

paragraph (f)(5)(ii) is equal to 90 percent of the fair market value of plan assets. If the value of plan assets determined under this paragraph (f)(5)(ii) is greater than 110 percent of the fair market value of plan assets on the valuation date, then the value of plan assets under this paragraph (f)(5)(ii) is equal to 110 percent of the fair market value of plan assets.

(B) *Subtraction of credit balance.* If a plan has a funding standard account credit balance as of the valuation date for the plan's pre-effective plan year, that balance is subtracted from the net asset value described in paragraph (f)(5)(ii)(A) of this section as of that valuation date.

(C) *Effect of funding standard carryover balance reduction for first effective plan year.* Notwithstanding paragraph (f)(5)(ii)(B) of this section, if, for the first effective plan year, the employer has made an election to reduce some or all of the funding standard carryover balance as of the first day of that year in accordance with § 1.430(f)-1(e), then the present value (determined as of the valuation date for the pre-effective plan year using the valuation interest rate for that pre-effective plan year) of the amount so reduced is not treated as part of the funding standard account credit balance when that balance is subtracted from the asset value under paragraph (f)(5)(ii)(B) of this section.

(6) *Transition rule for determining at-risk status.* In the case of plan years beginning in 2008, 2009, and 2010, paragraph (b)(1)(i) of this section is applied by substituting the following percentages for "80 percent"—

- (i) 65 percent in the case of 2008;
- (ii) 70 percent in the case of 2009; and
- (iii) 75 percent in the case of 2010.

**Linda E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 31

[REG-111583-07]

RIN 1545-BG50

#### Employment Tax Adjustments

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed amendments to regulations relating to employment tax adjustments and employment tax refund claims. These proposed amendments modify the process for making interest-free adjustments for both underpayments and overpayments of Federal Insurance Contributions Act (FICA) and Railroad Retirement Tax Act (RRTA) taxes and Federal income tax withholding (ITW) under sections 6205(a) and 6413(a), respectively, of the Internal Revenue Code (Code). These proposed amendments also modify the process for filing claims for refund of overpayments of employment taxes under sections 6402 and 6414.

These amendments are proposed in connection with the IRS's development of new forms to report adjustments to employment taxes which will replace the existing process of reporting adjustments of employment taxes on regularly filed employment tax returns. These proposed amendments affect taxpayers that file Form 941, "Employer's QUARTERLY Federal Tax Return," Form 943, "Employer's Annual Tax Return for Agricultural Employees," Form 944, "Employer's ANNUAL Federal Tax Return," Form 945, "Annual Return of Withheld Federal Income Tax," and Form CT-1, "Employer's Annual Railroad Retirement Tax Return," and any related Spanish-language returns or returns for U.S. possessions.

This document contains proposed amendments to regulations relating to the return requirements under section 6011 to reflect the changes to the adjustment and refund processes, and to reflect additional statutory and process updates. This document also contains proposed amendments to the regulations under section 6302 to clarify deposit obligations with respect to interest-free adjustments of underpayments and the effect of adjustments and refunds on the deposit schedule of a Form 943 filer.

This document also provides notice of a public hearing on these proposed amendments to the regulations.

**DATES:** Written or electronic comments must be received by March 27, 2008. Requests to speak (with outlines of topics to be discussed) at the public hearing scheduled for April 17, 2008, must be received by March 27, 2008.

*Applicability Dates:* See the Proposed Dates of Applicability section of the **SUPPLEMENTARY INFORMATION.**

*Effective Date:* See the Proposed Effective Date section of the **SUPPLEMENTARY INFORMATION.**

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-111583-07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-111583-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS-REG-111583-07). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, please contact Ligeia M. Donis of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-0047; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, please contact Richard Hurst at [Richard.A.Hurst@irscounsel.treas.gov](mailto:Richard.A.Hurst@irscounsel.treas.gov) or (202) 622-7180 (not toll-free numbers).

#### **SUPPLEMENTARY INFORMATION:**

##### **Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by February 29, 2008. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these proposed regulations is in §§ 31.6011(a)-1, 31.6011(a)-4,

31.6011(a)-5, 31.6205-1, 31.6402(a)-2, 31.6413(a)-1, 31.6413(a)-2, and 31.6414-1. This information is required by the IRS to verify compliance with return requirements under section 6011, employment tax adjustments under sections 6205 and 6413, and claims for refund of overpayments of employment taxes under sections 6402 and 6414. This information will be used to determine whether the amount of tax has been reported and calculated correctly. The likely respondents are employers.

*Estimated total annual reporting and/or recordkeeping burden:* 15,000,000 hours.

*Estimated average annual burden per respondent:* 10 hours.

*Estimated number of respondents:* 1,500,000.

*Estimated annual frequency of responses:* on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## Background

These proposed regulations are part of the IRS's effort to reduce taxpayer burden by permitting employers to make employment tax adjustments on a separately filed form as soon as an error is ascertained, rather than as a line adjustment on the employer's regularly filed employment tax return.

These proposed regulations amend the Employment Tax Regulations (26 CFR part 31) under section 6011 relating to the requirement to file a return, under sections 6205(a) and 6413(a) relating to the process for making adjustments of underpayments and overpayments, respectively, of employment taxes, under section 6302 relating to deposit obligations, and under sections 6402 and 6414 relating to the process of filing a claim for refund for an overpayment of employment taxes. For purposes of these proposed amendments to the regulations, the term *employment taxes* means the Federal Insurance Contributions Act (FICA) tax (both the Social Security and Medicare portions) imposed on both the employer and the employee, the Railroad Retirement Tax Act (RRTA) tax imposed on both the employer and employee, and federal

income tax withholding (ITW). To the extent that other types of withholding are treated as ITW under section 3402(a) (that is, gambling withholding, pension withholding, and backup withholding as set forth in sections 3402(q)(7), 3405(f), and 3406(h)(10), respectively), these other types of withholding are included in the term "employment taxes".

### *Interest-Free Adjustments*

Generally, the Internal Revenue Code (Code) requires that interest be paid to the IRS on any underpayment of tax and that interest be allowed and paid to the taxpayer on any overpayment of tax. See sections 6601(a) and 6611(a), respectively. An exception to the general rule, however, applies uniquely to employment taxes. Where an amount other than the correct amount of tax imposed by sections 3101 (employee FICA tax), 3111 (employer FICA tax), 3201 (employee RRTA tax), 3221 (employer RRTA tax), or 3402 (ITW) is reported to the IRS with respect to any payment of wages or compensation, sections 6205(a) and 6413(a) permit employers to make interest-free adjustments for underpayments and overpayments, respectively. Where the correct amount of tax has been reported but not paid, no adjustment to the amount is necessary; accordingly, the interest-free adjustment rules do not apply.

The legislative history of the predecessors to sections 6205 and 6413 indicates that the interest-free adjustment process was envisioned as a way to fix errors made in prior return periods as soon as they were discovered, without the need to go through more burdensome procedures. The adjustment process was designed to permit the employer to adjust, without interest, overpayments and underpayments of tax without the necessity in the former case of requiring the filing of a claim for refund and in the latter case of a notice and demand by the IRS for additional tax. Thus, the legislative history shows that Congress envisioned a process whereby the employer would correct prior errors, separate from the refund and notice and demand processes. Moreover, the legislative history indicates that Congress assumed that an overpayment adjustment would be accepted by the IRS only after the employer had returned to the employee any amount of previously overwithheld tax.

The existing regulations under section 6205(a) set forth the procedures for making interest-free adjustments for underpayments of employment taxes. They provide that if a return is filed and

less than the correct amount of employee or employer portions of FICA or RRTA tax is reported and paid, the employer shall adjust the underpayment (a) by reporting the additional amount due as an adjustment on a current return, or (b) by reporting such additional amount on a supplemental return. The IRS has not issued guidance or procedures for filing a supplemental return, other than indicating that the forms used to accept an assessment of employment taxes after an examination (that is, Form 2504, "Agreement and Collection of Additional Tax and Acceptance of Overassessment (Excise or Employment Tax)", and Form 2504-WC, "Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment in Worker Classification Cases (Employment Tax)") constitute supplemental returns for purposes of permitting the assessment to be made without interest. See Rev. Rul. 75-464 (1975-2 CB 474). Accordingly, outside of the examination context, interest-free adjustments of employment tax are made on a current return. (See § 601.601(d)(2)(ii)(b)).

