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From: [REDACTED]
Sent: Friday, February 02, 2018 5:53:07 PM
To: [REDACTED]
Cc: [REDACTED]
Bcc:
Subject: RE: Sections 6521, 3402(d), & 3102(f)(3)

We've addressed your issues below. Please let us know if you have further questions.

Thanks,

Issues

(1) Whether section 6521 allows an employer to offset self-employment compensation erroneously paid by its employees against its liability for the employees' share of FICA where section 3509 does not apply and section 6521 applies to the employees.

(2) What is the effect of the offset on the employer's penalties and additions to tax?

Facts

A taxpayer treated certain workers as nonemployees. After an examination, the Service determined that the workers are properly classified as the taxpayer's employees, that relief under Section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885 (relieving employers from FICA in certain circumstances), is not available,

and that the employer is liable for the employer and employee shares of FICA. Section 3509 does not apply because of evidence of intentional disregard. The employer would like a credit under section 6521 against its employee FICA liability where the workers reported their compensation on their individual income tax returns and paid self-employment compensation. The period of limitations on refund of self-employment tax is closed, but the period of limitations on assessment of employee FICA taxes is open.

Conclusions

(1) Section 6521 allows an employer to offset self-employment compensation erroneously paid by its employees against its liability for the employees' share of FICA where section 3509 does not apply and section 6521 applies to the employees.

(2) The applicability of section 6521 does not affect the employer's liability for penalties and additions to tax.

Analysis

Section 1401 imposes a tax upon each individual's self-employment income, which is defined generally by section 1402(b) as net earnings from self-employment.

Section 3101 of the Code imposes Federal Insurance Contributions Act (FICA) taxes on an employee. Section 3101(a) imposes Social Security tax, section 3101(b)(1) imposes Medicare tax, and section 3101(b)(2) imposes Additional Medicare tax on higher earners.^[1] Section 3102(a) requires an employer to deduct and withhold from the wages of an employee the taxes imposed on the employee by section 3101. Section 3102(b) makes the employer liable for those taxes. Although the employer is liable for the Social Security and Medicare taxes, the employee remains ultimately liable, and the

Service may collect the tax from either the employer or the employee. Karagozian v. Commissioner, 106 T.C.M. (CCH) 22 (2013), aff'd, 595 F. App'x 87 (2d Cir. 2015).^[iii] Section 3102(f)(3) provides that if an employer fails to deduct and withhold the Additional Medicare tax and that tax is paid by an employee, the tax shall not be collected from the employer, but the section does not relieve the employer from liability for penalties for failure to deduct and withhold. There is no corollary provision for the Social Security and Medicare taxes.

Section 6656 generally imposes a penalty for the failure to timely deposit taxes.

Section 6521 provides that *if* (1) an amount of self-employment income is erroneously treated as wages (or vice versa), and (2) correction of the error would require assessment of self-employment tax and refund or credit of the FICA tax imposed by section 3101 (or vice versa), and (3) the correction of the error is authorized as to one tax but prevented by rule of law (other than section 7122, offer-in-compromise) as to the other tax, *then* the authorized amount of the adjustment with respect to the one tax is reduced by the amount of the adjustment prevented by rule of law that would otherwise be required with respect to the other tax. This rule applies only where the required assessment and refund or credit are for the same taxable year. Bronson v. Commissioner, 64 T.C.M. (CCH) 1254 (1992).

Section 3509 generally provides, in relevant part, that an employer who fails to deduct and withhold from wages the employee's FICA taxes without intentionally disregarding its obligations is limited in its liability for the employee's FICA taxes to twenty percent of the amount determined under section 3101 (forty percent if the employer failed to file information returns without reasonable cause). Section

3509(d)(1)(C) provides, in relevant part, that if any part of the employer's liability for tax is determined under section 3509, section 6521 shall not apply.

Revenue Ruling 86-111 clarifies the application of section 6521:

[I]f the amount of the employer's liability for the employee's share of FICA is determined under section 3509, then section 6521 cannot effect a reduction in that employer liability. The only tax liability determined under section 3509, however, is the employer's. Moreover, section 3509(d)(1)(A) states that the employee's liability is not to be affected by the assessment and collection of the tax determined under section 3509. Accordingly, application of section 3509 to the employer's tax liability for the employee's share of FICA does not preclude the employee from enjoying the benefit of section 6521, if that section is otherwise available.

Rev. Rul. 86-111, 1986-2 C.B. 176 (1986). Because section 3509(d)(1)(C) does not render section 6521 inapplicable to the employee, it must be read to render section 6521 inapplicable to the employer. By inference, absent the applicability of section 3509, section 6521 could otherwise be applicable to the employer. Thus, where section 3509 does not apply and section 6521 applies, the employer's liability for the tax imposed by section 3101 is reduced by the amount the employees paid as self-employment tax.

Although no provision of law specifically addresses the impact of the employee's payment of Social Security and Medicare taxes required to be withheld by the employer on penalties applicable to the employer, those penalties apply according to their terms. Cf. § 3102(f)(3) (providing no relief to employer from liability for penalties for failure to deduct and withhold Additional Medicare tax where employee paid tax). An employer who fails to withhold and deposit FICA taxes has failed to do so regardless of whether its employees pay those taxes, and the employer therefore may still be liable for the penalty under section 6656.

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- ^[i] Social Security and Medicare are longstanding provisions, whereas the Additional Medicare tax was imposed by the Patient Protection and Affordable Care Act in 2010.
- ^[ii] Karagozian addressed liability for the 2008 taxable year, and therefore did not address the Additional Medicare tax.