q&A-19 for amounts in excess of salary reduction contributions to the health FSA.

The second concern with respect to Q&A-19 relates to the definition of salary reduction contributions. The rule in Q&A-19 could have the effect of excluding some employer flex credits from reportable cost. This is because the Q&A provides that there is no reportable cost with respect to a health FSA if the total salary reduction contributions for all qualified benefits equals or exceeds the amount in the health FSA. For, example, suppose an employee makes a salary reduction election (for all qualified benefits) of \$2,000, \$1,000 of which is for the health

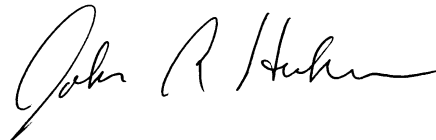
⁶ A health FSA is an excepted benefit under HIPAA regulations if other group health plan coverage, not limited to excepted benefits, is made available for the year to the class of participants by reason of their employment; and the arrangement is structured so that the maximum benefit payable to any participant in the class for a year cannot exceed two times the participant's salary reduction election under the arrangement for the year (or, if greater, cannot exceed \$500 plus the amount of the participant's salary reduction election). For this purpose, any amount that an employee can elect to receive as taxable income but elects to apply to the health flexible spending arrangement is considered a salary reduction election (regardless of whether the amount is characterized as salary or as a credit under the arrangement). Treas. Reg. § 54.9831-1(c)(3)(v).

FSA. The employer also makes flex contributions of \$1,000, \$500 of which is for the health FSA. Thus, the amount in the health FSA is \$1,500, which is less than total salary reduction contributions for all qualified benefits. In this case, Q&A-19 would not require reporting of any amount, even though a portion of the amount in the health FSA is not due to salary reduction contributions.

Presumably, the rule in Q&A-19 was adopted as a matter of administrative convenience for W-2 reporting (i.e., because otherwise employers could just modify their cafeteria plan documents to provide that salary reduction amounts apply to health FSA benefits first, until exhausted). While such a rule may be appropriate for administrative reasons in the case of the W-2 reporting requirement, we note that Section 125(i) contains a similar definition of salary reduction contributions. It would be inconsistent with the statute and the definition of salary reduction contributions in the proposed cafeteria plan regulations to treat such employer flex credits as subject to the cap on salary reduction contributions. Thus, ECFC requests that the IRS and Treasury Department clarify that, even if some portion of non-salary reduction contributions are excluded from reportable cost for W-2 reporting purposes, only salary reduction contributions actually made toward the cost of FSA benefits will be subject to Section 125(i) (and employer flex credits will not be).

ECFC appreciates this opportunity to comment and would be happy to discuss any of these issues with you. Please do not hesitate to contact me at 404-881-7885 or at john.hickman@alston.com if you have questions or if we can provide any additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "John R. Hickman". The signature is fluid and cursive, with the first name "John" being the most prominent.

John R. Hickman