The reporting of an underpayment of FICA tax or RRTA tax constitutes an interest-free adjustment when the underpayment is reported on a current return only if the current return is filed on or before the last day on which the return is required to be filed for the return period in which the error is ascertained. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it. If the amount of the underpayment is paid to the IRS by the due date for reporting the adjustment, it is paid without interest. However, if the underpayment is reported but the amount is not paid when due, interest begins to accrue from the due date for reporting the adjustment. The rules are the same for adjusting underpayments of ITW when less than the correct amount has been withheld, except that adjustments on the current return can only be made on a return for a return period in the same calendar year in which the wages or compensation is paid. Although the regulations do not address it, the relevant forms and instructions permit employers to adjust administrative errors involving ITW, that is, errors involving the inaccurate reporting of the amount withheld, and errors discovered as part of an examination for previous calendar years.

The existing regulations provide that an interest-free adjustment for an underpayment may not be made after a taxpayer has received notice and

demand from the IRS for payment of the amount based on an assessment or after a taxpayer has received a Notice of Determination of Worker Classification.

An underpayment adjustment may only be made within the period of limitations for assessment under section 6501(a) (generally 3 years from the date the original return is filed). Section 6501(b)(2) provides that, for purposes of section 6501, employment tax returns reporting FICA tax or ITW for any return period ending with or within a calendar year filed before April 15 of the succeeding calendar year will be deemed filed on April 15 of such succeeding calendar year.

The regulations also provide that where an employer fails to collect the correct amount of employee tax (either the employee share of FICA tax, the employee share of RRTA tax) or ITW with respect to wages or compensation paid during a given return period and discovers that error before it files the return for such return period, the employer is still required to report and pay the correct amount on a timely basis. If the employer fails to report and pay the correct amount, any subsequent correction of that error will not qualify as an interest-free adjustment. However, if the employer files a FICA tax return and should have filed a RRTA tax return, or vice versa, and reports and pays less than the correct amount of tax, an interest-free adjustment may be made by filing the correct type of return for each return period and reporting the additional amount of tax.

The existing regulations under section 6413(a) set forth the procedures for making interest-free adjustments for overpayments of employment taxes. They provide that, if an employer ascertains an overpayment error within the applicable period of limitations on credit or refund, the employer is required to repay or reimburse its employees the amount of overcollected employee FICA tax or employee RRTA tax prior to the due date of the return for the return period after the return period in which the error was ascertained and prior to the expiration of the applicable period of limitations. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it. An employer "reimburses" an employee by applying the overwithheld amount against taxes to be withheld on future wages. The employer must retain appropriate records to reflect that the employee has been repaid or reimbursed and that the employee has not filed a claim for refund of such tax or that any filed claim has been rejected.

The applicable period of limitations is set forth in section 6511 and is generally 3 years from the date the original return was filed or 2 years from the date the tax was paid, whichever is later. Section 6513(c)(1) provides that, for purposes of section 6511, employment tax returns reporting FICA tax or ITW for any return period ending with or within a calendar year filed before April 15 of the succeeding calendar year will be deemed filed on April 15 of such succeeding calendar year. Section 6513(c)(2) provides that if FICA tax or ITW with respect to remuneration or other amount paid during any return period ending with or within a calendar year is paid before April 15 of the succeeding calendar, for purposes of section 6511 such tax will be deemed paid on April 15 of such succeeding calendar year.

Once an employer repays or reimburses an employee, the employer may report both the employee and employer portions of FICA or RRTA tax as an overpayment on a current return. The reporting of the overpayment constitutes an interest-free adjustment if the overpayment is reported on a current return filed on or before the last day on which the return is required to be filed for the return period following the return period in which the error was ascertained. Because of the requirement to repay or reimburse employees, employers are given an extra return period in which to repay or reimburse their employees and make the adjustment. Similar rules apply for making interest-free adjustments for overpayments of ITW, except that an interest-free adjustment may only be made if the employer ascertains the error and repays or reimburses its employees within the same calendar year that the wages were paid and reports the adjustment on a return for such calendar year. For example, if an employer who is a Form 941 filer discovers an overpayment of ITW on December 15, 2009 for wages paid in June 2009, the employer must repay or reimburse its employees by December 31, 2009 and must report the adjustment on the fourth quarter 2009 Form 941.

An overpayment adjustment under section 6413(a) must be made within the period of limitations for credit or refund of the overpayment, as set forth in section 6511 and described above. The adjustment may be limited in amount under section 6511(b)(2) as described above. An interest-free adjustment for an overpayment may not be made once a claim for refund has been filed.

Currently, an interest-free adjustment, whether for an underpayment or an overpayment, is made by entering the

amount as a line adjustment on a current return and including the amount in calculating the current return period's liability on the return. The current return period adjustment can be made on Form 941, "Employer's QUARTERLY Federal Tax Return," Form 943, "Employer's Annual Tax Return for Agricultural Employees," Form 944, "Employer's ANNUAL Federal Tax Return," Form 945, "Annual Return of Withheld Federal Income Tax," or Form CT-1, "Employer's Annual Railroad Retirement Tax Return," and on any related Spanish-language returns or returns for U.S. possessions. The return on which the underpayment or overpayment adjustment is entered must include an attached statement explaining the adjustment, designating the return period in which the error occurred, and setting forth such other information as is required by the regulations and by the instructions relating to the return. Form 941c, "Supporting Statement to Correct Information," qualifies as such attached statement and includes the necessary certifications to establish that the employer has satisfied the requirements to repay or reimburse its employee for overpayment adjustments and to obtain statements that the employee has not filed a claim for refund or that the claim has been rejected.

#### *Claims for Refund*

For overpayments of employment taxes, section 6413(b) permits the filing of a claim for refund when an interest-free adjustment cannot be made. The existing regulations under section 6413(a) provide that an adjustment cannot be made after a claim for refund is filed. Under the regulatory authority in section 6413(b), the IRS has permitted taxpayers to choose between filing a claim for refund pursuant to section 6402(a) and making an interest-free adjustment pursuant to section 6413(a) to correct an overpayment of employment taxes. The preamble to Treasury decision 6472 (1960-2 CB 351), which promulgated the existing regulations, indicated an intent to make the overpayment adjustment process permissive. An extensive evaluation of these regulations in the late 1970's confirmed the optional nature of the overpayment adjustment process, and is reflected in Rev. Rul. 81-310 (1981-2 CB 241). (See § 601.601(d)(2)(ii)(b)).

Under section 6402(a), the IRS, within the applicable period of limitations on credit or refund, may credit the amount of an overpayment, including any interest, against any tax liability of the person who made the overpayment and

shall, subject to certain offsets, refund any balance to such person. A claim for refund under section 6402(a) must be filed within the period of limitations on credit or refund as set forth in section 6511. Such refund may be limited in amount pursuant to section 6513(c)(2). Claims for refund are not granted automatically and the IRS is not required to act on the refund claim. Section 6532(a) provides that a taxpayer cannot file a suit for refund before the expiration of 6 months from the date of filing a claim for refund unless the IRS renders a decision on the claim within that time. The taxpayer must file suit within 2 years of the date the claim was disallowed.

The existing regulations under section 6402(a) set out the procedures for filing a claim for refund of overpaid FICA and RRTA taxes. The regulations permit an employer to file a claim for refund for an overpayment of FICA or RRTA tax, but require the employer to include a statement that the employer has repaid the employee's share of FICA or RRTA tax to the employee or has secured the written consent of the employee to allowance of the refund or credit. The employer must retain appropriate records reflecting that it has repaid its employee or obtained the employee's consent and that the employee has not filed a claim for refund of such tax or that any filed claim has been rejected.

Section 6414 permits refunds of ITW only to the extent the amount of the ITW overpayment was not actually deducted and withheld from an employee. The existing regulations under section 6414 set out the procedures for filing a claim for refund of overpaid ITW and are similar to the procedures for filing a claim for refund of overpaid FICA or RRTA tax, except that an employer may not file a claim for an overpayment of ITW for an amount the employer deducted or withheld from an employee.

