

## Legislative Brief

### Application of Retroactive Increase in Transit Benefits

The American Taxpayer Relief Act increased the maximum monthly transit benefit for employees from \$125 per participating employee to \$240 per participating employee. This change was made retroactive for the period of Jan. 1, 2012, through Dec. 31, 2012.

To address employers' questions regarding the retroactive application of the increase, the IRS issued Notice 2013-8. This Notice clarifies how the increase applies for 2012 and provides special administrative procedures for employers to use in filing the following forms:

- Form 941, Employer's quarterly Federal Tax Return, for the fourth quarter of 2012 to reflect changes in the excludable amount for transit benefits provided in all quarters of 2012; and
- Forms W-2, Wage and Tax Statement.

#### BACKGROUND

Fringe benefits that qualify as qualified transportation fringe benefits are excluded from employees' gross income. Qualified transportation fringe benefits (when provided by an employer to an employee) include:

- Transportation in a commuter highway vehicle between home and work;
- Any transit pass;
- Qualified parking.

Under the initial law providing for the fringe benefit exclusion, the amount of employer-provided fringe benefits that may be excluded from gross income was set at \$100 per month for the aggregate of commuter transportation and transit passes (transit benefits) and \$175 for qualified parking. These amounts were adjusted annually for inflation.

Before ATRA was passed, the maximum monthly excludable amount for 2012 for transit benefits was \$125 and the maximum monthly excludable amount for qualified parking was \$240.

## Application of Retroactive Increase in Transit Benefits (continued)

ATRA increased the maximum monthly excludable amount for employer-provided transit benefits to equal to the maximum monthly excludable amount for qualified parking. The amendment is effective retroactively beginning on Jan. 1, 2012, and extending through Dec. 31, 2013. This means that the maximum monthly excludable amount for employer-provided transit benefits for 2012 is \$240. The maximum monthly excludable amount for 2013 is \$245.

### **CORRECTING OVERPAYMENTS OF FICA AND INCOME TAXES**

Amounts that are excluded from gross income as qualified transportation fringe benefits are also excluded from Federal Insurance Contributions Act (FICA) taxes (both social security and Medicare) and Federal income tax withholding.

Generally, corrections of overpayments of FICA tax are made after an error has been ascertained using the appropriate IRS adjustment process or its refund claim process. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

Before making an adjustment of an overpayment of FICA tax, an employer generally must repay or reimburse its employee in the amount of the over-collection. To repay the employee, the employer makes a direct payment to the employee. To reimburse the employee, the employer applies the amount of the over-collection to the employee's FICA tax attached to the employee's wages.

This repayment or reimbursement must be made before the period of limitations on credits or refunds expires. For FICA tax over-collected in a prior year, the employer must also secure the employee's written statement confirming that the employee has not made any previous claims (or the claims were rejected) and will not make any future claims for refund or credit of the amount of the over-collected FICA tax. Employers cannot adjust overpayments of withheld income tax after the end of the calendar year.

There are rules for making a refund claim for an overpayment of FICA tax. Under these rules, an employer has a duty to assure that its employee's rights to recover over-collected taxes are protected by repaying or reimbursing over-collected amounts. Alternatively, an employer may obtain the employee's consent to the filing of the refund claim. No refund to the employer is allowed for the overpayment of withheld income tax that the employer deducted or withheld from an employee.

To make employment tax corrections for overpayments (that is, to make adjustments or to claim refunds), an employer uses the "X" form that corresponds to the return being corrected. Thus, an employer corrects over-reported taxes on a previously filed Form 941 by filing Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund. A separate X form must be filed for each taxable period.

## Application of Retroactive Increase in Transit Benefits (continued)

### **EMPLOYERS that PROVIDED TRANSIT BENEFITS IN EXCESS OF \$125 PER MONTH AND LESS THAN OR EQUAL TO \$240 PER MONTH IN 2012**

Pursuant to the change made by ATRA, which was retroactive to January 1, 2012, any excess transit benefits provided by an employer to an employee are excluded from the employee's gross income and wages. "Excess transit benefits" are those in excess of \$125 (the former maximum monthly excludable amount) up to \$240 (the amended maximum monthly excludable amount). The exclusion applies whether the employer provided the transit benefits out of its own funds or whether the transit benefits were provided through salary reduction arrangements.

