



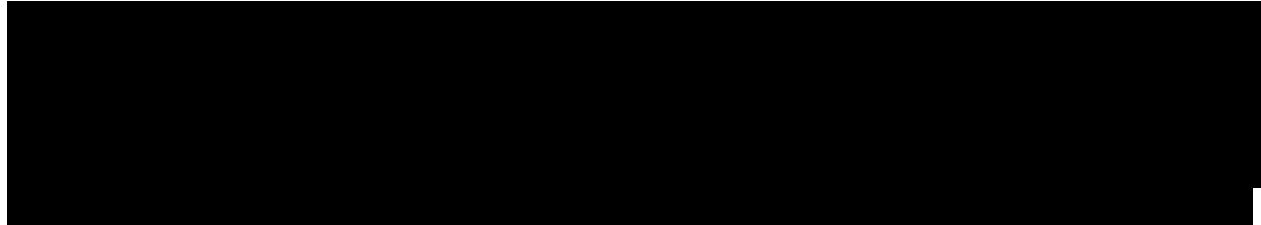
DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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COR-117407-00



Dear [REDACTED]:

This responds to your request for assistance with an issue involving excess wages paid to employees in previous years. Specifically, your inquiry concerns the proper method for correcting an overpayment of employment taxes. IRS Publication 15, (Circular E, Employer's Tax Guide), contains guidance on this issue in Section 13, Reporting Adjustments on Form 941. We have enclosed a copy of Publication 15 for your information.

Unfortunately, we are not able to issue a ruling on this issue due to the fact that your submission does not comport with the requirements for requesting a private letter ruling. Revenue Procedure 2000-1, 2000-1 I.R.B. 4, sets forth procedures for requesting letter rulings. We have included a copy of Revenue Procedure 2000-1 for your information. If you wish to request formal guidance, such as a private letter ruling, you should follow the procedures set forth in Revenue Procedure 2000-1. In the absence of a request for formal guidance, we are only able to provide general information. Accordingly, in response to your request, we have reviewed the facts provided to us and set forth the following general information, which we hope will be helpful to you.

As we understand the facts you have presented, employees erroneously received excess wages when they were incorrectly paid shift differential for non-worked hours in violation of a collective bargaining agreement with the union. The excessive wages were paid in 1995, 1996, 1997, 1998 and 1999. The employer and the union have agreed to a salary recoupment procedure that permits the employer to deduct 10% of the total gross pay from each successive paycheck received by the employee until the employee has paid back the entire amount of excess wages paid in previous years. Your inquiry concerns the employer's obligation to withhold income taxes and taxes under the Federal Insurance Contributions Act (FICA).

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Section 6413(a) of the Internal Revenue Code (the "Code") provides guidance on how to correct overpayments of FICA. Section 6413(a) provides that if more than the correct amount of the employer FICA under § 3111 or employee FICA under § 3101 is paid on any payment of remuneration, proper adjustments, of both the tax and the amount to be deducted shall be made, without interest, as prescribed by regulations. Section 6413(b) of the Code provides that if more than the correct amount of employer or employee FICA tax is paid on any remuneration, and the overpayment cannot be adjusted under section 6413(a), the amount of the overpayment must be refunded as prescribed by the regulations.

Section 31.6413(a)-1(b)(1) of the Employment Tax Regulations concerns repayments by employers of FICA taxes erroneously collected from employees, if the repayment is made after the employer has filed its return for the period in which the tax was erroneously collected. The regulation provides that if an employer collects from an employee and pays more than the correct amount of tax under section 3101, and if the error is ascertained within the applicable period of limitation on credit or refund, the employer shall repay or reimburse the employee in the amount thereof prior to the expiration of the return period following the return period in which the error is ascertained and prior to the expiration of such limitation period.¹ The regulation further provides that if such repayment by the employer occurs, the employer shall obtain and keep as part of his records a written receipt of the employee showing the date and the amount of the repayment. In addition, if an employer repays or reimburses an employee in any calendar year an overpayment of tax collected under section 3101, section 31.6413(a)-1(b)(1) of the regulations provides that the employer shall obtain and keep as part of his records a written statement that the employee has not and will not claim any refund or credit for such overpayment (or if the employee has filed a claim, that such claim has been rejected). The employer may obtain credit for such payment pursuant to section 31.6413(a)-2(a)(1) of the regulations.

Section 31.6413(a)-2(a)(1) of the regulations provides that after an employer repays or reimburses an employee in the amount of an overcollection, the employer may claim credit for the amount in the manner, and subject to the conditions, stated in § 31.6402(a)-2 of the regulations. The credit constitutes an adjustment, without interest, if the amount of the credit is entered on a return for a period ending on or

¹ You have indicated that the overpayments occurred from 1995 through 1999, inclusive. Generally, you may make an adjustment only within 3 years of the return due date or the date the return was filed, whichever is later. Assuming that the employer filed timely Forms 941 by April 15 of the year after the close of each tax year, the only years remaining open under the period of limitations are 1997, 1998 and 1999.