An employer makes a claim for refund by filing Form 843, "Claim for Refund and Request for Abatement", with a Form 941c attached (or an equivalent statement). Form 941c includes the amounts to be refunded and the necessary certifications to establish that the employer has repaid the employee or obtained the employee's consent to filing the claim for refund, and has obtained a statement that the employee has not filed a claim for refund or that the claim has been rejected.

#### *Reason for Amendments*

The current process for adjusting underpayments or overpayments of employment taxes raises a number of issues both for employers and the IRS,

primarily because the current process requires employers to make adjustments to past return periods in connection with the filing of their current returns. The IRS believes it will reduce the burden for taxpayers, as well as improve tax administration, if the adjustment process for employment tax returns is revised by creating a separate "adjusted return" to make adjustments to past return periods that can be filed independently of a return for any other return period.

#### **Explanation of Provisions**

##### *Adjusted Return Replaces Current Return Process*

The proposed amendments change the process by which employers can make interest-free adjustments to correct underpayments or overpayments of employment tax. The proposed amendments to the regulations eliminate the existing process that uses the current return to make adjustments and replace it with a new process which will use a separately filed adjusted return to make adjustments. Unlike Form 941c, the new adjusted return will not be filed as an attachment to a current return and will not affect the liability reported on the current return.

The proposed amendments to the regulations also eliminate any reference to the use of supplemental returns to make adjustments. The proposed amendments provide that Forms 2504 and 2504-WC will be treated as adjusted returns under the same rationale and criteria that they have been treated as supplemental returns under Rev. Rul. 75-464. Thus, corrections reported on these forms following an examination will continue to be eligible for interest-free adjustment treatment. See § 601.601(d)(2)(ii)(b).

The proposed amendments to the regulations do not affect the existing rules on correcting undercollections of employee tax (either the employee share of FICA or RRTA tax), or ITW when an employer discovers the error during the return period in which the undercollection occurred. In such case, the employer must report and pay the correct amount on a timely basis as if the correct amount of tax had been collected. If the employer fails to report and pay the correct amount, any subsequent correction of that error will not be an interest-free adjustment.

##### *Time for Filing Adjusted Return*

An employer may file an adjusted return correcting an underpayment or an overpayment as soon as the employer ascertains the underpayment or overpayment error, rather than waiting

to report the adjustment with the regularly filed employment tax return. The adjusted return for an underpayment may only be filed within the applicable period of limitations for assessing the underpayment, and the adjusted return for an overpayment may only be filed before the 90th day prior to the expiration of the applicable period of limitations on credit or refund. If the original return reporting FICA tax or ITW for the return period in which the wages were paid was timely filed and the taxes were timely paid, the limitations period for both assessment and credit or refund begins to run on April 15 of the year following the year in which the wages were paid and ends three years after that. Thus, for example, if wages are paid on June 6, 2009, and an original employment tax return reporting those wages is filed July 31, 2009 and the reported taxes are timely paid, the period of limitations for assessment or for credit or refund would expire April 15, 2013. An adjusted return reporting an underpayment must be filed by April 15, 2013. An adjusted return reporting an overpayment must be filed by January 15, 2013, the date which is 90 days before the expiration of the period of limitations on credit or refund. A claim for refund for the same overpayment will be timely if filed by April 15, 2013.

The proposed amendments to the regulations provide that an adjustment will be interest-free only if it is reported on an adjusted return within a certain amount of time after it is discovered. Specifically, the adjusted return reporting an underpayment must be filed by the due date of the return for the return period in which the error is ascertained; the amount of the underpayment must be paid by the time the adjusted return is filed, or interest will begin to accrue from the date the adjusted return is filed. In addition, subject to limited exceptions, for underpayments of ITW where the incorrect amount was withheld, an adjusted return may be filed only for errors ascertained during the calendar year in which the wages were paid and must be filed by the due date of the return for the return period in which the error is ascertained. In addition, for overpayments of ITW where the incorrect amount was withheld, the adjusted return may be filed only for errors ascertained during the calendar year in which the wages were paid, the employer must repay or reimburse the employees within the same calendar year that the wages were paid, and the adjusted return must be filed by the due date of the return for the return period

following the return period in which the error is ascertained.

#### *Treatment as Interest-Free Adjustment Where Original Return Never Filed*

The proposed amendments to the regulations also provide that interest-free adjustments for underpayments of FICA tax, RRTA tax, and ITW are available under certain circumstances where the underpayment arises because the employer failed to file an original return. As in the existing regulations, an interest-free adjustment is available if an employer filed a FICA tax return when a RRTA tax return should have been filed, or vice versa. In addition, interest-free adjustment treatment is generally available if an employer failed to file a return for a return period solely because the employer failed to treat any individuals as employees. The latter interest-free adjustment provision was originally proposed in 1992 (EE-12-92, 57 FR 58423) and is being re-proposed as part of these proposed amendments to the regulations. The proposed regulations in EE-12-92 will be withdrawn once these proposed amendments to the regulations are finalized.

To constitute an interest-free adjustment in these circumstances, the employer must file an original return of the correct type for each return period for which the employer failed to file the correct return and report on the return the additional amount of tax. Generally, such reporting will constitute an interest-free adjustment if the return is filed by the due date of the return for the return period in which the error is ascertained. The amount reported must be paid by the time the original return is filed or interest will accrue from that date.

#### *Repayment or Reimbursement of Employees Required for Interest-Free Adjustments of Overpayments*

When an overpayment error is ascertained, the proposed amendments to the regulations retain the rule that the employer must repay or reimburse the employee's share of FICA or RRTA tax before making the overpayment adjustment of both the employees' and employer's taxes. Such repayment or reimbursement must occur by the due date of the return for the return period following the return period in which the error is ascertained and within the applicable period of limitations on credit or refund. However, the requirement to repay or reimburse does not apply to the extent that taxes were not withheld from the employee or if, after reasonable efforts, the employer cannot locate the employee; in such

case, the employer may make an adjustment for only the employer share of FICA or RRTA tax. The adjusted return reporting the overpayment may only be filed once the employer has repaid or reimbursed its employees to the extent required. The employer must certify on the adjusted return that it has repaid or reimbursed its employees to the extent required. Because repayment or reimbursement of overwithheld ITW must be made within the same calendar year, and annual Forms 943, 944, and 945 are normally filed after the close of the calendar year, there can be no repayment or reimbursement of ITW after filing such annual returns. Thus, no overpayment adjustments of ITW can generally be made for such returns, except for administrative errors, that is, errors involving the inaccurate reporting of the amount actually withheld. Note that in the case of backup withholding reported on Form 945, repayment of erroneous withholding is not required and is permitted only in certain circumstances. See § 31.6413(a)-3.

#### *Deposits, Payments, and Credits*

The proposed amendments to the regulations under section 6302 provide that an employer making an interest-free adjustment must pay the amount of the adjustment by the time it files an adjusted return; such timely payment will satisfy the employer's deposit obligations with respect to the adjustment. In addition, the proposed amendments to the regulations governing agricultural employers (Form 943 filers) provide that for purposes of determining the amount of accumulated taxes in the employer's lookback period (which determines the employer's deposit schedule), adjustments to tax liability made pursuant to the filing of adjusted returns or claims for refund will not be taken into account. This rule is consistent with the rule already in effect with respect to Form 941 and Form 944 filers that adjustments to prior return periods are not taken into account in determining the employment tax liability for such prior return period. See § 31.6302-1T(b)(4).

For interest-free adjustments of underpayments, the amount must be paid when the adjusted return is filed. If the amount is not paid when the adjusted return is filed, interest will begin to accrue as of the date the adjusted return is filed.

Consistent with the legislative history of section 6413, the adjusted overpayment amount will be applied as a credit toward payment of the employer's liability for the calendar quarter (or calendar year for annual returns being adjusted) in which the

adjusted return is filed, unless the IRS notifies the employer that the credit will be applied to a different return period or that the employer is not entitled to the adjustment under applicable laws or procedures.

