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memorandum

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to: Jeremy H. Fetter
Area Counsel (Gulf Coast Area Dallas)
(Tax Exempt & Government Entities Division Counsel)

from: Mikhail Zhidkov
Senior Technician Reviewer
Employment Tax Branch 2
(Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) CC:EEE:EOET:ET2)

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subject: Refund of Overpayment of Taxes Imposed Under the Federal Insurance Contribution Act in a Subsequent Year Following the Use of Tax Equalization Methods

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether an employer is eligible to receive a refund for an overpayment of tax imposed by the Federal Insurance Contributions Act (FICA) paid on behalf of an employee on a foreign assignment in a year after the calendar year in which wages were paid without the employer first repaying or reimbursing the employee the employee's portion of social security tax or securing the employee's consent to the allowance of the claim for refund in a situation where the employer uses a tax equalization program to adjust the employee's pay.

CONCLUSION

Generally, in order to receive a refund for an overpayment of FICA tax, an employer must repay or reimburse its employee the employee's portion of FICA tax or secure the employee's consent to the allowance of the claim for refund and include the consent

together with a claim for the refund of such employee tax in accordance with Rev. Proc. 2017-28, 2017-14 I.R.B. 1061. This is true where an employer uses a tax equalization program to adjust employee's pay because FICA taxes are considered withheld from the employee's wages in this situation.

BACKGROUND[1]

Companies with a multinational presence often station employees in countries other than the employee's country of citizenship or residence. When doing so, these companies frequently offer tax equalization programs to employees. Tax equalization programs are agreements entered into between employers and employees and are intended to result in the employee having no economic gain or loss with respect to tax liability because of the international assignment. After all expected taxes are considered, an employee may be better or worse off economically because of the international assignment if an adjustment to salary is not made. The tax equalization program is designed to result in the employee paying approximately the same amount of tax as the employee would have paid had the employee not been placed on an international assignment.

Under the tax equalization process, a company will enter into a tax equalization agreement with its employee prior to stationing the employee in a new country. As part of the tax equalization agreement, the company and the employee will calculate what is commonly referred to as a "hypothetical tax." The hypothetical tax calculation made before the beginning of the tax year constitutes an approximation of what the employee's overall tax liability would be for the upcoming year if that employee were to remain in the employee's country of citizenship (approximate hypothetical tax). The employee's previously agreed upon salary for the upcoming year is then reduced by the amount of this approximate hypothetical tax, and the employee is not entitled to receive that portion of the employee's previously agreed upon salary. The company will then usually pay all taxes owed on remuneration the employee receives from that company on behalf of the employee for both the country where the employee is stationed (host country) as well as the employee's country of citizenship.

For employees stationed in the United States, or United States employees stationed abroad, the company will generally remit FICA taxes owed on remuneration the employee receives and file quarterly Forms 941. The company will also show the employee's share of FICA tax as Social Security and Medicare tax withheld in boxes 3 and 5 of the employee's Form W-2 it files and furnishes to the employee after the end of the calendar year.

[1] This section provides a general overview of the tax equalization process as background. The particulars of each tax equalization scheme vary from company to company, but the legal determination detailed in this document is not dependent on the particular facts and circumstances described in this section.

FACTS

A United States company sends a non-United States citizen employee on international assignment to the United States and pays the employee remuneration subject to FICA taxes under §§ 3101 and 3111. Under the company's tax equalization program, the company agrees in advance of the international assignment to pay the employee a stated amount of remuneration, net of any taxes owed on the remuneration, which is intended to equal the after-tax remuneration the employee would receive if they had remained in the employee's country of citizenship instead of accepting a foreign assignment. The United States company reduces that employee's salary by the approximate hypothetical tax and pays the required FICA taxes throughout the year in which remuneration is paid to the employee. Under the agreement, after the hypothetical tax is subtracted from the employee's pay, the employer purports to be solely responsible for paying taxes, including FICA taxes, on tax equalized pay, without subtracting any additional amount from the agreed upon remuneration or later adjusting such pay.

The issue presented is whether the United States company that pays the employee's share of FICA tax withholding in excess of what should have been withheld is entitled to claim a refund of the excess withholding in a year subsequent to the calendar year in which the remuneration that gave rise to the United States tax liability was paid to the employee without first repaying or reimbursing the employee the employee's share of FICA tax or securing the employee's consent to the allowance of the claim for refund.

LAW

Sections 3101 and 3111 impose taxes under FICA on "wages" as that term is defined in section 3121(a), with respect to "employment" as that term is defined in section 3121(b). The term "wages" is defined in section 3121(a) as all remuneration for employment, with certain specific exceptions. Section 3121(b) defines the term "employment" as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions. Neither the exceptions in section 3121(a) nor (b) are relevant to tax equalization programs.[2]

Section 3121(a)(6)(A) excludes from wages the payment by an employer (without deduction from the remuneration of the employee) of the tax imposed upon an employee under section 3101 with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor.

