DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities) by Jerry E. Holmes
CC:TEGE:EOEG

SUBJECT: Erroneous Retirement Contributions by Governmental Entities

This Field Service Advice responds to your memorandum dated July 20, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

## DISCLOSURE STATEMENT

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official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Plan A =

Plan B =

State =

Employer =

ISSUES

(1) Whether employees have constructive receipt of amounts refunded to the employer from a qualified plan (Plan A), which amounts represent erroneous contributions that were made by the employer to the qualified plan and which are in the possession of the employer.

(2) Whether the employer may transfer a portion of the above returned contributions into the correct retirement plan, Plan B, without income tax consequences to the employees.

(3) If an employer pays Federal Insurance Contributions Act (FICA) taxes that may no longer be assessed under the applicable statute of limitations, whether the employees would be entitled to a refund of the employee portion of the FICA taxes.

(4) Whether an exception to the assessment statute of limitations exists for administrative errors related to amounts that were designated as employee contributions to a qualified plan.

CONCLUSIONS

(1) These distributions to the employer are not subject to section 402 of the Internal Revenue Code governing distributions to a beneficiary of a trust. Therefore, under the submitted facts, the employees are not in constructive receipt of the erroneous contributions that have been refunded by the qualified plan to the employer and that are in the possession of the employer.

(2) It may be possible to handle the case under the Audit Cap Program. Thus, it may be possible to fashion a correction methodology that would allow the employers to contribute a portion of the refund from Plan A to Plan B.

(3) The employee would not be entitled to a refund of employee FICA taxes paid by the employer.

(4) No applicable exception exists to the statute of limitations for purposes of making FICA tax assessments.

FACTS

The discussion of the facts herein is based on the information submitted and should not be considered as a definitive statement of either (a) the qualified status of either Plan A or Plan B, (b) whether the employee contributions are includible in the gross income of the employees at the time contributions are made to Plan A or Plan B, or (c) whether remuneration paid to participants in Plan A or Plan B is subject to social security taxes (i.e., the tax imposed by sections 3101(a) and 3111(a)).

According to the facts submitted, the employer, a school district of a State, contributed certain amounts as employee contributions to a State plan qualified under section 401(a), Plan A. The employee contributions were not included in the gross income of the employee at the time the contributions are made (presumably because the employee contributions were “picked up” and paid by the employer under section 414(h)(2)). The wages of participants in Plan A are not subject to the social security tax portion (i.e., sections 3101(a) and 3111(a)) of the FICA tax.

It was later discovered that the employer’s contributions to Plan A on behalf of some of its employees were erroneous, and the employer should have made contributions from the workers’ salaries to another section 401(a) plan, Plan B. The wages of participants in Plan B are subject to the social security tax portion of the FICA tax, and the employee contributions that should have been made to Plan B would also have been not includible in the gross income of the employees at the time contributed to Plan B. When Plan A discovered that some of the employees for whom contributions were made were not entitled to participate, it repaid the erroneous contributions, plus interest, to the employer. Under the facts at the time the request was submitted, the employer has possession of the refunded contributions. The employer intends to make corrections and pay the social security tax for the years that are open under the statute of limitations. However, some of these employees’ wages were paid in years for which the statute of limitations for purposes of assessment has expired.

LAW AND ANALYSIS

(1) Under the circumstances, any distributions to the employees would be made by the employers and not by Plan A. Therefore, we do not believe these distributions are subject to section 402 governing distributions to a beneficiary of a trust.

Accordingly, under the submitted facts, the employees are not in constructive receipt of distributions that are in the possession of the employer and have not been paid to the employees.

(3) Section 3101 imposes the employee portion of the FICA taxes on the wages received by an employee with respect to employment. Under section 3102(a), the tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Section 3102(b) provides that every employer required to deduct the FICA employee tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

The period of limitations on assessments of FICA taxes is found in section 6501. Section 6501 provides generally, except as otherwise provided in section 6501, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed.

Section 6501(b)(2) provides that for purposes of section 6501, if a return of tax imposed by chapter 3, 21, or 24 for any period ending with or within a calendar year is filed before April 15 of the succeeding calendar year, such return shall be considered filed on April 15 of such calendar year. FICA taxes are imposed under chapter 21.