#### *Refunds for Overpayments*

As in the existing regulations, in lieu of making an interest-free adjustment for an overpayment, employers may file a claim for refund pursuant to section 6402 or 6414 for the amount of the overpayment. Furthermore, if an employer cannot make an interest-free adjustment with respect to an overpayment because the period of limitations for claiming a credit or refund for such overpayment will expire within 90 days or because the IRS has otherwise notified the employer that it is not entitled to the adjustment, the employer may recover the overpayment only by filing a claim for refund. The proposed amendments to the regulations under section 6414 continue to provide that an employer can only file a claim for refund for ITW that was not withheld from the employee. Prior to filing a claim for refund under section 6402 for FICA or RRTA tax, employers must either repay or reimburse the employees or obtain the employees' consents to the allowance of the refund, except to the extent that the overpayment does not include taxes withheld from the employee or, after reasonable efforts, the employer cannot locate the employee or the employee will not provide the requested consent. The employer must certify that it has either repaid or reimbursed the employee or obtained the employee's consent to the extent required.

Under the proposed amendments to the regulations, employers will file the prescribed form to claim a refund. However, Form 941c will no longer be used as an attachment to a claim for refund.

#### *Tax Returns or Statements*

This notice of proposed rulemaking also proposes amendments to the regulations for reporting employment taxes under section 6011 to reflect the changes to the adjustment and refund processes. In particular, the proposed amendments remove references to Form 941c from the regulations under section 6011 because Form 941c will no longer be used. The proposed amendments also remove references to other obsolete tax returns, add references to current tax returns in use, and make minor stylistic changes to the text of the regulations.

The proposed amendments also update the section 6011 regulations to conform to current law due to the

enactment of section 3510, added to the Code by section 2(b)(1) of the Social Security Domestic Employment Reform Act of 1994 (Public Law 103-387), which mandates annual returns for domestic service employment taxes, and to reflect current procedures. Schedule H (Form 1040), rather than Form 942, is the prescribed form for reporting wages for domestic service in a private home paid in calendar years beginning after December 31, 1994. If an employer is required to file Form 941, Form 943, or Form 944, the employer may choose to report wages with respect to domestic workers on Form 941, Form 943, or Form 944, instead of reporting such wages on Schedule H (Form 1040).

#### Proposed Effective Date

The amendments to the regulations as proposed will be effective on the date they are published as final regulations in the **Federal Register**.

#### Proposed Dates of Applicability

With respect to the regulations under Code sections 6205, 6302, 6402, 6413, and 6414, the regulations, as proposed, apply to any error ascertained on or after January 1, 2009.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

Because the regulations under section 6302 do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

The proposed amendments to the regulations under section 6011, 6205, 6402, 6413, and 6414 affect all taxpayers that file employment tax returns. Therefore, the IRS has determined that these proposed amendments will have an impact on a substantial number of small entities.

The IRS has determined, however, that the impact on entities affected by the proposed amendments to the regulations will not be significant. The proposed amendments to the regulations require taxpayers who file employment tax returns and who make interest-free adjustments to their employment taxes for either underpayments or overpayments or who file claims for refund for an overpayment of employment tax to provide an explanation setting forth the basis for the correction or the claim in

detail, designating the return period in which the error was ascertained and the return period being corrected, and setting forth such other information as may be required by the instructions to the form. In addition, for adjustments of overpayments and for claims for refund, taxpayers must also obtain and retain the written receipt of the employee showing the date and amount of the repayment, or the written consent of the employee. For purposes of overpayment adjustments and claims for refund of employee FICA and RRTA tax overcollected in an earlier year, the employer must also obtain and retain the written statement from the employee providing that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and that the employee will not claim refund or credit of the amount.

This collection of information is not new to the proposed regulations and has been in existence since the 1960s, when the existing regulations were promulgated. In addition, the proposed amendments to the regulations are being made in conjunction with a project of the Office of Taxpayer Burden Reduction which seeks to revise the process for making corrections to employment tax returns to make it less burdensome to taxpayers. The filing of a claim for refund and the making of an interest-free adjustment pursuant to both the existing and proposed regulations are voluntary on the part of taxpayers.

Based on these facts, the IRS hereby certifies that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing has been scheduled for April 17,

2008, at 10 a.m., in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments and an outline of the topics to be discussed and the time to be devoted to each topic by March 27, 2008.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal author of these proposed regulations is Ligeia M. Donis of the Office of the Division Counsel/ Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

#### **PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE**

**Paragraph 1.** The authority citation for part 31 continues to read, in part, as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

**Par. 2.** Section 31.6011(a)–1 is amended by revising paragraphs (a)(2), (a)(3), (a)(4) and (c) to read as follows:

**§ 31.6011(a)–1 Returns under Federal Insurance Contributions Act.**

(a) \* \* \*

(2) *Employers of agricultural workers.* Every employer who pays wages for agricultural labor with respect to taxes imposed by the Federal Insurance Contributions Act must make a return for the first calendar year in which the employer pays such wages and for each subsequent calendar year (whether or not wages are paid) until the employer has filed a final return in accordance with § 31.6011(a)–6. Form 943, “Employer’s Annual Federal Tax Return for Agricultural Employees,” is the form prescribed for making the annual return required by this section, except that, if the employer’s principal place of business is in Puerto Rico, or if the employer has employees who are subject to income tax withholding for Puerto Rico, the return must be made on Form 943–PR, “Planilla para la Declaración ANUAL de la Contribución Federal del Patrono de Empleados Agrícolas.”

(3) *Employers of domestic workers.* Schedule H (Form 1040), “Household Employment Taxes,” is the form prescribed for use by every employer in making a return as required under paragraph (a)(1) of this section in respect of wages, as defined in the Federal Insurance Contributions Act, paid by the employer in any calendar year for domestic service as defined in section 3510. Schedule H (Form 1040) is generally filed as an attachment to an income tax return, however, if the employer does not otherwise have an obligation to file an income tax return, Schedule H (Form 1040) may be filed as a separate return. If, however, the employer is required under paragraph (a)(1) of this section to make a return on Form 941, “Employer’s QUARTERLY Federal Tax Return,” or under paragraph (a)(2) of this section to make a return on Form 943, “Employer’s Annual Federal Tax Return For Agricultural Employees,” or under paragraph (a)(5) of this section to make a return on Form 944, “Employer’s ANNUAL Federal Tax Return,” the employer may choose instead to report wages with respect to domestic workers on such Form 941, Form 943 or Form 944. If such wages are included on Form 941, Form 943 or Form 944, the employer must also include Federal unemployment tax for the employee(s) on Form 940, “Employer’s Annual Federal Unemployment (FUTA) Tax Return,” under the provisions of § 31.6011(a)–3.

(4) *Employers in Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, or the Commonwealth of the Northern*

*Mariana Islands.* Form 941–PR, “Planilla para la Declaración Federal TRIMESTRAL del Patrono,” (or Form 944–PR, “Planilla para la Declaración Federal ANUAL del Patrono,” if the IRS notified the employer that the Form 944–PR must be filed in lieu of Form 941–PR) is the form prescribed for use in making the return required under paragraph (a)(1) (or (a)(5)) of this section in the case of every employer whose principal place of business is in Puerto Rico, or if the employer has employees who are subject to income tax withholding for Puerto Rico. Form 941–SS, “Employer’s QUARTERLY Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands),” (or Form 944–SS, “Employer’s ANNUAL Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands),” if the IRS notified the employer that Form 944–SS must be filed in lieu of Form 941–SS) is the form prescribed for use in making the return required under paragraph (a)(1) (or (a)(5)) of this section in the case of every employer whose principal place of business is in the U.S. Virgin Islands, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands, or if the employer has employees who are subject to income tax withholding for these U.S. possessions. However, Form 941 (or Form 944 if the IRS notified the employer that Form 944 must be filed in lieu of Form 941) is the form prescribed for making such return in the case of every such employer who is required pursuant to § 31.6011(a)–4 to make a return of income tax withheld from wages.

\* \* \* \* \*

(c) *Adjustments and refunds.* For rules applicable to adjustments and refunds of employment taxes, see sections 6205, 6402, 6413, and 6414, and the applicable regulations.