### **SPECIAL ADMINISTRATIVE PROCEDURE FOR making ADJUSTMENTS FOR 2012 ON THE FORM 941 FILED FOR THE FOURTH QUARTER OF 2012**

Employers that originally reported excess transit benefits as includible in gross income and wages, and withheld income taxes and FICA taxes, would normally be required to file Form 941-X for each quarter to correct the error. However, the IRS is providing a special administrative procedure for employers that treated excess transit benefits as wages and that have not yet filed their fourth quarter Form 941 for 2012.

Employers that wish to use this special administrative procedure must repay or reimburse their employees the over-collected FICA tax on the excess transit benefits for all four quarters of 2012 on or before filing the fourth quarter Form 941. The employer, in reporting amounts on its fourth quarter Form 941, may reduce the fourth quarter Wages, tips and compensation reported on line 2, Taxable social security wages reported on line 5a, and Medicare wages and tips reported on line 5c, by the excess transit benefits for all four quarters of 2012.

By taking advantage of this special administrative procedure, employers will avoid having to file Forms 941-X, and will also avoid having to file Forms W-2c as discussed below.

This procedure can only be used to the extent that employers have repaid or reimbursed their employees for the employee share of FICA tax attributable to the excess transit benefits. Under this special administrative procedure, employers may only correct the employer share of FICA tax that corresponds to the employees' share of FICA tax that has been repaid or reimbursed to the employees.

Employers using this special procedure do not need to obtain written statements from their employees confirming, for each employee, 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 over-collected in a prior year.

The repayment or reimbursement of over-withheld social security tax and the corresponding reduction for wages reported on Form 941, line 5a, Taxable social security wages, must take

## Application of Retroactive Increase in Transit Benefits (continued)

into account that refunds or credits of social security tax are limited to the amount paid on that portion of the excess transit benefits that, when added to other wages for the year, did not exceed the social security wage base for 2012 (\$110,100).

The same procedures are available to filers of other employment tax returns reporting FICA taxes (for example, the related Spanish-language return or return for U.S. possessions) and to filers of employment tax returns reporting taxes under the Railroad Retirement Tax Act.

### **EMPLOYER INSTRUCTIONS – FOURTH QUARTER FORM 941 HAS BEEN FILED OR THE EMPLOYER HAS NOT REPAID OR REIMBURSED ALL EMPLOYEES**

Employers that have filed the fourth quarter Form 941 must use Form 941-X to make an adjustment or claim a refund for any quarter in 2012 with regard to the overpayment of tax on the excess transit benefits after repaying or reimbursing the employees or, for refund claims, securing consents from its employees.

Similarly, employers that, on or before filing the fourth quarter Form 941, have not repaid or reimbursed some or all employees who received excess transit benefits in 2012 must use Form 941-X to make an adjustment or claim for refund with respect to the excess transit benefits provided to those employees and must follow the normal procedures.

### **EMPLOYER INSTRUCTIONS – FORM W-2**

Employers that have not furnished 2012 Forms W-2 to their employees should take into account the increased exclusion for transit benefits in calculating the amount of wages reported in box 1, Wages, tips, other compensation; box 3, Social security wages; and box 5, Medicare wages and tips.

Employers that have repaid or reimbursed their employees for the over-collected FICA taxes prior to furnishing Form W-2 should reduce the amounts of withheld tax reported in box 4, Social security tax withheld, and box 6, Medicare tax withheld, by the amounts of the repayments or reimbursements.

In all cases, however, employers must report in box 2, Federal income tax withheld, the amount of income tax actually withheld during 2012. The additional income tax withholding will be applied against the taxes shown on the employee's individual income tax return (Form 1040, U.S. Individual Income Tax Return).

Employers that repaid or reimbursed their employees for the over-collected FICA taxes after furnishing Forms W-2 to their employees but before filing Forms W-2 with the Social Security Administration (SSA), should check the "Void" box at the top of each incorrect Form W-2 (Copy A). The employer should prepare new Forms W-2 with the correct information, and send these

## Application of Retroactive Increase in Transit Benefits (continued)

new Forms W-2 (Copy A) to the SSA. The employers should write "CORRECTED" on the employees' new copies (B, C, and 2), and furnish them to the employees. See the 2012 Instructions for Forms W-2 and W-3.

Employers that have already filed 2012 Forms W-2 with SSA will need to file Forms W-2c, Corrected Wage and Tax Statement, to take into account the increased exclusion for transit benefits.

Source: Internal Revenue Service

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