


**Pennsylvania's State System of Higher Education
Tax Procedures for University Operations**

**Tax Procedure 2015-4
Wage Repayments**

Approved by:  _____
Vice Chancellor for Administration and Finance

Date: November 2, 2015

History:

Revised:

Additional History:

Related Policies, Procedures, or Standards: [State System Procedure/Standard Number 2011-08, Human Resources Manual of Commonwealth Management Directives and Manuals; Commonwealth Management Directive 315.8, Restitution of Overpayments and Collection of Employee Debts](#); collective bargaining agreements/memorandums of understanding, as applicable

Internal Revenue Service (IRS) References: IRS Publication 15, *(Circular E), Employer's Tax Guide*

All references to "university" or "universities" in this document apply to the 14 State System universities, all branch campuses, and the Office of the Chancellor.

I. Background and Summary

IRS regulations state that when an employee repays an employer for an overpayment of wages, the employer may offset the repayments against current-year Form W-2 wages only when the employee repays the wages in the same calendar year as the overpayment occurred. The State System, however, sometimes allows employees to repay part or all of overpaid wages in the following calendar year.

II. Definitions

- A. **Wages.** Wages generally include all pay given to an employee for services performed. The pay may be in cash or in other forms, including salaries, annual and sick leave, awards, fringe benefits, and compensation paid to a former employee for services performed while still employed.
- B. **Additional Medicare Tax.** The Medicare tax of 0.9% that is withheld on wages paid in excess of \$200,000 in a calendar year (in addition to the Medicare tax of 1.45% on wages less than \$200,000).

III. IRS Regulations (per IRS Publication 15)

- A. **Repayment of current year wages.** If an employer receives repayments for wages paid during a prior quarter in the current calendar year, income tax withholding, social security, and Medicare taxes can be recovered for the repaid wages.
- B. **Repayment of prior year wages.** If an employer receives repayments for wages paid during a prior calendar year or years:

1. The respective social security and Medicare taxes can be recovered, but only for the previous three years.
 2. The respective income tax withheld cannot be recovered because the wages were income to the employee for the prior year.
 3. Any respective "Additional Medicare Tax" withheld cannot be recovered.
 4. The employer must file Forms W-2c (corrected W-2) with the Social Security Administration to correct social security and Medicare wages and taxes for up to three previous years.
 5. The employer will **not** correct wages in box 1 on the respective Forms W-2c for the amount paid in error because the employee received and had use of those funds during the respective year(s).
 6. The employee will receive a copy of any Form W-2c filed on his/her behalf.
- C. **Employee reporting of repayment on tax return.** The wages paid in error in the prior year(s) remain taxable to the employee for that (those) year(s). This is because the employee received and had use of those funds during that (those) year(s). The employee is not entitled to file an amended return (Form 1040X) to recover the income tax on these wages. Instead, the employee is entitled to a deduction (or credit in some cases) for the repaid wages on his/her income tax return for the year of repayment. However, the employee should file an amended return (Form 1040X) to recover any "Additional Medicare Tax" paid on the wages paid in error in the prior year(s).

IV. State System Procedures

- A. When a wage overpayment is discovered:
1. If the overpayment is discovered by the employee, the employee must immediately notify the university human resources or payroll office.
 2. If the overpayment is discovered by the university, the university must immediately notify the employee in accordance with [Commonwealth Management Directive 315.8](#) or the employee's collective bargaining agreement/memorandum of understanding, as applicable.
 3. The university payroll office must generate a claim in SAP.
 4. The employee must work with his/her human resources office to determine repayment terms in accordance with [Commonwealth Management Directive 315.8](#) or the employee's collective bargaining agreement/memorandum of understanding, as applicable.
- B. When a wage overpayment can be and is repaid automatically, via SAP, in full from the employee's next pay, **in the same calendar year in which the overpayment occurred:**

1. The claim entered in SAP (section IV.A.3.) will generate the necessary adjustments for wages and income taxes, social security, and Medicare taxes withholding, and most other related deductions. Some manual adjustments may be required.
 2. The employee's Form W-2 will reflect the repayment of the wages and the adjustments to withholdings; i.e., the wages will appear on the Form W-2 as if the overpayment never occurred.
- C. When a wage overpayment cannot be recovered completely in the employee's next pay (i.e., if the overpayment is greater than the employee's next pay) and/or if the overpayment is repaid via a repayment plan with multiple payroll deductions, and the repayments occur **in the same calendar year in which the overpayment occurred**:
1. The university payroll office must contact the State System payroll accounting office so that any necessary transactions can be entered in SAP.
 2. The State System payroll accounting office will ensure that the necessary adjustments are generated in SAP for wages and income taxes, social security, and Medicare taxes withholding, and most other related deductions. Some manual adjustments may be required.
 3. The employee's Form W-2 will reflect the repayment of the wages and the adjustments to withholdings; i.e., the wages will appear on the Form W-2 as if the overpayment never occurred.
- D. When a wage overpayment cannot be recovered completely in the employee's next pay (i.e., if the overpayment is greater than the employee's next pay) and/or if it is repaid via a repayment plan with multiple payroll deductions, and the repayments **cross over into the calendar year(s)** following the year in which the overpayment occurred:
1. The university human resources/payroll office must advise the employee that:
 - a. IRS regulations do not allow the State System to recover an employee's federal income taxes withheld on overpaid wages that are not repaid by the end of the calendar year in which the overpayment occurred.
 - b. IRS regulations will not allow the State System to show future year repayments as reductions of wages, neither by issuing an IRS Form W-2c for the year of overpayment nor by reducing Form W-2 wages in the year repayment is made.
 - c. State and local regulations follow IRS regulations with regard to sections a. and b. above.
 2. The university payroll office must contact the State System payroll accounting office so that the necessary SAP transactions can be entered to reflect the repayment plan.
 3. The State System payroll accounting office will ensure that the necessary adjustments are generated in SAP for the full amount of social security and Medicare taxes withholding and the related wages.