\* \* \* \* \*

**Par. 3.** Section 31.6011(a)–4 is amended by revising paragraph (a)(2) to read as follows:

**§ 31.6011(a)–4 Returns of income tax withheld.**

(a) \* \* \*

(2) *Wages paid for domestic service.* Schedule H (Form 1040), “Household Employment Taxes,” is the form prescribed for making the return required under paragraph (a)(1) of this section with respect to income tax withheld, pursuant to an agreement under section 3402(p), from wages paid for domestic service in a private home of the employer. Schedule H (Form

1040) is generally filed as an attachment to an income tax return; however, if the employer does not otherwise have an obligation to file an income tax return, Schedule H (Form 1040) may be filed as a separate return. The preceding sentence shall not apply in the case of an employer who has chosen under § 31.6011(a)–1(a)(3) to use Form 941, “Employer’s QUARTERLY Federal Tax Return,” Form 943, “Employer’s Annual Federal Tax Return for Agricultural Employees,” or Form 944, “Employer’s ANNUAL Federal Tax Return,” as the return with respect to such payments for purposes of the Federal Insurance Contributions Act. For the requirements relating for Schedule H (Form 1040) with respect to qualified State individual income taxes, see § 301.6361–1(d)(3)(iv) of this chapter.

\* \* \* \* \*

**Par. 4.** Section 31.6011(a)–5 is amended by revising paragraph (a) to read as follows:

**§ 31.6011(a)–5 Monthly returns.**

(a) *In general—(1) Requirement.* The provisions of this section are applicable in respect of the taxes reportable on returns required pursuant to § 31.6011(a)–1 or § 31.6011(a)–4. An employer (or other person) who is required by § 31.6011(a)–1 or § 31.6011(a)–4 to make quarterly or annual returns on any such form shall, in lieu of making such quarterly or annual returns, make returns of such taxes in accordance with the provisions of this section if the employer is so notified in writing by the IRS. Every employer (or other person) notified by the IRS shall make a return for the calendar month in which the notice is received, for each of the prior calendar months in the return period, and for each calendar month afterwards (whether or not wages are paid in any such month) until the employer has filed a final return or is required to make quarterly or annual returns pursuant to notification as provided in paragraph (a)(2) of this section. Each return required under this section shall be made on the form prescribed for making the return which would otherwise be required of the employer (or other person) under the provisions of § 31.6011(a)–1 or § 31.6011(a)–4, except that, if some other form is furnished by the IRS for use in lieu of such prescribed form, the return shall be made on such other prescribed form. The IRS may notify any employer (or other person)—

(i) Who by reason of notification as provided in § 301.7512–1 of this chapter (Regulations on Procedure and Administration), is required to comply

with the provisions of such § 301.7512-1; or

(ii) Who failed to—

(A) Make any return required pursuant to § 31.6011(a)-1 or § 31.6011(a)-4;

(B) Pay tax reportable on any such form; or

(C) Deposit any such tax as required under the provisions of § 31.6302(c)-1.

(2) *Termination of requirement.* The IRS, in its discretion, may notify the employer in writing that the employer shall discontinue the filing of monthly returns under this section. If the employer is so notified, the IRS will provide the employer with instructions for filing the final monthly return. Afterwards, the employer shall make quarterly or annual returns in accordance with the provisions of § 31.6011(a)-1 or § 31.6011(a)-4.

\* \* \* \* \*

**Par. 5.** Section 31.6205-1 is amended to read as follows:

**§ 31.6205-1 Adjustments of underpayments.**

(a) *In general.* (1) An employer who has undercollected or underpaid employee Federal Insurance Contributions Act (FICA) tax under section 3101 or employer FICA tax under section 3111, employee Railroad Retirement Tax Act (RRTA) tax under section 3201 or employer RRTA tax under section 3221, or income tax required under section 3402 to be withheld, with respect to any payment of wages or compensation, shall correct such error as provided in this section. Such correction may constitute an interest-free adjustment as provided in paragraph (b) or (c) of this section.

(2) No correction will be eligible for interest-free adjustment treatment if the failure to report relates to an issue that was raised in an examination of a prior return period or if the employer knowingly underreported its employment tax liability.

(3) Every correction under this section of an underpayment of tax with respect to a payment of wages or compensation shall be made on the prescribed form that corresponds to the return being corrected. The form, filed in accordance with this section and the instructions, will constitute an adjusted return for the return period being corrected.

(4) Every adjusted return on which an underpayment is corrected pursuant to this section shall designate the return period in which the error was ascertained and the return period being corrected, explain in detail the grounds and facts relied upon to support the correction, and set forth such other information as may be required by the

regulations in this section and by the instructions relating to the form.

(5) For purposes of this section, an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(6) No correction will be eligible for interest-free adjustment treatment pursuant to this section after the earlier of the following:

(i) Receipt from the IRS of notice and demand for payment thereof based upon an assessment.

(ii) Receipt from the IRS of a Notice of Determination of Worker Classification (Notice of Determination) in connection with such underpayment. Prior to receipt of a Notice of Determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit that would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a Notice of Determination and to petition the Tax Court under section 7436.

(7) Subject to the exceptions specified in paragraphs (a)(2) and (a)(6) of this section, Form 2504, "Agreement and Collection of Additional Tax and Acceptance of Overassessment (Excise or Employment Tax)," and Form 2504-WC, "Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment in Worker Classification Cases (Employment Tax)," constitute adjusted returns for purposes of this section.

(8) For provisions related to furnishing employee statements and corrected employee statements reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-1 of this chapter. For provisions relating to filing information returns and corrected information returns reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-2 of this chapter.

(b) *Federal Insurance Contributions Act and Railroad Retirement Tax Act—*

(1) *Undercollection ascertained before return is filed.* If an employer collects less than the correct amount of employee FICA or RRTA tax from an employee with respect to a payment of wages or compensation, and if the employer ascertains the error before filing the return on which the employee tax with respect to such wages or compensation is required to be reported, the employer shall nevertheless report on the return and pay to the IRS the correct amount of employee tax. If the employer does not report and pay the correct amount of tax on a timely basis in these circumstances, the employer

may not later correct the error through an interest-free adjustment.

(2) *Error ascertained after return is filed.* (i) If an employer files a return on which FICA tax or RRTA tax is required to be reported, and reports on the return less than the correct amount of employee or employer FICA or RRTA tax with respect to a payment of wages or compensation, and if the employer ascertains the error after filing the return, the employer shall correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the underpayment of tax by reporting the additional amount due on an adjusted return for the return period in which the wages or compensation was paid, accompanied by a detailed explanation of the amount being reported on the adjusted return and any other information as may be required by this section and by the instructions relating to the form. The reporting of the underpayment on an adjusted return constitutes an adjustment within the meaning of this section only if the adjusted return is filed within the period of limitations for assessment for the return period being corrected, and by the due date for filing the return for the return period in which the error is ascertained. For purposes of the preceding sentence, the due date for filing the adjusted return is determined by reference to the return being corrected. The amount of the underpayment adjusted in accordance with this section must be paid to the IRS by the time the adjusted return is filed. If an adjustment is reported pursuant to this section, but the amount of the adjustment is not paid when due, interest accrues from that date (see section 6601).

(ii) If an employer files a return reporting FICA tax for a return period although the employer was required to file a return reporting RRTA tax, or vice versa, and reports on the return less than the correct amount that should have been reported on the return required to be filed, and if the employer ascertains the error after filing the return, the employer shall correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the underpayment of tax by reporting the additional amount due on an original return for the correct tax for the return period for which the incorrect return was filed, accompanied by a detailed explanation of the amount being reported on the original return and any other information as may be required by the regulations in this section and by the instructions relating to the form. The reporting of the additional amount for



the period constitutes an adjustment within the meaning of this section only if the return is filed by the due date of the return for reporting the correct tax for the return period in which the error is ascertained. The amount of the underpayment adjusted in accordance with this section must be paid to the IRS by the time the return is filed. If an adjustment is reported pursuant to this section, but the amount of the adjustment is not paid when due, interest accrues from that date (see section 6601).

(3) *Return not filed because of failure to treat individual as employee.* If an employer fails to file a return for a return period solely because the employer failed to treat any individuals properly as employees for the return period (and, therefore, failed to withhold and pay any employer or employee FICA or RRTA tax with respect to wages or compensation paid to the employees), and if the employer ascertains the error after the due date of the return, the employer shall correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the underpayment of tax by reporting the amount due on an original return for the return period for which the employer failed to file a return, accompanied by a detailed explanation of the amount being reported on the original return and any other information as may be required by this section and by the instructions relating to the form. The reporting of the correct amount of tax for the return period constitutes an adjustment within the meaning of this section only if the return is filed by the due date of the return for reporting such tax for the return period in which the error is ascertained. The amount of the underpayment adjusted in accordance with this section must be paid to the IRS by the time the return is filed. If an adjustment is reported pursuant to this section, but the amount of the adjustment is not paid when due, interest accrues from that date (see section 6601).