Section 6501(c) contains a number of exceptions to the general rule contained in section 6501(a). For example, section 6501(c)(4) provides an exception where before the expiration of the time prescribed for the assessment of the tax, both the Secretary and the taxpayer consent in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. Section 6501(c)(4) further provides that the period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

Section 301.6511(a)-1(a) of the Procedure and Administration Regulations provides that in the case of any tax (other than a tax payable by stamp), if a return is filed, a claim for credit or refund of an overpayment must be filed by the taxpayer within 3 years from the time the return was filed or within 2 years from the time the tax was paid, whichever of such periods expires the later.

The period of limitations on claims for refund or credit is found in section 6511. Section 6511 generally provides that claim for credit or refund of an overpayment of tax in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.

Section 6513(a) provides that for purposes of section 6511, any return filed before the last day prescribed for the filing thereof shall be considered as filed on such last day. Section 6513(c) provides, in part, that, notwithstanding section 6513(a), for purposes of section 6511 with respect to any tax imposed by chapter 21 – (1) if an return for any period ending with or within a calendar year if filed before April 15 of the succeeding calendar year, such return shall be considered filed on April 15 of such succeeding calendar year, and (2) if a tax with respect to remuneration or other amount paid during any period ending with or within a calendar year is paid before April 15 of the succeeding calendar year, such tax shall be considered paid on April 15 of such succeeding calendar year.

Section 6413(a)(1) provides that proper adjustment of both the tax and the amount to be deducted must be made without interest, as prescribed by regulations, if more than the correct amount of FICA tax is paid with respect to any payment of remuneration. Section 6413(b) states that the amount of such overpayment must be refunded, as provided by regulations, if an adjustment under section 6413(a) cannot be made.

Section 6205(a) provides for the proper adjustment of both the tax and the amount to be deducted if less than the correct amount of employer or employee FICA tax is paid with respect to any payment of wages. Section 31.6205-1(b)(3) of the Employment Tax Regulations states that if an employer collects no employee tax or less than the correct amount of employee tax from an employee with respect to a payment of wages, the employer shall collect the amount of the undercollection by deducting such amount from remuneration of the employee, if any, under his control after he ascertains the error. Such deductions may be made even though the remuneration, for any reason, does not constitute wages. If a deduction is not made, the obligations of the employee to the employer for the undercollection is a matter of settlement between the employee and the employer.

Section 6401(a) provides that the term “overpayment” includes that part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation applicable thereto.

The authority provided in section 31.6205-1(b)(3) for the employer to make deductions from the other remuneration of the employee for collection of FICA employee tax from the employee in an adjustment situation is subject to the

applicable period of limitations. The authority under these regulations to withhold from other employee remuneration to pay FICA employee tax does not extend to withholding to make an adjustment and pay an employee FICA tax if the employer knows that liability for that tax has expired under the employer's and employee's period of limitations for assessment. Thus, an employer making a voluntary payment of tax in a situation where the employer knows the liability for that tax has expired under the employer's and employee's period of limitations for assessment could make the payment only from its own funds. Because the employer would be making the payment from its own funds, only the employer would be entitled to any refund of taxes related to this overpayment of the tax. See Rev. Rul. 83-136, 1983-1 C.B. 244.

We note that there may be an issue under State law with respect to any liability existing between the employer and the employees with respect to the refunded employee contributions from the qualified plan, but that issue is outside our jurisdiction.

(4) There is no applicable exception to the period of limitations. The exception for extensions of the statute of limitations found in section 6501(c)(4) does not apply because any attempted extension here would be after the running of the period of limitations. Cf. King v. Merit Systems Protection Board, 105 F.3d 635 (Fed. Cir. 1997), in which "there was an incorrect allocation of ... withheld [amounts from a federal employee's salary] within the [federal] government." 105 F.3d 640.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Joyce Kahn, Manager, Voluntary Compliance indicated that should taxpayers wish to pursue the Audit Cap option, they should coordinate with her on this case.

Please call if you have any further questions.