

GMS Flash Alert

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United States – IRS Guidance on FICA Refunds and Tax Equalization Programs

On June 9, 2023, the U.S. Internal Revenue Service (IRS) released a Chief Counsel Advice memorandum¹ that addresses how the rules related to obtaining a refund of overpaid Federal Insurance Contributions Act (FICA) taxes apply to employers that fund the employee share of FICA under tax equalization arrangements. The memorandum concludes that to receive a refund for an overpayment of FICA, an employer must generally repay or reimburse its employee the employee's portion of FICA or secure the employee's consent to the allowance of the claim for refund, and that this rule generally applies where an employer uses a tax equalization program to adjust employee pay because FICA taxes are generally considered withheld from employee wages under tax equalization arrangements.

WHY THIS MATTERS

The IRS memorandum reaffirms the position previously promulgated by the IRS 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 are, in effect, deducted from the employee's pay and are deemed to have been withheld from the employee. As a result, in order to obtain a refund of excess FICA tax after the calendar year in which wages are paid to an employee, employers that are responsible for funding an employee's FICA tax liability under a tax equalization arrangement must generally first reimburse the employee for the employee portion of the tax or secure the employee's consent to the allowance of the claim for refund, as employers cannot claim that the taxes are excepted from the aforementioned procedural requirement on the grounds that the FICA taxes funded by the employer on behalf of the employee are not considered withheld from the employee.

As such, it is generally recommended that global mobility programs with tax equalization arrangements review their policies and procedures to confirm they have the proper processes in place to either reimburse employees for their share of the overpayment or obtain employee consent in the event the employer would like to obtain a refund of overpaid FICA tax.

Background

There are specific rules that govern when a refund claim for an overpayment of FICA tax may be made. In general, no refund or credit for FICA 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 over-collected 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 over-collection. 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.

Pursuant to Rev. Rul. 86-14,² 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. 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.

Overview of Chief Counsel Advice

The IRS memorandum considers the scenario of a United States company that sends a non-U.S. citizen employee on international assignment to the United States and pays the employee remuneration subject to FICA taxes. 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 he or she had remained in the employee's country of citizenship instead of accepting an international 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.

This prearranged plan results in additional current income and current wages to the employee in addition to the stated wages. 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.

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 U.S. tax liability was paid to the employee without first repaying or reimbursing that employee his or her share of FICA tax or securing his or her consent to the allowance of the claim for refund in accordance with Rev. Proc. 2017-28.³ Therefore, given the requirement that an employer reimburse its employee or secure an employee's consent before receiving a credit or refund for an overpayment of FICA taxes does not apply to the extent that the taxes were not withheld from the employee, the issue of whether or not the employer is subject to such requirements for claiming a refund of FICA taxes hinges upon whether or not the FICA tax gross-ups are deemed to be withheld from the employee.

While the IRS memorandum states that there are some limited circumstances when FICA taxes are not deemed to be withheld from the employee, it concludes that such provisions are not relevant to the tax equalization agreements being discussed and that the taxes paid on the employee's behalf are deemed to have been withheld from the employee since the tax payments made on behalf of the employee under the tax equalization program described in the memorandum are included in the employee's gross income. As a result of the taxes being deemed to be withheld from the employee, the

United States company does not qualify for the exception to the requirement to reimburse its employee or secure the employee's consent before receiving a credit or refund for an overpayment of FICA taxes, as this exception only applies to situations in which taxes are not considered to be withheld from the employee. As a result of not qualifying for the exception, any excess FICA taxes withheld by the 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.

FOOTNOTES:

1 See [Chief Counsel Advice 202323005](#).

2 Rev. Rul. 86-14, 1986-5 C.B. 304.

3 [Rev. Proc. 2017-28, 2017-14 I.R.B. 1061](#). 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 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.

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