(c) *Income tax required to be withheld from wages—(1) Undercollection ascertained before return is filed.* If an employer collects less than the correct amount of income tax required to be withheld from wages under section 3402, and if the employer ascertains the error before filing the return on which the withheld tax is required to be reported, the employer shall nevertheless report on the return and pay to the IRS the correct amount of tax required to be withheld. If the employer does not report and pay the correct amount of tax on a timely basis in these

circumstances, the employer may not correct the error through an interest-free adjustment.

(2) *Error ascertained after return is filed.* If an employer files a return on which income tax required to be withheld from wages is required to be reported and reports on the return less than the correct amount of income tax required to be withheld, and if the employer ascertains the error after filing the return, the employer shall correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the underpayment of tax by reporting the additional amount due on an adjusted return for the return period in which the wages were paid, accompanied by a detailed explanation of the amount being reported on the adjusted return and any other information as may be required by this section and by the instructions relating to the form. The reporting of the underpayment on an adjusted return constitutes an adjustment within the meaning of this section only if the adjusted return is filed by the due date for filing the return for the return period in which the error is ascertained. For purposes of the preceding sentence, the due date for filing the adjusted return is determined by reference to the return being corrected. However, an adjustment may only be reported pursuant to this section if the error is ascertained within the same calendar year that the wages to the employee were paid, unless the underpayment is attributable to an administrative error, that is, an error involving the inaccurate reporting of the amount actually withheld, or the adjustment is reported on a Form 2504 or Form 2504-WC. The amount of the underpayment adjusted in accordance with this section must be paid to the IRS by the time the adjusted return is filed. If an adjustment is reported pursuant to this section, but the amount of the adjustment is not paid when due, interest accrues from that date (see section 6601).

(3) *Return not filed because of failure to treat individual as employee.* If an employer fails to file a return for a return period solely because the employer failed to treat any individuals properly as employees for the return period (and, therefore, failed to withhold and pay any income tax required to be withheld from wages), the employer shall correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the underpayment of tax by reporting the correct amount on an original return for the return period for which the employer failed to file a

return and pay the tax to the IRS. The reporting of the correct amount of tax for the return period constitutes an adjustment within the meaning of this section only if the return is filed by the due date of the return for reporting such tax for the return period in which the error is ascertained. However, an adjustment may only be reported pursuant to this section if the error is ascertained within the same calendar year that the wages to the employee were paid or section 3509 applies to determine the amount of the underpayment. The amount of the underpayment adjusted in accordance with this section must be paid to the IRS by the time the adjusted return is filed. If an adjustment is reported pursuant to this section, but the amount of the adjustment is not paid when due, interest accrues from that date (see section 6601).

(d) *Deductions from employee—(1) Federal Insurance Contributions Tax Act and Railroad Retirement Tax Act.* If an employer collects less than the correct amount of employee FICA or RRTA tax from an employee with respect to a payment of wages or compensation, the employer must collect the amount of the undercollection by deducting the amount from remuneration of the employee, if any, paid after the employer ascertains the error. Such deductions may be made even though the remuneration, for any reason, does not constitute wages or compensation. The correct amount of an undercollection of employee tax from an employee must be reported and paid, as provided in paragraph (b) of this section, whether or not the undercollection is corrected by a deduction made as prescribed in this paragraph (d)(1), and even if the deduction is made after the return on which the employee tax must be reported is due. If such a deduction is not made, the obligation of the employee to the employer with respect to the undercollection is a matter for settlement between the employee and the employer. If an employer makes an erroneous collection of employee tax from two or more of its employees, a separate settlement must be made with respect to each employee. An overcollection of employee tax from one employee may not be used to offset an undercollection of such tax from another employee. For provisions relating to the employer's liability for the tax, whether or not it collects the tax from the employee, see § 31.3102-1(d). This paragraph (d)(1) does not apply if

section 3509 applies to determine the employer's liability.

(2) *Income tax required to be withheld from wages.* If an employer collects less than the correct amount of income tax required to be withheld from wages during a calendar year, the employer must collect the amount of the undercollection on or before the last day of the year by deducting the amount from remuneration of the employee, if any, paid after the employer ascertains the error. Such deductions may be made even though the remuneration, for any reason, does not constitute wages. The correct amount of an undercollection of income tax from an employee must be reported and paid, as provided in paragraph (c) of this section, whether or not the undercollection is corrected by a deduction made as prescribed in this paragraph (d)(2), and even if the deduction is made after the return on which the tax must be reported is due. If such a deduction is not made, the obligation of the employee to the employer with respect to the undercollection is a matter for settlement between the employee and the employer within the calendar year. If an employer makes an erroneous collection of income tax from two or more of its employees, a separate settlement must be made with respect to each employee. An overcollection of income tax from one employee may not be used to offset an undercollection of such tax from another employee. For provisions relating to the employer's liability for the tax, whether or not it collects the tax from the employee, see § 31.3403-1. For provisions relating to the employer's liability for an underpayment of tax unless the employer can show that the income tax against which the tax under section 3402 may be credited has been paid, see § 31.3402(d)-1. This paragraph (d)(2) does not apply if section 3509 applies to determine the employer's liability.

**Par. 6.** Section 31.6302-0 is amended by adding a new entry for § 31.6302-1(c)(7) to read as follows:

**§ 31.6302-0 Table of contents.**

\* \* \* \* \*

**§ 31.6302-1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.**

\* \* \* \* \*

(c) \* \* \*

(7) *Exception to the monthly and semi-weekly deposit rules for employers making interest-free adjustments.*

\* \* \* \* \*

**Par. 7.** Section 31.6302-1 is amended by adding paragraph (c)(7) and revising paragraph (g)(4) to read as follows:

**§ 31.6302-1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.**

\* \* \* \* \*

(c) \* \* \*

(7) *Exception to the monthly and semi-weekly deposit rules for employers making interest-free adjustments.* An employer filing an adjusted return under § 31.6205-1 to report taxes that were accumulated in a prior return period shall pay the amount of the adjustment by the time it files the adjusted return, and the amount timely paid will be deemed to have been timely deposited by the employer. The payment may accompany the adjusted return, be made by electronic funds transfer, or be made by other methods of payment as provided by the instructions relating to the adjusted return.

\* \* \* \* \*

(g) \* \* \*

(4) *Lookback period.* The tax liability shown on the original return for the return period is the amount taken into account in determining whether the accumulated taxes for the lookback period exceed \$50,000. The employer does not take into account any adjustments to tax liability made pursuant to the filing of adjusted returns or claims for refund pursuant to sections 6205, 6402, 6413 and 6414 filed after the due date of the original return when determining accumulated taxes for the lookback period.

\* \* \* \* \*

**Par. 8.** Section 31.6402(a)-1 is amended by revising paragraph (a) to read as follows:

**§ 31.6402(a)-1 Credits or refunds.**

(a) *In general.* For regulations under section 6402 of special application to credits or refunds of employment taxes, see §§ 31.6402(a)-2, 31.6402(a)-3, and 31.6414-1. For regulations under section 6402 of general application to credits or refunds, see §§ 301.6402-1 and 301.6402-2 of this chapter (Regulations on Procedure and Administration). For provisions relating to adjustments without interest of overpayments of taxes under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act or income tax withholding, see §§ 31.6413(a)-1 and 31.6413(a)-2.

\* \* \* \* \*

**Par. 9.** Section 31.6402(a)-2 is amended by revising paragraph (a) and

removing paragraph (c) to read as follows:

**§ 31.6402(a)-2 Credit or refund of tax under Federal Insurance Contributions Act or Railroad Retirement Tax Act.**

(a) *Claim by person who paid tax to IRS—(1) In general.* (i) Any person may file a claim for credit or refund for an overpayment (except to the extent that the overpayment must be credited pursuant to § 31.3503-1) if the person paid to the IRS more than the correct amount of employee tax under section 3101 or employer tax under section 3111 of the Federal Insurance Contributions Act (FICA), employee tax under section 3201, employee representative tax under section 3211, or employer tax under section 3221 of the Railroad Retirement Tax Act (RRTA), or interest, addition to the tax, additional amount, or penalty with respect to any such tax.

