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LACamillo

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Director, Office of Employment Tax Administration & Compliance  
CP:EX:ST:ET

Chief, Branch 2, Employee Benefits and Exempt Organizations  
CC:EBEO

Application of I.R.C. § 6205 on Audits/Reviews by Federal  
Agencies in Enforcing Certain Federal Labor Laws

This responds to your inquiry on whether the procedures for making interest-free adjustments under I.R.C. § 6205 would apply in situations where various federal government agencies, such as the Department of Labor, exercise statutory authority to collect erroneously unpaid back wages from employers and pay such back wages over to the appropriate employees.

Employment Tax Liability on Back Wages

Interest on unpaid taxes generally begins to accrue on the first date upon which such taxes are due and not paid. Thus, before determining when liability for interest on unpaid employment taxes begins to accrue, it is first necessary to determine the date upon which such employment taxes are due to be paid. For situations involving back wages, the issue presented ~~is whether liability for payment of employment taxes accrues when the wages are earned or, alternatively, when the wages are actually paid.~~

Section 3101 of the Code imposes social security taxes on an individual on wages received with respect to employment. Section 3101(a) and (b) provides that the rate of tax depends on the calendar year in which the wages are received by the individual. Section 3111 imposes social security taxes on an employer on wages paid with respect to employment. Section 3111(a) and (b) provides that the rate of tax depends on the calendar year in which the wages are paid by the employer.

Section 3102 of the Code requires the employer to deduct the tax imposed by section 3101 from the employee's wages as and when paid.

Section 31.3101-2(c) of the Employment Tax Regulations provides that the employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received.

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As you know, the Fair Labor Standards Act authorizes the Department of Labor to collect unpaid wages from employers and to then pay over such wages to the affected employees. The Service's position is that liability for employment taxes is computed on an "as paid" basis when the taxpayer receives unpaid minimum wages or unpaid overtime compensation pursuant to the Fair Labor Standards Act. See Rev. Rul. 55-203, 1955-1 C.B. 114. Thus, FICA tax and income tax required to be collected at the source should be deducted and withheld at the time the employer turns the money over to the government for distribution to the individuals involved. Id. at p. 115. Such taxes, together with the employer's portion of the FICA tax, should be reported in the employer's quarterly federal tax return, Form 941, for the quarter during which the taxes were deducted and withheld and should be paid to the government in the usual manner. Id. We see no reason why the same treatment would not apply to back wages collected by other federal agencies exercising similar authority to collect and pay over back wages pursuant to other federal statutes.

Based on the foregoing, it is clear that employment tax on back wages is due to be paid on the due date of the return for the quarter in which such wages are actually paid over to the government for payment to the affected employees, and not at the time such wages were actually earned. Thus, the earliest date upon which interest could begin to accrue on unpaid employment tax relating to such back wages is the day after the due date of the return for the quarter in which such wages were paid to the Department of Labor or other federal agency.

#### Interest Free Adjustments Under Section 6205

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Section 6205(a) provides that if less than the correct amount of employee's FICA tax (section 3101), employer's FICA tax (section 3111), Railroad Retirement Tax (sections 3201 or 3221), or withholding tax (section 3402) is paid with respect to any payment of wages or compensation, proper adjustments of both the tax and amount deducted shall be made, without interest, as prescribed by regulations.

Section 31.6205-1(a) of the Employment Tax Regulations sets forth the general requirements for adjusting underpayments of the aforementioned taxes. It provides that an underpayment of tax shall be reported on a return form which is prescribed for use,

at the time the correction is made, for reporting the particular tax being adjusted.<sup>1</sup> It also provides that if FICA tax is being adjusted, certain information concerning the employee is required. For purposes of section 31.6205-1, an error is ascertained when an employer has sufficient knowledge of the error to be able to correct it. Interest shall not be due on the correction of an underpayment of tax if the correction is made in accordance with procedures that are described below.

Paragraph (b), subparagraph (2) of section 31.6205-1 of the regulations sets forth the method for adjusting an underpayment of FICA tax ascertained after the return has been filed. Paragraph (c), subparagraph (2) sets forth the method to be used for reporting underpayments of income tax ascertained after the return has been filed. If the steps set forth therein are followed, interest will not be charged on the underpayments of these taxes.

Section 31.6205-1(b)(2) of the regulations provides that the employer shall adjust the underpayment of FICA tax (a) by reporting the additional tax due as an adjustment on a return filed on or before the last day on which the return is required to be filed for the quarter in which the error is ascertained, or (b) by reporting the additional tax on a supplemental return for the quarter in which the wages were paid to which the tax relates. The adjustment or supplemental return must be reported or filed on or before the due date of the return for the quarter in which the error is ascertained. The amount of tax due must also be paid at the time for reporting the adjustment. If all of these steps are followed, the reported underpayment will not be subject to interest. However, if the adjustment is properly reported, but the additional tax due is not paid by the due date, interest thereafter accrues.

Section 31.6205-1(c)(2) of the regulations provides that the employer shall report an underpayment of withholding tax (a) by reporting the additional tax on a return for any quarter in the calendar year in which the wages were paid, or (b) by reporting the additional tax on a supplemental return for the quarter in which the wages were paid to which the tax relates. To constitute an adjustment within the meaning of section 31.6205-1, the return or supplemental return reporting the underpayment must be filed by the due date of the return for the quarter in which the error was ascertained.

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<sup>1</sup> For purposes of making interest free adjustments, the date the "error" is ascertained must be established. See item C, Form 941c. There may be instances where the taxpayer's rationale for failing to pay employment taxes is so devoid of legal support that it could not have been the result of an innocent mistake. In such cases, an interest free adjustment is not appropriate.

Interest Free Adjustments for Employment Tax on Back Wages

You have inquired whether I.R.C. § 6205 would apply to situations where various federal agencies exercise their authority to determine that employers owe back wages to their employees. You have advised that agencies which have such authority include the Department of Labor (Fair Labor Standards Act), General Accounting Office (Davis-Bacon Act), National Labor Relations Board (Labor-Management Relation Act) and the Department of Housing and Urban Development.

As explained above, employment tax on back wages is due at the time such wages are paid to the employee. Thus, in situations where federal agencies collect back wages from employers, if the employer timely pays and reports the employment tax with respect to the back wages on the quarterly return due for the quarter during which the money was turned over to the Department of Labor or other federal agency, there will be no interest, because the employment tax will have been paid when due.

However, if the employer makes an error and fails to report or pay the full amount of employment tax due on back wages by the due date of the return for the quarter in which such back wages were turned over to the government, interest will generally accrue from the day after the due date of such return, unless the employer is eligible for an interest-free adjustment under the provisions of section 6205 described above.

The attorney assigned to this matter is Lynne Camillo. She can be reached at (202) 622-6040.

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