4. The State System payroll accounting office will ensure that the necessary adjustments are generated in SAP for income taxes, wages, and other deductions that are repaid in the current year.
 5. In January following the year in which the overpayment occurs, the State System payroll accounting office will notify the university payroll office of the amount that the employee did not repay by the end of the calendar year. Since IRS, state, and local regulations do not allow the State System to recover taxes withheld on overpaid wages that are not repaid by the end of the calendar year in which the overpayment occurred, the balance owed by the employee will be increased by the amount of taxes that the State System is no longer able to recover from the taxing authorities.
 6. The SAP payroll deductions will continue to be made from the employee's wages on the new higher amount. It may be necessary to revise the repayment plan.
 7. The employee's Form W-2 for the year in which the overpayment occurred will reflect only the amount that the employee repaid in that year as a reduction of wages and associated taxes.
- E. When an overpayment is discovered to have occurred in a prior calendar year:
1. The university payroll office must generate a claim in SAP.
 2. The university payroll office must immediately notify the State System payroll accounting office.
 3. The university human resources/payroll office must advise the employee that:
 - a. IRS regulations do not allow the State System to recover an employee's federal income taxes withheld on overpaid wages that were not repaid by the end of the calendar year in which the overpayment occurred.
 - b. IRS regulations will not allow the State System to show repayments of prior year overpayments as reductions of wages, neither by issuing an IRS Form W-2c for the year of overpayment nor by reducing Form W-2 wages in the year repayment is made.
 - c. State and local regulations follow IRS regulations with regard to a. and b. above.
 4. The State System payroll accounting office will ensure that the necessary transactions are generated in SAP so that the claim is correctly processed.
 5. The State System payroll accounting office will calculate the amount due from the employee and notify the university human resources/payroll office of the amount.
 6. The university human resources/payroll office must notify the employee of the amount due and develop a repayment plan.
 7. The employee must repay the overpayment in accordance with [Commonwealth Management Directive 315.8](#) or the employee's collective bargaining agreement/memorandum of understanding, as applicable.

8. The State System payroll accounting office will ensure that the necessary adjustments are generated in SAP for the full amount of social security and Medicare taxes withholding for up to the previous three years and the related wages for up to the previous three years and will issue a Form W-2c to reflect only those adjustments.
- F. When an overpayment to a **separated** employee is discovered before the employee has received his/her final pay:
1. Sections IV.A.–IV.E., above, will apply, as applicable, except that the overpayment is required to be recouped **in full** from the employee's final pay(s).
 2. If the employee's final pay(s) is/are not sufficient to repay the overpayment, then the procedures in section IV.G., below, will apply to the amount not recovered.
- G. When an overpayment is discovered for a **separated** employee after the employee has received his/her final pay:
1. The university payroll office must immediately notify the State System payroll accounting office, who will calculate the amount due, recoup the social security and Medicare taxes as applicable, and ensure that any necessary adjustments are made for Form W-2 reporting.
 2. The university human resources/payroll office must notify the employee in writing of the amount due.
 3. The employee must remit repayment in full by check or money order within ten days.
 4. If the employee does not remit repayment in full within ten days, the university must notify the State System payroll operations manager.
 5. The State System payroll operations manager will recover the balance owed from the employee's State Employees' Retirement System (SERS) retirement account if applicable and possible.
 6. If the employee does not participate in SERS, or does not have a sufficient balance in his/her SERS retirement account to pay the balance due, the university will initiate standard collection procedures, including referral to the Office of Attorney General.
- H. If an employee repays an overpayment by issuing a personal check instead of having deductions from payroll, the same procedures as above will apply with regard to the timing of the repayments (i.e., whether or not repayments cross fiscal years) and the associated Form W-2 reporting.
- I. In all cases:
1. Social security and Medicare taxes will be recovered in full for up to three previous years. IRS regulations prevent recovery beyond three years.

2. Any retirement, medical, long-term disability, or other benefit contributions associated with the overpayment(s) will be recovered in full from the vendor when applicable and possible. In some circumstances, the contributions must be repaid by the employee.
 3. Recovered retirement, medical, and long-term disability employee contributions automatically will be used toward the employee's repayment, lowering the amount that the employee owes.
 4. State and local income taxes, unemployment taxes, and all other deductions related to the overpayment(s) can be recovered only to the extent repayment is made in the year of overpayment.
 5. The amount due from the employee will include all taxes and deductions that were unable to be recovered.
- J. The tax implications of wage repayments can be complex and variable. When circumstances arise that are not directly addressed in the above procedures, universities and the Office of the Chancellor will together determine the appropriate course of action to maintain compliance with IRS regulations and requirements for employee repayment.
- K. Employees should consult their tax advisor regarding how to report repayments on their tax return.