(ii) The claim for credit or refund must be made in the manner and subject to the conditions stated in this section. The claim for credit or refund must designate the return period to which the claim relates, explain in detail the grounds and facts relied upon to support the claim, and set forth such other information as may be required by this section and by the instructions relating to the form used to make such claim. No refund or credit pursuant to this section for employer tax will be allowed unless the employer has first repaid or reimbursed its employee 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. 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. No refund or credit of employee FICA or RRTA tax overcollected in an earlier year will be allowed if the employee has claimed a refund or credit of the amount of the overcollection which has not been rejected or if the employee has taken the amount of such tax into account in claiming a credit against or refund of the employee's income tax, including instances in which the employee has included an overcollection of employee FICA or RRTA tax in computing a special refund (see § 31.6413(c)-1).

(iii) For adjustments without interest of overpayments of taxes under the FICA or the RRTA, see § 31.6413(a)-2.

(iv) For provisions related to furnishing employee statements and

corrected employee statements reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-1 of this chapter. For provisions relating to filing information returns and corrected information returns reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-2 of this chapter.

(v) For the period of limitations on credit or refund of taxes, see § 301.6511(a)-1 of this chapter (Regulations on Procedure and Administration).

(2) *Statements supporting employer's claims for employee tax.* (i) Every claim, filed by an employer, for refund or credit of employee FICA tax under section 3101 or employee RRTA tax under section 3201 collected from an employee must include a certification that the employer has repaid or reimbursed the tax to its employee or has secured the employee's written consent to allowance of the filing of the claim for refund except to the extent that the taxes were not withheld from the employee. The employer must retain as part of its records the written receipt of the employee showing the date and amount of the repayment, evidence of reimbursement, or the written consent of the employee, whichever is used in support of the claim.

(ii) Every claim, filed by an employer, for refund or credit of employee FICA tax under section 3101 or employee RRTA tax under section 3201 collected from an employee in a calendar year prior to the year in which the credit or refund is claimed, also must include a certification that the employer has obtained the employee's written statement that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and that the employee will not claim refund or credit of the amount. The employer must retain the employee's written statement as part of the employer's records.

\* \* \* \* \*

**Par. 10.** Section 31.6413(a)-1 is revised to read as follows:

**§ 31.6413(a)-1 Repayment or reimbursement by employer of tax erroneously collected from employee.**

(a) *Federal Insurance Contributions Act and Railroad Retirement Tax Act—*

(1) *Overcollection ascertained before return is filed.* (i) If an employer during any return period collects from an employee more than the correct amount of employee Federal Insurance Contributions Act (FICA) tax under section 3101 or employee Railroad Retirement Tax Act (RRTA) tax under

section 3201, and if the employer ascertains the error before filing the return on which the employee tax is required to be reported, repays or reimburses the amount of the overcollection to the employee before filing the return for such return period, and obtains and keeps as part of its records the written receipt of the employee showing the date and amount of the repayment or evidence of reimbursement, the employer shall not report on any return or pay to the IRS the amount of the overcollection.

(ii) Any overcollection not repaid or reimbursed to the employee as provided in paragraph (a)(1)(i) of this section shall be reported and paid to the IRS on the return for reporting such tax for the return period in which the overcollection is made. However, the reporting and payment of the overcollection may be treated as an error ascertained after the return is filed for purposes of paragraph (a)(2) of this section.

(iii) For purposes of this paragraph (a)(1), an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(2) *Error ascertained after return is filed.* (i) If an employer files a return for a return period on which FICA tax or RRTA tax is reported, collects from an employee and pays to the IRS more than the correct amount of the employee FICA or RRTA tax, and if the employer ascertains the error within the applicable period of limitations on credit or refund, the employer shall repay or reimburse the employee in the amount of the overcollection 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 limitations period. However, this paragraph (d)(2) does not apply to the extent that, after reasonable efforts, the employer cannot locate the employee. This paragraph (d)(2) has no application in any case in which an overcollection is made the subject of a claim by the employer for refund or credit, and the employer chooses to secure the written consent of the employee to the allowance of the refund or credit under the procedure provided in § 31.6402(a)-2.

(ii) If the employer repays the amount of the overcollection to an employee, the employer shall obtain and keep as part of its records the written receipt of the employee, showing the date and amount of the repayment.

(iii) If the employer reimburses the amount of the overcollection to an employee, the employer shall keep as part of its records evidence of reimbursement. The employer shall

reimburse the employee by applying the amount of the overcollection against the employee FICA or RRTA tax which attaches to wages or compensation paid by the employer to the employee prior to the expiration of the return period following the return period in which the error is ascertained and prior to the expiration of the applicable period of limitations on credit or refund. If the amount of the overcollection exceeds the amount so applied against such employee tax, the excess amount shall be repaid to the employee as required by this section.

(iv) If, in any calendar year, an employer repays or reimburses an employee in the amount of an overcollection of employee FICA or RRTA tax that was collected from the employee in a prior calendar year, the employer shall obtain from the employee and keep as part of its records a written statement that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and that the employee will not claim refund or credit of such amount. For this purpose, a claim for refund or credit by the employee includes instances in which the employee has included an overcollection of employee FICA or RRTA tax in computing a special refund (see § 31.6413(c)-1).

(v) For purposes of this paragraph (a)(2), an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(vi) For the period of limitations on credit or refund of taxes, see § 301.6511(a)-1 of this chapter (Regulations on Procedure and Administration).

(b) *Income tax withheld from wages—*

(1) *Overcollection ascertained before return is filed.* (i) If an employer during any return period collects from an employee more than the correct amount of tax required to be withheld from wages under section 3402, and if the employer ascertains the error before filing the return on which such tax is required to be reported, repays or reimburses the amount of the overcollection to the employee before filing the return for such return period and before the end of the calendar year in which the overcollection was made, and obtains and keeps as part of its records the written receipt of the employee showing the date and amount of the repayment or evidence of reimbursement, the employer shall not report on any return or pay to the IRS the amount of the overcollection.

(ii) Any overcollection not repaid or reimbursed to the employee as provided in paragraph (b)(1)(i) of this section

shall be reported and paid to the IRS on the return for reporting such tax for the return period in which the overcollection is made. However, the reporting and payment of the overcollection may be treated as an error ascertained after the return is filed for purposes of paragraph (b)(2) of this section.

(iii) For purposes of this paragraph (b)(1), an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(2) *Error ascertained after return is filed.* (i) If an employer files a return for a return period on which tax required to be withheld from wages is reported, collects from an employee and pays to the IRS more than the correct amount of the tax required to be withheld from wages, and if the employer ascertains the error after filing the return but before the end of the calendar year in which the wages were paid, the employer shall repay or reimburse the employee in the amount of the overcollection prior to the end of the calendar year and by the expiration of the return period following the return period in which the error is ascertained. However, this paragraph does not apply to the extent that, after reasonable efforts, the employer cannot locate the employee.

(ii) If the employer repays the amount of the overcollection to an employee, the employer shall obtain and keep as part of its records the written receipt of the employee, showing the date and amount of the repayment.

(iii) If the employer reimburses the amount of the overcollection to an employee, the employer shall keep as part of its records evidence of reimbursement. The employer shall reimburse the employee by applying the amount of the overcollection against the tax under section 3402, which otherwise would be required to be withheld from wages paid by the employer to the employee in the calendar year in which the overcollection is made and prior to the expiration of the return period following the return period in which the error is ascertained. If the amount of the overcollection exceeds the amount so applied against such tax, the excess amount shall be repaid to the employee as required by this section.

(iv) For purposes of this paragraph (b)(2), an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

**Par. 11.** Section 31.6413(a)-2 is revised to read as follows:

**§ 31.6413(a)-2 Adjustments of overpayments.**

(a) *In general.* (1) An employer who has overcollected or overpaid employee Federal Insurance Contributions Act (FICA) tax under section 3101 or employer FICA tax under section 3111, employee Railroad Retirement Tax (RRTA) tax under section 3201 or employer RRTA tax under section 3221, or income tax required under section 3402 to be withheld, and has repaid the amount of the overcollection of such tax to the employee, shall correct such error as provided in this section. Such correction may constitute an interest-free adjustment as provided in paragraph (b) or (c) of this section.

