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From: [redacted]
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To: [redacted]
Cc:
Bcc:
Subject:

I understand that the taxpayer regularly sends employees to work overseas. The taxpayer has a tax equalization program under which it adjusts the overseas employees' pay so that the employees will have no net economic gain or loss with respect to tax liability because of the foreign assignment. After all expected taxes are considered, both foreign and in the United States, an employee may be better or worse off economically because of the foreign assignment if an adjustment to salary is not made. In order to make the foreign assignment tax neutral, the taxpayer adjusts the employee's remuneration, either increasing it or decreasing it. This adjustment is based on what is referred to as the "hypothetical tax." Hypothetical tax is simply all the U.S. federal and state taxes that the employee would owe if the employee stayed in the United States. The hypothetical tax is compared to the anticipated foreign and domestic taxes, and remuneration is adjusted so the employee is no better or worse off because of taxes. Oftentimes an employee will save on taxes overall because the foreign taxing jurisdiction may not impose an income tax, and section 911 allows for an earned income exclusion and a housing exclusion from U.S. gross income for employees working outside the U.S.

The taxpayer has filed for a refund of employment taxes. The taxpayer claims that it pays all of the employment taxes on the wages earned by employees who are assigned overseas without actually withholding the taxes. The taxpayer says they are paying the taxes out of their own pocket, and then subsequently collecting hypothetical taxes from their employees. The taxpayer claims that it intentionally overpays employment taxes in order to avoid penalties, and trues up later by claiming refunds. The taxpayer asserts that it does not need to contact employees or get their consent to claim refunds of the employee share of FICA because they didn't actually withhold taxes from their employees' wages.

My view is that, if the taxpayer has a prearranged plan to pay the employees' income tax withholding and employee FICA on an amount of "stated wages", then the taxpayer is simply determining the employee's wages under a particular method and the income tax withholding and employee FICA is actually withheld on a grossed-up amount, and the ITW and FICA is being paid as the wages are paid. Because the taxpayer is actually withholding the taxes from the employees' grossed-up wages under its plan, the taxpayer is not entitled to a refund of income tax withholding for a prior year and any refund of employee FICA taxes would be subject to the usual rules, including the requirement that the employer procure consents. The employees are getting current credit for the ITW under the taxpayer's plan, I assume. This is different from a situation where in a subsequent year, the employer discovered a possible error and paid the ITW and employee FICA from its own funds (and the employee gets no credit for ITW), and then applied for a refund.

If an employer has a prearranged plan to pay an amount of wages ("stated wages") to an employee net of income tax withholding (and thus facially pay the income tax withholding of the employee out of its own funds rather than deducting the withholding from the employee's "stated wages" in the year of the wage payment), this plan would result in additional current income and current wages to the employee in addition to the stated wages. In this situation, the employee's stated wages are grossed-up to determine the wages for income tax withholding purposes, because the payment of income tax withholding creates additional wages (and the wages are also "pyramided"). See Rev. Rul. 58-113, 1958-1 C.B. 362. This also applies for purposes of determining current FICA wages. Rev. Rul. 86-14, 1986-1 C.B. 304. The employer is just using a different method of determining wages (i.e., the wages are grossed-up) when it pays the employee's employment taxes on this basis.

In summary, when an employer has a pre-arranged plan to pay employment taxes in this manner, it is actually withholding employment taxes from a grossed-up amount of wages and should not be able to get a refund of ITW, and employee FICA could be amended for a prior year but the calculations need to be made with respect to a grossed-up amount of wages in the year of payment of the wages and subsequent payments of employee FICA taxes for the employee are also grossed-up.

I hope this is helpful. Please let me know if I may be of further assistance.