

IRS Guidance on Overcollected Additional Medicare Tax

The Spring 2014 SSA/IRS Reporter provides guidance to employers that collect too much additional Medicare taxes from their employees or that remit too much of these taxes to Treasury. The guidance depends on whether the employer detects the error before or after filing Form 941.

The rules and limits related to Social Security taxes and the additional Medicare tax can lead to a rollercoaster ride of confusion for taxpayers and their employers. In April 2014, the IRS tried to address some of the confusion in the Spring 2014 edition of the SSA/IRS Reporter (www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/SSA-IRS-Reporter). Page 7 of that document provides guidance on how an employer should correct overcollections that are discovered before or after filing Form 941, “Employer’s Quarterly Federal Tax Return.”

Beginning in 1994, the ceiling on the 1.45% Medicare tax was removed. Hence, it is applicable to all covered wages for both the employer and employee. This means the employer pays the 1.45% Medicare tax, and the employee pays a 2.35% Medicare tax on all covered wages. Once a taxpayer

earns \$117,000 in wages within a year, the 6.2% Social Security tax is no longer collected from earned wages, and the employer stops collecting those taxes on behalf of its employee.

When that same taxpayer earns more than \$200,000 in wages in the year, the employer begins withholding the 0.9% additional Medicare tax. While the employer is responsible for collecting this additional tax, the taxpayer might not be responsible for paying it if

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he or she is married, filing jointly, and the combined wages of the employee and spouse are less than \$250,000. Taxpayers caught between these limits are able to seek a refund of the excess withheld tax when they file their annual tax return. But if the couple files as married filing separately, then the additional Medicare tax is applicable for amounts greater than

\$125,000. In that situation, most individuals will likely underpay the tax because the employer is only responsible to begin collecting after \$200,000. The missing amount will need to be made up by the taxpayer when filing his or her return.

Individual taxpayers should be aware that if they don’t pay enough tax during the year—either through withholding or by making estimated taxes—they may be subject to an underpayment penalty. For 2014, the penalty generally applies if tax payments for a taxpayer don’t equal the lesser of 90% of the individual’s 2013 tax or 100% of the 2012 tax. But if a taxpayer’s adjusted gross income exceeds \$150,000 (\$75,000 for married filing separately), 110% is substituted for the 100%. For this discussion, the important issue is that the additional Medicare tax isn’t excluded when determining if the taxpayer paid enough taxes.

As noted, employers are responsible for collecting and remitting the additional Medicare tax. But what procedures should the employer follow if it collects too much additional Medicare tax? The answer depends on when the overcollection is discovered.

Before Form 941 Is Filed

When an employer withholds too much of the additional Medicare tax from employee wages and discovers the error before filing Form 941 for the quarter during which the error was made, the employer can avoid reporting the over-withheld amount under certain conditions. Specifically, the employer needs to repay or reimburse the overwithheld amount by the due date of Form 941. In addition, the employer needs to keep in its records a receipt from the employee showing the date and amount of payment or a record of reimbursement.

After Form 941 Is Filed

When the employer discovers the error after filing Form 941 but before the end of the calendar year, the employer can either repay or reimburse the employee for the overwithheld amount.

If the employer elects to repay the overwithheld amount, it must do so before the end of the calendar year during which the error was made. In addition, the employer needs to keep in its records the employee's written receipt as to the date and amount repaid.

If the employer elects to reimburse employees for the overwithheld amounts by reducing future withheld taxes, it must complete the reimbursement during the same calendar year in which the error occurred. As one might suspect, the employer needs to keep evidence of the reimbursement as part of its records. A potential problem that may arise is if the overcollected amount exceeds the amount that can be reimbursed to the employee by reduc-

ing future taxes. In this situation, the employer must repay the excess overcollected amount to the employee and again maintain records to that effect.

Correcting Overpayments to Treasury

If an employer discovers an overpayment after remitting the taxes to Treasury, the organization can correct the overpayment with an interest-free adjustment by following a two-step process. Step 1 requires the employer to repay or

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reimburse the employee or employees within the same calendar year that the wages were paid. Step 2 is to seek reimbursement from Treasury. It's important to note that Step 2 can only happen *after* the employee or employees have been reimbursed—an organization can't complete Step 2 without first completing Step 1. To request repayment, the employer reports both the employee and employer portions of additional Medicare tax as an overpayment on Form 941-X, "Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund."

To further emphasize the importance of reimbursing the employees first, the employer is required to certify on Form 941-X that it has repaid or reimbursed its

employees. Failure to follow this specific procedure could easily bring severe consequences from Treasury.

Refunds of Overpayments of Additional Medicare Tax

An employer can file a claim for refund for additional Medicare tax amounts that were overpaid to the IRS, but only if the amounts weren't withheld from the employee. Likewise, an employee can claim a credit for any overwithholdings of additional Medicare tax on his or her income tax return. The credit is computed on Form 8959, "Additional Medicare Tax," and is submitted with the taxpayer's Form 1040.

If the overpayment is discovered after the taxpayer files Form 1040, then the taxpayer follows the standard protocol for reporting an error on the tax return. That is, the taxpayer needs to file Form 1040X, "Amended U.S. Individual Income Tax Return," to seek a refund of the overpayment amount.

So if you are an employer that has overcollected the 0.9% additional Medicare tax from employees, the IRS has now provided guidance for correcting the error. The critical issue underlying the guidance is whether you detected the error before or after filing Form 941. **SF**

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