Generally, an employer may correct overpayments of FICA tax after an error has been ascertained using the refund claim process under section 6402 or using the adjustment

[2] As discussed further below, section 3121(a)(6)(A) excludes from wages an employer's payment of the employee's share of FICA for domestic service in a private home or for agricultural labor. To the extent tax equalization programs include agricultural or household employees, section 3121(a)(6)(A) could apply. This memo does not analyze such situations.

process under section 6413. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

Section 6402 establishes the procedures for filing claims for refund. Section 6402(a) provides, in part, that in the case of any overpayment, the Secretary may credit the amount of such overpayment against any tax liability of the person who made the overpayment and shall refund the balance to such person.

Section 31.6402(a)-2 provides rules under which a refund claim for an overpayment of FICA tax may be made. Pursuant to § 31.6402(a)-2(a), no refund or credit for FICA employer tax will be allowed unless the employer has first repaid or reimbursed its employee for the employee FICA tax or has secured the employee's consent to the allowance of the claim for refund and includes a claim for the refund of such employee tax. For refund claims for employee tax overcollected in prior years, the employer must also certify that it has obtained the employee's written statement confirming that the employee has not made any previous claims (or the claims were rejected) and will not make any future claims for refund of the amount of the overcollection. However, this requirement does not apply to the extent that the employee FICA taxes were not withheld from the employee or, after the employer makes reasonable efforts to repay or reimburse the employee or secure the employee's consent, the employer cannot locate the employee or the employee will not provide consent.

Section 6413(a)(1) generally provides for interest-free adjustments in such manner and at such times as the Secretary prescribes by regulation if more than the correct amount of tax imposed by §§ 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of remuneration.

Section 6413(b) generally provides for a refund if an overpayment cannot be adjusted under § 6413(a) in such manner and at such times as the Secretary prescribes by regulation if more than the correct amount of tax imposed by §§ 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of remuneration.

Section 31.6413(a)-1(a) and Section 31.6413(a)-2 generally provide procedures for the interest-free adjustments of overpayments of FICA tax withheld from wages. Under section 31.6413(a)-1(a) and section 31.6413(a)-2(b) of the Treasury regulations, before making an adjustment of an overpayment of FICA tax with respect to an employee, an employer generally must repay or reimburse the employee in the amount of the over-collection prior to the expiration of the period of limitations on credit or refund, and, for FICA tax overcollected in a prior year, must also secure the employee's written statement confirming that the employee has not made any previous claims (or the claims were rejected) and will not make any future claims for refund or credit of the amount of the overcollected FICA tax.

Under § 31.6413(a)-2(c)(2), an employer can correct an overpayment of income tax withholding due to an administrative error. An administrative error involves the

inaccurate reporting of the amount withheld due to transposition error or math error on the employment tax returns

Under § 3509(a), if any employer fails to deduct and withhold any tax under subchapter A of chapter 21 with respect to any employee by reason of treating such employee as not being an employee for purposes of such subchapter, the amount of the employer's liability for such taxes with respect to such employee shall be determined as if the taxes imposed under such subchapter were 20 percent of the amount imposed under such subchapter without regard to this subparagraph. Section 3509(d)(1)(B) provides that the employer shall not be entitled to recover from the employee any tax determined under this section.

In First National Bank of Chicago v. United States, 964 F.2d 1137 (Fed. Cir. 1992), the Court considered whether an employer was required to comply with procedural requirements for claiming a refund of FICA taxes when the taxes were paid by the employer and the payment of the FICA taxes did not itself result in additional FICA wages because of a statutory exception then applicable. The court held that only FICA wages to an employee could be "collected from an employee" for purposes of the regulations. The court then reasoned that because the FICA taxes were paid by the employer on behalf of the employees, and because the payments the employer made on behalf of the employee were exempted from FICA under § 3121(a)(6)(A),[3] the payments were not FICA wages. The court noted that, "[g]enerally, income taxes and FICA taxes are considered to have been 'collected from an employee' even though the employee has not in fact ever received the amount of the tax." However, since the payments in this case were "never income which could have been included in and then deducted from the employees' FICA wages," they could not be "collected from an employee," so no collection occurred, and the employer was not subject to the procedural requirements for claiming a refund of FICA taxes.

Rev. Rul. 86-14, 1986-5 C.B. 304, determines that FICA tax payments that are made on an employee's behalf are generally additional income to the employee and should be reported as additional wages.[4] The ruling also states that any FICA payments made on an employee's behalf should be reported as "Social Security Tax Withheld" on the Form W- 2. Finally, the ruling states that when a tax liability is incurred by an employer on behalf of an employee and those funds are included in the employee's gross income, the funds were, in effect, deducted from the employee's pay.

Rev. Proc. 2017-28 provides guidance to employers on the requirements for employee consent used by an employer to support a claim for refund of overpaid taxes under

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[3] The Omnibus Reconciliation Act of 1980 amended this exception to cover pay only for domestic services in the employer's home and for agricultural labor. See Omnibus Reconciliation Act of 1980, Pub.L. 96–499. The payments in question in this case were all made before the 1980 amendment became effective.