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before the last day of the return period following the return period in which the error was ascertained. No credit or adjustment for an overpayment may be entered on a return after a claim for refund of such an overpayment is filed.

Section 31.6413(a)-2(a)(2) of the regulations provides that an employer may claim credit for the amount of overpaid employer FICA tax in the manner, and subject to the conditions, stated in § 31.6402(a)-2 of the regulations. The credit constitutes an adjustment, without interest, if the amount of the credit is entered on the same return on which the employer adjusts a corresponding overpayment of employee tax.

The FICA tax consequences of the repayment of an erroneous salary payment which was previously included in FICA wages are as follows provided the applicable statute of limitations is met and to the extent additional FICA taxes were paid because of inclusion of the erroneous salary payment in wages (i.e., the employee's other remuneration for employment paid by the employer during the prior year did not equal or exceed the maximum wage base for the prior year). The repayment of the erroneous salary payment by the employee creates an overcollection and overpayment of FICA taxes for that prior year. Actual repayment of wages by the employee to the employer (through payroll deduction or otherwise) must occur before an overpayment exists. The mere fact that it is established that an employee received an erroneous wage payment in a prior year (and is liable to the employer for such repayment) does not create an overpayment of FICA taxes in the prior year. If the employee does not repay the erroneous salary payment, the employee is still in actual receipt of the wages in question, and thus, such amounts remain wages and no overpayment exists.

Based on the foregoing provisions of the Code and the regulations, we suggest that the employer adjust the overpayments of FICA in the following manner. If there has been an overcollection of employee FICA tax from the remuneration of an employee paid in a prior year that is open under the period of limitations, the employer should repay or reimburse the employees in the amount of the overcollection prior to expiration of the limitations period. The employer should obtain and keep as part of its records the written receipt of the employee, showing the date and amount of the repayment and stating that (a) the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (b) the employee will not claim refund or credit of such amount.

After repaying or reimbursing the employees and obtaining the requisite employee certifications, the employer may correct the errors on prior quarter Forms 941 by claiming credit for the employee FICA on the Form 941 for the period in which the error was ascertained or on the Form 941 for the return period following the return period in which the error was ascertained. For this purpose, the error is ascertained when a repayment of excess wages is made by the employee. The employer may also claim credit for an overpayment of employer FICA with respect to the excess wages that are repaid by the employees, and such credit shall constitute an adjustment, without

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interest, if the amount thereof is entered on the same return on which the employer adjusts a corresponding overpayment of employee tax. The employer must provide background information and certifications supporting prior quarter adjustments. The employer should file with Form 941 a Form 941c, Supporting Statement To Correct Information, or attach a statement that shows:

- What the error was.
- Quarter in which the error was made.
- Date on which the wages were repaid.
- That the employer repaid the employee tax or received from each affected employee a written consent to this refund or credit.
- That the employer received from the employee a written statement that he or she will not claim a refund or credit for the amount of the overcollected social security and Medicare taxes.

If, for some reason, the employer is unable to adjust the overpayment of FICA pursuant to the procedure set forth above, the employer may file claims for refund (Forms 843) along with its Forms 941 and 941c for each quarter in which the wages are repaid by the employees.

Pursuant to section 31.6051-1(c) of the regulations, to the extent repayments of excess wages made by an employee result in a reduced amount of FICA wages and reduced amounts of employee FICA taxes paid for prior years, the employer is required to furnish corrected Forms W-2 for the prior years showing the employee's corrected "social security wages" and corrected "social security tax withheld." No changes should be made in the entries for "wages, tips, other compensation" or for "federal income tax withheld."

The wages paid in error in the prior year remain taxable to the employee for that year. This is because the employee received and had use of those funds during that year. The employee is not entitled to file an amended return to recover the income tax on these wages. Instead, the employees may take account of repayments of wages received in a prior year for federal income tax purposes only by taking the repayment as an itemized deduction (subject to the 2 percent floor under Code section 67).

Finally, the employer must withhold and pay employment tax on the gross amount of wages paid to employees (including the amounts recouped to correct wage overpayments in prior years). Repayments of salary received in prior years do not reduce the amount of wages paid to the employee for FICA and federal income tax

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withholding purposes in the year of repayment. Thus, any remuneration for employment in the year of repayment which is used to repay the erroneous salary is not excludable from wages for FICA and federal income tax withholding purposes.

This letter provides general information only. It describes well-established interpretations or principles of tax law without applying them to a specific set of facts. It is advisory only and has no binding effect with the Internal Revenue Service. This letter is intended only to provide you with general guidance for determining how to comply with applicable law.

The attorney assigned to this matter is Lynne Camillo (Employee ID# 50-01066). She can be reached at (202) 622-6040.

Sincerely,

Jerry E. Holmes
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

Enclosures:
As stated