

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Mary Gorman  
Assistant Division Counsel  
Small Business/Self Employed  
Office of Chief Counsel

from: Dan E. Boeskin  
Assistant Branch Chief, Employment Tax, Branch 1  
Tax Exempt & Government Entities  
Office of Chief Counsel

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subject: Code Section 45B Credit Timing

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This is in response to your inquiry dated July 29, 2008. Your question involves situations arising under section 3121(q) of the Internal Revenue Code ("the Code") where an employer receives a "notice and demand" for additional Federal Insurance Contributions Act (FICA) taxes (employer's share) for tips not reported in a prior year.

Issue

Is the Code section 45B credit available to the employer in the year of notice and demand under section 3121(q) of the Code or the year in which the unreported tips were received by the employee.

Conclusion

The Code section 45B credit is available to the employer in the year of notice and demand under section 3121(q) not the year in which the unreported tips were received by the employee.

## Facts

The factual situation described in your request for advice is as follows. In a prior tax year an employee receives cash tips which constitute “wages” as described in section 3121(a) of the Code but the employee fails to report the tip amounts to his or her employer in the year the tips were received. Thereafter, the employee’s employer receives in the current tax year a notice and demand for the employer share of FICA taxes as provided in section 3121(q) of the Code with respect to the tip amounts the employee received in the prior year. The employee’s employer seeks a current year credit under section 45B for the amount of FICA tax.

## Law and Analysis

Sections 3101 and 3111 of the Code impose FICA taxes on “wages” as that term is defined in section 3121(a). Section 3121(a) of the Code defines “wages” for FICA purposes as all remuneration for employment with certain specific exceptions. Section 3121(a)(12)(A) excludes from the FICA tips paid in any medium other than cash. Section 3121(a)(12)(B) excludes cash tips received by an employee in any calendar month in the course of the employee's employment by an employer, unless the amount of the cash tips is \$20 or more.

FICA taxes consist of the Old-Age, Survivors, and Disability Insurance (OASDI) tax and the Hospital Insurance tax. These taxes are imposed equally on both the employer under section 3111(a) and (b) and on the employee under section 3101(a) and (b). The amount of wages for OASDI purposes is limited to an annually adjusted amount (\$102,000 for 2008) under Code section 3121(a). Accordingly, once an employee’s wages reach this annually adjusted amount (the wage base), the OASDI portion of the FICA tax does not apply thereafter.

Section 3102(a) requires employers to deduct and pay over the employee portion of the FICA tax. However, section 3102(c)(1) provides a special rule applicable to tips. It states, for purposes relevant here, that the withholding requirement of subsection (a) is applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a), and only to the extent that collection can be made by the employer by deducting the amount of the tax from wages paid to the employee (excluding tips). Employment Tax Regulations section 31.3102-3(a)(2) provides that an employer is required to deduct and withhold the tax on tips constituting wages only for those tips the employee reports to the employer in a written statement as required under Code section 6053(a).

Under section 3121(q) of the Code, tips received by an employee in the course of the employee's employment are considered remuneration for that employment (and are deemed to have been paid by the employer for purposes of the employer portion of the FICA taxes imposed by section 3111(a) and (b)). The remuneration is deemed to be paid when a written statement including the tips is furnished to the employer by the employee

pursuant to section 6053(a). However, if the employee either did not furnish the statement or if the statement furnished was inaccurate or incomplete, in determining the employer's liability in connection with the FICA tax imposed on the employer by section 3111 with respect to the tips, the remuneration is deemed, for purposes of Subtitle F (Procedure and Administration), to be paid on the date on which notice and demand for the taxes is made to the employer by the Secretary.

In operation with section 38 of the Code, section 45B provides a tax credit equal to the "excess employer social security tax" amount paid or incurred by the taxpayer during the taxable year. The excess employer social security tax is defined in relevant part in subsection 45B(b)(1) as any tax paid by an employer under section 3111 with respect to tips that are deemed under section 3121(q) to have been paid by the employer to an employee.

In the factual situation described above, the unreported tips in question are actually received in a prior year by the employee. The effect of section 3121(q) of the Code is to establish the employer's liability for the employer share of FICA tax when the employer in fact becomes aware of the previously unreported tips by deeming the tips to have been paid when the notice and demand is received by the employer. After the employer becomes aware of the previously unreported tips by receiving the notice and demand, the employer is required under section 3121(q) to undertake the obligations as provided in Subtitle F (for example to make timely deposits, timely report the wages, and to make timely payment) with respect to the previously unreported tip amounts. The issues regarding the timing of the section 45B credit arises because section 3121(q) is limited to the purposes of Subtitle F and Subtitle F does not contain section 45B. Section 45B is part of Subtitle A (Income Taxes).

It is clear that the statutory language of section 3121(q) of the Code is limited to purposes of Subtitle F. However, it is our view that the operative language appears in Code section 45B itself and not section 3121(q). The section 45B credit is applied to the taxable year that the "excess social security tax" amount is paid or incurred, and the subsection 45B(b)(1) definition of "excess social security tax" is limited to tips that "are deemed to have been paid by the employer to the employee pursuant to section 3121(q)." In view of this provision that defines "excess social security tax" amounts, we conclude that such tax amounts cannot be paid or incurred prior to the time that the tip amounts are deemed to have been paid under section 3121(q) which occurs on the date on which notice and demand for the employer portion of the FICA tax is made to the employer by the Secretary. Accordingly, we find no basis for concluding that the "excess social security tax" amounts arise in the year in which the tips are actually received by the employee. Thus, the Code section 45B credit is available to the employer in the year of "notice and demand" not the year in which the unreported tips were received by the employee.

The conclusion that the Section 45B credit applies in the year of notice and demand is based on the fact that the "excess social security tax" amounts are paid or incurred in the year of notice and demand. However, whether amounts are "wages" for purposes of

determining the annual wage base is controlled by the definition of wages provided in Code section 3121(a). The fact that the unreported tip amounts are deemed to have been paid at the time of notice and demand for purposes of Subtitle F under section 3121(q) or that the employer's section 45B credit applies in the year of notice and demand, does not change the character of the tip amounts as wages for purposes of Code section 3121(a) when they are actually received by the employee. Accordingly, our conclusion with regard to the timing of the section 45B credit is consistent with Q&A 10 of Revenue Ruling 95-7, 1995-1 C.B. 185, which provides that the liability is computed using the wage base applicable to the year in which the tips were actually received by the employee.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Linda Conway at (202) 622-0047 if you have any further questions.