Treasury ruling allows refund of amounts subject to employment tax under DOMA

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In brief

On June 26, 2013, the US Supreme Court held in US v. Windsor that Section 3 of the US Defense of Marriage Act (DOMA) is unconstitutional. Under DOMA, married same-sex couples and their families were not eligible for certain tax benefits and protections (collectively, qualified benefits) that were available to married couples of the opposite sex. The Treasury Department issued Revenue Ruling 2013-17 on August 29, 2013. The Ruling provides for treatment of same-sex couples legally married in one state as married for all federal tax purposes. This position removes doubt following the US v. Windsor decision as to whether the Internal Revenue Service (IRS) would treat same-sex couples differently in states where same-sex marriages are not recognized.

This Ruling clears the way for employers to seek a refund of social security and Medicare taxes (FICA) paid on qualified benefits which were treated under DOMA as excludible only with respect to opposite sex spouses and dependents. For example, same-sex couples could not exclude the value of employer-paid health care coverage, certain tuition benefits or group-term life insurance premiums from their gross income and wages, yet amounts were excludible from the wages of married couples of the opposite sex. As a result, the imputed value of these and other qualified benefits were subject to FICA and income taxes.

Subject to the applicable three-year statute of limitations, the Ruling allows for employers to seek a refund of FICA taxes paid on the imputed value of qualified benefits. The Treasury Department announced separately that future guidance will be provided describing specific streamlined procedures employers must follow to perfect their claims for refund. FICA tax refunds have special requirements. Employers need to act now to (1) ensure qualified benefits are coded properly in payroll systems to ensure exclusion where appropriate (2) notify affected employees of the FICA refund opportunity and (3) identify the payroll data required for filing claims. It is anticipated that IRS guidance will provide a specific template and transmission method for these claims.

In detail: what does this mean for employers?

Current treatment

First, employers will treat qualified benefits provided to a same-sex spouse and dependents whose marriage is recognized under any state law as excludible fringe benefits in the same manner as opposite sex spouse and dependents.

Prior years

Employers that originally included the value of qualified benefits for eligible same-sex spouses in gross income and wages and withheld the applicable employment taxes are now entitled to claim refunds or credits, for themselves and their affected employees. For these purposes, the required information is in significant part likely already available and in the payroll system. To the extent qualified benefits have been excluded from wages in states that recognize same-sex marriage, most payroll systems include specific coding for those benefits. Therefore, identification of affected employees and refund amounts should not be difficult relative to the more complex analysis required on other benefit matters. Employers may need to establish a method for identifying those employees whose marriage was validly entered into in a state whose laws authorize the marriage of two individuals of the same sex but are currently domiciled in a state that does not recognize the validity of same-sex marriages.

The claim for refund, made on Form 941-x, *Adjusted Employer's Quarterly Tax Return or Claim for Refund*, is for FICA taxes paid on qualified benefits provided during any years that are still open under the statute of limitations. For most employers, claims can be filed for periods beginning in 2010. Those employers that took steps to protect the statute on prior periods by filing protective claims may now perfect those claims as part of this process. Income tax withholding refunds, by contrast, are limited to withholding made during the current calendar year.

The process for filing FICA refund claims can be exacting and requires administrative oversight. While employers may see relief in the anticipated stream-lined procedures, employer requirements relative to employee FICA tax are likely to remain in place. The IRS requires an employer to act on behalf of its affected employees when the employer seeks a refund of FICA tax paid by the employer. The IRS requires employers to provide employees notice and an opportunity to participate in the employer's FICA refund claim. This requirement applies to employers perfecting previously filed protective claims or those filing original claims.

To provide employees an opportunity to participate, an employer must secure the employee's written statement confirming that the employee has not made any previous claims and will not make any future claims for refund or credit of the amount of the over collected FICA tax. The employer is required to wait a reasonable period of time (typically 45 days) for the employee's response. If an affirmative response is received, the employee's FICA refund claim should be included with the employer's claim. If no response is received or the employee denies inclusion, then the employer may generally exclude the employee from the claim and only request the employer's portion of FICA taxes.

In addition, employers will need to prepare and file Forms W-2C, *Corrected Wage and Tax Statement*, for all employees who provided their consent in a timely manner.

Prior periods in 2013

It is anticipated that the IRS will provide simplified procedures for correcting overpayments made in 2013 and employers will likely have options relative to the method of recovery. Unlike prior years, both FICA and income tax amounts withheld from eligible payments in 2013 may be credited or refunded. Employers seeking adjustments are required to repay or refund the overpayments to employees, as appropriate.

The takeaway

A significant opportunity exists for employers and employees to obtain refunds or credits for employment taxes, and in some cases, income taxes associated with eligible benefits provided to same-sex spouses. At this time, employers should begin to gather the data and provide necessary notice to eligible employees.

Additional resources

Additional insights from PwC will be forthcoming.

For details about how DOMA affects:

- income, estate, and gift taxes, please see *DOMA overturned: impact on income, estate, and gift taxes* (dated July 2) or
- benefit plans, please see *What does the DOMA decision mean for employer-sponsored benefit plans* (dated June 28, 2013).

Let's talk

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