
IRS provides special procedures for employment tax refunds related to DOMA

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In brief

In response to the US Supreme Court's recent decision in *US v. Windsor*, the Internal Revenue Service (IRS) on September 23 issued Notice 2013-61 (Notice) providing guidance for employers wishing to obtain a refund of employment taxes paid on certain benefits provided to married same-sex spouses that were originally treated as taxable wages.

Windsor held that Section 3 of the 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 (qualified benefits) that were available to married couples of the opposite sex. On August 29, the Department of the Treasury issued Revenue Ruling 2013 17 (Ruling) announcing that it would recognize all legally married same-sex couples for all federal tax purposes regardless of where the couple lives.

Subject to the applicable three-year statute of limitations, the Ruling allows employers to seek a refund of both employer and employee shares of Federal Insurance Contributions Act (FICA) taxes paid on the imputed value of qualified benefits. Additionally, the Ruling allows for a correction of income taxes that were overwithheld during 2013.

The Notice also provides special procedures for employers to seek a refund of employment taxes paid during 2013 and amounts paid in prior years (generally 2010, 2011 and 2012) for which the statute of limitations has not yet expired with respect to employer's Forms 941, *Employer's Quarterly Federal Tax Return*. Employers will need to take certain actions between now and December 31, 2013, in order to take full advantage of these special procedures.

In detail

Prior to *Windsor*, married 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 income tax withholding and social security and Medicare taxes under FICA.

Under existing procedures for employment tax refunds or adjustments, an employer generally must (1) provide notice to the affected employees,

(2) seek statements and consent from employees, (3) repay or reimburse the employees for the employees' share of withheld taxes, (4) file a Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, for each affected quarter, and (5) in most cases, file Forms W-2c, *Corrected Wage and Tax Statement*.

Although employers may use the existing refund or adjustment procedures with respect to qualified benefits, the Notice sets forth special procedures to assist employers and employees in expediting this process. To summarize, the Notice provides alternative prior year adjustment procedures, two distinct current year adjustment procedures, and certain procedures that apply specifically to the third quarter of 2013. In short, these special procedures allow employers to file a single Form 941-X for the entire year and, with respect to 2013, to alleviate the need to file corrected Form W-2s.

Prior year adjustments

For prior years (generally 2010, 2011, and 2012) for which the applicable statute of limitations on filing a refund claim has not expired, employers may use special procedures to seek a refund or make an adjustment. Refund claims for prior years should include only social security and Medicare taxes. Employers using this special procedure will need to provide notice to their affected employees and to seek a written statement (Employee Statement) confirming that the employee did not make a claim (or if the employee did make a claim, the claim was rejected) and will not make a claim for refund of FICA tax overcollected in a prior year.

The statements will also seek consent to file a claim for refund on behalf of the employees. Instead of filing a Form 941-X for each quarter, the employer may file a single Form 941-X for the entire year related only to FICA taxes paid on qualified benefits. On the top of the first page of the Form 941-X, the employer will write WINDSOR in dark, bold letters. After refunding the employee the overcollected FICA taxes, the employer will file with the IRS, and provide to the affected employees, a

Form W-2c. The employee may use the Form W-2c to file a Form 1040X, *Amended U.S. Individual Tax Return*, and receive a refund of income taxes withheld on qualified benefits.

Alternative 1 for 2013 adjustments

Notice 2013-61 outlines two special administrative procedures available for employers that withheld employment taxes on the imputed value of qualified benefits paid during 2013 to married same-sex couples.

First, the Notice provides a special administrative procedure for employers that have not yet filed their fourth quarter Form 941 for 2013 and want to make a correction before the close of the calendar year. Employers who want to use this special administrative procedure must repay or reimburse their employees for the overcollected federal income and FICA taxes on qualified benefits for all four quarters of 2013 on or before December 31, 2013. The employer should report the reduced wages and applicable taxes attributable to the qualified benefits on the fourth quarter Form 941. In effect, by taking advantage of this special administrative procedure at year-end, wage and related tax withholding amounts will be correct and employers will avoid having to file Forms 941-X and Forms W-2c as discussed below. In effect, Alternative 1 allows employers to report the correct wages and related tax withholding amounts without having to file amended returns as discussed below.

Under Alternative 1, employers may correct only the employer share of FICA tax that corresponds to the employees' share of FICA tax that has been repaid or reimbursed to the employees by December 31, 2013. Employers using this special procedure will furnish and file Forms W-2 that report both the reduction in

wages as well as the repayment of tax withholdings attributable to the qualified benefits.

Alternative 2 for 2013 adjustments

Under normal correction procedures, employers that included the imputed value of qualified benefits in wages and also withheld income and FICA taxes would be required to file Form 941-X for each quarter of 2013 to correct the error, as noted above. Pursuant to Notice 2013-61, employers that do not repay or reimburse affected employees by December 31, 2013, will file the fourth quarter 2013 Form 941 without the adjustments described in Alternative 1. These employers may take advantage of a second special administrative procedure using a single Form 941-X. Unlike the first alternative, employers will only be allowed to seek a refund of the FICA taxes attributable to qualified benefits, not federal income tax, because the 2013 calendar year will have closed.

Under Alternative 2, an employer may file one Form 941-X for the fourth quarter of 2013 to make adjustments or claim refunds or credits of overpayments of FICA taxes with respect to same-sex spouse benefits paid in all quarters of 2013, provided the employer has satisfied the usual requirements for filing Form 941-X. These include repaying or reimbursing the over collected employee FICA tax to employees (or, for refund claims, securing consents from employees), and obtaining the required Employee Statement. The employer will need to provide the IRS and the affected employees with the appropriate Form W-2 or W-2c as required. The employee may use Form W-2 or W-2c to file a Form 1040X and receive a refund of income taxes withheld on qualified benefits.

Third quarter of 2013 adjustments

Employers have two options with respect to correcting federal income and FICA tax withholdings related to qualified benefits for the third quarter of 2013. Under the first option, an employer can repay or reimburse employees for the overcollected federal income and FICA taxes on qualified benefits on or before the last day of the third quarter (*i.e.*, September 30, 2013). In that case, the third quarter Form 941, due October 31, 2013, should reflect the reduction in federal income and FICA wages and withholdings. No adjustments should

be needed for the third quarter thereafter.

Alternatively, an employer may choose to not repay or reimburse its employees for the overcollected federal income and FICA taxes attributable to qualified benefits by the end of the third quarter. In that case, the employer would report the federal income and FICA wages and withholding as paid on the third quarter Form 941. Either special procedure outlined in the foregoing sections could be used to make the adjustment for the wages or

withholding applied to qualified benefits in 2013.

The takeaway

The Notice provides simplified procedures for filing refund claims or making adjustments with respect to qualified benefits provided to married same-sex couples. Employers need to locate and assemble the required data to support these claims or adjustments and communicate with their affected employees. To take full advantage of these special procedures, employers will generally need to act before December 31, 2013.

Let's talk

For more information, contact a member of your PwC engagement team or one of the individuals listed below:

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