[4] Consistent with the Omnibus Reconciliation Act of 1980, Rev. Rul. 86-14 does not apply to payments that are for domestic service in the employer's private home or for agricultural labor.

FICA. It clarifies the basic requirements for both a request for employee consent and for the employee consent and permits employee consent to be requested, furnished, and retained in an electronic format. It also contains guidance concerning what constitutes "reasonable efforts" if employee consent is not secured in order to permit the employer to claim a refund of the employer share of overpaid FICA.

ANALYSIS

In the tax equalization program described, the United States company contractually agrees to withhold FICA taxes on all wages or payments for services that are paid to the employee by the employer under §§ 3101, including taxes paid on the employee's behalf. The employee similarly agrees to the reduced salary in exchange for the United States company paying all of the employee's taxes owed on remuneration the employee receives from that company in both the United States and in the employee's country of citizenship. Thus, the employer has a prearranged contract to pay an amount of stated wages to the employee net of any tax withholding (and thus, as a matter of internal bookkeeping, pay the tax withholding of the employee out of its own funds rather than deducting the withholding from the employee's stated wages in the year of payment).

This prearranged plan results in additional current income and current wages to the employee in addition to the stated wages. See Rev. Rul. 86-14. The amount of taxes paid on behalf of the employee by the United States employer is deemed to have been withheld by the United States company and should be included in income and wages on the employee's Form W-2, unless otherwise excepted. See Rev. Rul. 86-14.

To the extent that the employer pays an amount of FICA tax in excess of the sum due under §§ 3101 or 3111, the employer can file a claim for credit or refund for an overpayment. See § 31.6402(a)-2(a)(1)(i). However, an employer may not generally receive a refund of overpaid FICA tax without making reasonable efforts to protect its employees' interests with respect to Old-Age, Survivors, and Disability Insurance.[5] For this reason, the employer must first repay or reimburse its employee or secure the employee's consent to the allowance of the claim for refund before filing a claim for credit or refund for an overpayment. See § 31.6402(a)-2(a)(1)(ii). However, this requirement does not apply to the extent that the taxes were not withheld from the employee, or, after the employer makes reasonable efforts to repay or reimburse the employee or secure the employee's consent, the employer cannot locate the employee or the employee will not provide consent. See § 31.6402(a)-2(a)(1)(ii).

Generally, the employee's share of FICA taxes is considered to be withheld from the employee in tax equalization arrangements. While there are some limited circumstances when FICA taxes are not withheld from the employee, they are not relevant to the tax equalization agreements being discussed here. For example:

[5] This requirement also aids in proper tax administration by preventing a claim for refund by an employee on the same overpayment of FICA taxes claimed by the employer.

- Amounts that are reported as withheld due to administrative error fall into the exception to the requirement that the employer reimburse its employee or secure an employee's consent before receiving a credit or refund for an overpayment of FICA taxes. See § 31.6402(a)-2, 31.6413(a)-2(c)(2).
- When the Code explicitly deems FICA taxes paid by an employer to be not withheld from an employee, those payments are not considered to be withheld from the employee. See § 3509(d)(1)(B).
- When an employer pays FICA taxes on behalf of an employee but neither the underlying benefits that generated the FICA tax liability nor the tax payments the employer made on behalf of its employees could be included in and then deducted from wages under § 3121, then those FICA tax payments were not withheld from the employee. See First National Bank of Chicago, 964 F.2d at 1140-1.
- In cases where an employer makes a payment of the employee's portion of FICA taxes without deduction from the remuneration of the employee or a payment required from an employee under a State unemployment compensation law with respect to remuneration paid to an employee for domestic service in the employer's home or for agricultural labor, the employer's payment of FICA taxes is not considered to be withheld from the employee. See § 3121(a)(6).

In the tax equalization agreements being discussed, the tax payments made on behalf of an employee are included in the employee's gross income, even if the accounting processes used by the United States company under its tax equalization program do not identify the payments as being withheld because the employee has agreed to accept a lower salary in advance in exchange for the employer's agreement to pay all taxes on the employee's behalf. For this reason, regardless of any internal accounting, the taxes paid on the employee's behalf are deemed to have been withheld from the employee. See Rev. Rul. 86-14. The United States company therefore does not fall into the exception to the requirement to reimburse its employee or secure an employee's consent before receiving a credit or refund for an overpayment of FICA taxes because the tax liability incurred on behalf of an employee is included in the employee's gross income. See § 31.6402(a)-2(a)(1)(ii). This exception only applies to situations in which taxes were not withheld from the employee. In this case, the payments are deemed to be withheld. Excess FICA taxes withheld by an employer may be recovered through a claim for credit or refund only after the employer first repays or reimburses its employee or secures the employee's consent to the allowance of the claim for refund. See § 31.6402(a)-2(a)(1)(ii).

Please call Matthew Leiwant at (202) 317-4774 if you have any further questions.