(2) Every correction under this section of an overpayment of tax shall be made on the prescribed form that corresponds to the return being corrected. The form, filed in accordance with this section and the instructions, will constitute an adjusted return for the return period being corrected.

(3) Every adjusted return on which an overpayment is corrected pursuant to this section shall include a certification that the employer has repaid or reimbursed its employee, except where taxes were not withheld from the employee or where, after reasonable efforts, the employer cannot locate the employee. Every adjusted return shall designate the return period in which the error was ascertained and the return period being corrected, explain in detail the grounds and facts relied upon to support the correction, and set forth such other information as may be required by this section and § 31.6413(a)-1 and by the instructions relating to the form. Every adjusted return, filed by an employer, for overpayment of employee FICA tax under section 3101 or employee RRTA tax under section 3201 collected from an employee in a calendar year prior to the year in which the adjusted return is filed, must also include a certification that the employer has obtained the employee's written statement that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and that the employee will not claim refund or credit of the amount.

(4) For purposes of this section, an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(5) For provisions related to furnishing employee statements and corrected employee statements reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-1 of this chapter. For

provisions relating to filing information returns and corrected information returns reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-2 of this chapter.

(b) *Federal Insurance Contributions Act and Railroad Retirement Tax Act—(1) Overcollection ascertained before return is filed.* If an employer collects more than the correct amount of employee FICA or RRTA tax from an employee, and if the employer ascertains the error before filing the return on which the employee tax with respect to such wages or compensation is required to be reported, and repays or reimburses the employee under § 31.6413(a)-1(a)(1), the employer shall not report on any return or pay to the IRS the amount of the overcollection. If the employer does not repay or reimburse the amount of the overcollection under § 31.6413(a)-1(a)(1) before filing the return, the employer must report the amount of the overcollection on the return. However, the reporting and payment of the overcollection may be treated as an error ascertained after the return is filed for purposes of paragraph (b)(2) of this section.

(2) *Error ascertained after return is filed—(i) Employee tax.* If an employer files a return for a return period on which FICA tax or RRTA tax is required to be reported and reports on the return more than the correct amount of employee FICA or RRTA tax, and if the employer ascertains the error after filing the return, and repays or reimburses the employee the amount of the overcollection of employee tax, as provided in § 31.6413(a)-1(a)(2), the employer may correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the overpayment of tax by reporting the overpayment on an adjusted return for the return period in which the wages or compensation was paid, accompanied by a detailed explanation of the amount being reported on the adjusted return as required by paragraph (a)(3) of this section. Except as provided in paragraph (d) of this section, the reporting of the overpayment on an adjusted return constitutes an adjustment within the meaning of this section only if the adjusted return is filed by the due date of the return for the return period following the return period in which the error is ascertained and before the expiration of the period of limitations on credit or refund. For purposes of the preceding sentence, the due date for filing the adjusted return is determined by reference to the return

being corrected. The employer shall take the adjusted amount as a credit towards payment of employment tax liabilities for the return period in which the adjusted return is filed unless the IRS notifies the employer that the adjustment is not permitted under paragraph (d) of this section.

(ii) *Employer tax.* If an employer files a return for a return period on which FICA tax or RRTA tax is required to be reported and reports on the return more than the correct amount of employer FICA or RRTA tax, and if the employer ascertains the error after filing the return, the employer may correct the error through an interest-free adjustment as provided in this section. The employer must first repay or reimburse the employee the amount of any overcollection of employee tax, if any, pursuant to § 31.6413(a)-1(a)(2), before making the adjustment for the employer share, unless the employer could not locate the employee after reasonable efforts. The employer shall adjust the overpayment of tax by reporting the overpayment on an adjusted return for the return period in which the wages or compensation was paid, accompanied by a detailed explanation of the amount being reported on the adjusted return as required by paragraph (a)(3) of this section. Except as provided in paragraph (d) of this section, the reporting of the overpayment on an adjusted return constitutes an adjustment within the meaning of this section only if the adjusted return is filed by the due date of the return for the return period following the return period in which the error is ascertained and before the expiration of the period of limitations on credit or refund. For purposes of the preceding sentence, the due date for filing the adjusted return is determined by reference to the return being corrected. The employer shall take the adjusted amount as a credit towards payment of employment tax liabilities for the return period in which the adjusted return is filed unless the IRS notifies the employer that the adjustment is not permitted under paragraph (d) of this section.

(c) *Income tax withheld from wages—*  
(1) *Overcollection ascertained before return is filed.* If an employer collects more than the correct amount of income tax required to be withheld from wages, and if the employer ascertains the error before filing the return on which the tax is required to be reported, and repays or reimburses the employee under § 31.6413(a)-1(b)(1), the employer shall not report on any return or pay to the IRS the amount of the overcollection. If the employer does not repay or reimburse the amount of the

overcollection under § 31.6413(a)-1(b)(1) before filing the return, the employer must report the amount of the overcollection on the return. However, the reporting and payment of the overcollection may be treated as an error ascertained after the return is filed for purposes of paragraph (c)(2) of this section.

(2) *Error ascertained after return is filed.* If an employer files a return for a return period on which income tax required to be withheld from wages is required to be reported and reports on the return more than the correct amount of income tax required to be withheld, and if the employer ascertains the error after filing the return, and repays or reimburses the employee in the amount of the overcollection as provided in § 31.6413(a)-1(b)(2), the employer may correct the error through an interest-free adjustment as provided in this section. The employer shall adjust the overpayment of tax by reporting the overpayment on an adjusted return for the return period in which the wages were paid, accompanied by a detailed explanation of the amount being reported on the adjusted return as required in paragraph (a)(3) of this section. Except as provided in paragraph (d) of this section, the reporting of the overpayment on an adjusted return constitutes an adjustment within the meaning of this section only if the adjusted return is filed by the due date of the return for the return period following the return period in which the error is ascertained. For purposes of the preceding sentence, the due date for filing the adjusted return is determined by reference to the return being corrected. If the amount of the overcollection is not repaid or reimbursed to the employee under § 31.6413(a)-1(b)(2), there is no overpayment to be adjusted under this section. However, the employer may adjust an overpayment of tax attributable to an administrative error, that is, an error involving the inaccurate reporting of the amount withheld, pursuant to this section. The employer shall take the adjusted amount as a credit towards payment of employment tax liabilities for the return period in which the adjusted return is filed unless the IRS notifies the employer that the adjustment is not permitted under paragraph (d) of this section.

(d) *Adjustments not permitted—*(1) *In general.* If an adjustment cannot be made, a claim for refund or credit may be filed in accordance with § 31.6402(a)-2 or § 31.6414-1.

(2) *90-day exception.* No adjustment in respect of an overpayment may be made if the overpayment relates to a

return period for which the period of limitations on credit or refund of such overpayment will expire within 90 days of filing the adjusted return.

(3) *No adjustment after claim for refund filed.* No adjustment in respect of an overpayment may be made after the filing of a claim for credit or refund of such overpayment under § 31.6402(a)-2.

(4) *No adjustment after IRS notification.* No adjustment may be made upon notification by the IRS that the adjustment is not permitted.

**Par. 12.** Section 31.6414-1 is amended by revising paragraph (a) to read as follows:

**§ 31.6414-1 Credit or refund of income tax withheld from wages.**

(a) *In general.* (1) Any employer who pays to the IRS more than the correct amount of income tax required to be withheld from wages under section 3402 or interest, addition to the tax, additional amount, or penalty with respect to such tax, may file a claim for refund of the overpayment in the manner and subject to the conditions stated in this section. The claim for refund must designate the return period to which the claim relates, explain in detail the grounds and facts relied upon to support the claim, and set forth such other information as may be required by the regulations in this section and by the instructions relating to the form. No refund to the employer will be allowed under this section for the amount of any overpayment of tax which the employer deducted or withheld from an employee.

(2) For provisions related to furnishing employee statements and corrected employee statements reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-1. For provisions relating to filing information returns and corrected information returns reporting wages and withheld taxes, see sections 6041 and 6051 and §§ 1.6041-2 and 31.6051-2.

(3) For interest-free adjustments of overpayments of income tax withheld from wages, see § 31.6413(a)-2.

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