

Prior Year Salary Overpayments

An overpayment must be recovered within the same tax year to be reflected on the employee's current W-2. Repayment for wages received in error in a prior year must be reported on Form 941X to recover the social security and Medicare taxes. Forms W-2c/W-3c must also be filed with the SSA to correct social security and Medicare wages and taxes.

Taxable income includes all wages actually or constructively received in a tax year. Wages paid in error in the prior calendar year remain taxable to the employee for that year because the employee received and had use of those funds during that year.

Reference IRS Publication 15 (circular E): <https://www.irs.gov/pub/irs-pdf/p15.pdf>

Section 451 of the Internal Revenue Code states that the amount of an item of income shall be included in the gross income of the employee for the taxable year in which the employee received the income unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for in a different period. Regulation 1.451-1 states that under the cash receipts and disbursements method of accounting, items of income are includible in gross income when actually or constructively received. Under section 461 of the Code, any deduction or credit for income tax purposes is allowed only for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Amounts withheld for federal and state income tax in a prior year overpayment are not credited and must be repaid by the employee as they cannot be recovered from the Internal Revenue Service and/or Franchise Tax Board. The employee is given credit for the repayment by the district for social security and Medicare taxes on the excess income received in the prior year when a corrected W-2 is filed.

THE RECOVERY PROCESS

When the employee repays the employer the following tax year, if the amount repaid is \$3,000 or less, the employee may deduct the amount repaid from their income in the year it's repaid. Beginning in 2018, you can no longer claim any miscellaneous itemized deductions. If the amount repaid is more than \$3,000, they may deduct the repayment as an other itemized deduction on Schedule A (Form 1040), line 16 or take a credit against the tax for the year in which it's repaid.

Reference IRS Publication 525: <https://www.irs.gov/pub/irs-pdf/p525.pdf>

A repayment agreement must be signed by the district and the employee before collection of any monies.

If the employee refuses to sign a repayment agreement, the employee would then be advised that legal action may be taken to recover the overpayment.

The district should obtain and keep as part of its records a written statement that the employee has not and will not claim any refund or credit for such overpayment of social security and Medicare taxes [regulation 31.6413(a)-1(b)(1)]. The district reports the repayment for Social Security and Medicare tax on Forms W-2c and issues a copy to the employee once the repayment is received in full.

(DISTRICT LETTERHEAD)

Date _____

Dear _____:

This is to advise you that pay warrant(s) number(s) _____ for the period(s) _____ issued _____ resulted in an overpayment of \$ _____. This error was due to: _____

_____.

Please reference the enclosed documentation.

Please submit a personal check for the overpayment payable to:

_____. Attach the payment to this notice and return it to the Payroll Department via district mail or mail if to the address shown above.

If you have any questions or would like to make an appointment to make other repayment arrangements, please call _____ at _____.

Sincerely,

Payroll or HR Supervisor

Date: _____

To: _____

Payroll Department

_____ District

From: _____

Subject: Salary Repayment Agreement

I, _____, understand the explanation of the salary overpayment made to me in the amount of \$ _____. I hereby authorize the district to deduct \$ _____ each month from my wages to offset this indebtedness.

I further understand that should I terminate employment before liquidating this overpayment, the balance is due and payable at the time of termination.

Employee Signature

Date

Instructions for Form 113

Instructions for completing Form 113 for Prior Year — Salary Overpayment Computation and/or W-2 Correction

Note: In compliance with IRS code 451, cannot be processed through payroll.

Employee reimburses by personal check:

1. Line (A) Was paid: complete this row using the amounts from the original warrant.
2. Line (B) Earned: Recalculate Social Security tax, Medicare tax, and PERS or STRS contributions. **Do not recalculate Federal W/H, State W/H, TSA, 125C, or other deductions.**
Contact Retirement Reporting if you have questions on how to calculate retirement on an overpayment. A listing of PERS and STRS rates by fiscal year can be found on the Retirement Reporting website:
<https://www.sdcoe.net/business-services/financial-services/retirement-reporting/Pages/retirement-reporting.aspx>
3. Complete W-2c. (See year end processing Section 27 - Corrected W-2Cs)

When the district receives money from the employee for a prior calendar year overpayment, the correct IRS process is shown in the following example:

1. District completes Form 113, Salary Overpayment Computation and W-2 Correction.
2. District issues a W-2c/W-3c for the prior year, correcting only Social Security wages/taxes and Medicare wages/taxes. District **does not** correct wages, tips, and other compensation.
3. District submits Form 113 and the appropriate W-2c/W-3c to the County Office, Payroll Services SS/MED/W2c unit