

7. Supplemental Wages

Supplemental wages are wage payments to an employee that are not regular wages. They include, but are not limited to, bonuses, commissions, overtime pay, payments for accumulated sick leave, severance pay, awards, prizes, back pay, retroactive pay increases, and payments for nondeductible moving expenses. Other payments subject to the supplemental wage rules include taxable fringe benefits and expense allowances paid under a nonaccountable plan. How you withhold on supplemental wages depends on whether the supplemental payment is identified as a separate payment from regular wages. See Regulations section 31.3402(g)-1 for additional guidance for wages paid after January 1, 2007. Also see Revenue Ruling 2008-29, 2008-24 I.R.B. 1149, available at www.irs.gov/irb/2008-24_IRB/ar08.html.

Withholding on supplemental wages when an employee receives more than \$1 million of supplemental wages from you during the calendar year. Special rules apply to the extent supplemental wages paid to any one employee during the calendar year exceed \$1 million. If a supplemental wage payment, together with other supplemental wage payments made to the employee during the calendar year, exceeds \$1 million, the excess is subject to withholding at 35% (or the highest rate of income tax for the year). Withhold using the 35% rate without regard to the employee's Form W-4. In determining supplemental wages paid to the employee during the year, include payments from all businesses under common control. For more information, see Treasury Decision 9276, 2006-37 I.R.B. 423, available at www.irs.gov/irb/2006-37_IRB/ar09.html.

Withholding on supplemental wage payments to an employee who does not receive \$1 million of supplemental wages during the calendar year. If the supplemental wages paid to the employee during the calendar year are less than or equal to \$1 million, the following rules apply in determining the amount of income tax to be withheld.

Supplemental wages combined with regular wages. If you pay supplemental wages with regular wages but do not specify the amount of each, withhold federal income tax as if the total were a single payment for a regular payroll period.

Supplemental wages identified separately from regular wages. If you pay supplemental wages separately (or combine them in a single payment and specify the amount of each), the federal income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages.

1. If you withheld income tax from an employee's regular wages in the current or immediately preceding calendar year, you can use one of the following methods for the supplemental wages.
 - a. Withhold a flat 25% (no other percentage allowed).
 - b. If the supplemental wages are paid concurrently with regular wages, add the supplemental wages to the concurrently paid regular wages. If there are no concurrently paid regular wages, add the supplemental wages to alternatively, either the regular wages paid or to be paid for the current payroll period or the regular wages paid for the preceding payroll period. Figure the income tax withholding as if the total of the regular wages and supplemental wages is a single payment. Subtract the tax withheld from the regular wages. Withhold the remaining tax from the supplemental wages. If there were other payments of supplemental wages paid during the payroll period made before the current payment of supplemental wages, aggregate all the payments of supplemental wages paid during the payroll period with the regular wages paid during the payroll period, calculate the tax on the total, subtract the tax already withheld from the regular wages and the previous supplemental wage payments, and withhold the remaining tax.
2. If you did not withhold income tax from the employee's regular wages in the current or immediately preceding calendar year, use method 1-b above. This would occur, for example, when the value of the employee's withholding allowances claimed on Form W-4 is more than the wages.

Regardless of the method you use to withhold income tax on supplemental wages, they are subject to social security, Medicare, and FUTA taxes.

Example 1.

You pay John Peters a base salary on the 1st of each month. He is single and claims one withholding allowance. In January he is paid \$1,000. Using the wage bracket tables, you withhold \$52 from this amount. In February, he receives salary of \$1,000 plus a commission of \$2,000, which you combine with regular wages and do not separately identify. You figure the withholding based on the total of \$3,000. The correct withholding from the tables is \$342.

Example 2.

You pay Sharon Warren a base salary on the 1st of each month. She is single and claims one allowance. Her May 1 pay is \$2,000. Using the wage bracket tables, you withhold \$192. On May 14 she receives a bonus of \$1,000. Electing to use supplemental wage withholding method 1-b, you:

1. Add the bonus amount to the amount of wages from the most recent base salary pay date (May 1)
($\$2,000 + \$1,000 = \$3,000$).
2. Determine the amount of withholding on the combined \$3,000 amount to be \$342 using the wage bracket tables.
3. Subtract the amount withheld from wages on the most recent base salary pay date (May 1) from the combined withholding amount ($\$342 - \$192 = \$150$).
4. Withhold \$150 from the bonus payment.

Example 3.

The facts are the same as in Example 2, except you elect to use the flat rate method of withholding on the bonus. You withhold 25% of \$1,000, or \$250, from Sharon's bonus payment.

Example 4.

The facts are the same as in Example 2, except you elect to pay Sharon a second bonus of \$2,000 on May 28. Using supplemental wage withholding method 1-b, you:

1. Add the first and second bonus amounts to the amount of wages from the most recent base salary pay date (May 1)
($\$2,000 + \$1,000 + \$2,000 = \$5,000$).
2. Determine the amount of withholding on the combined \$5,000 amount to be \$800 using the wage bracket tables.
3. Subtract the amounts withheld from wages on the most recent base salary pay date (May 1) and the amounts withheld from the first bonus payment from the combined withholding amount
($\$800 - \$192 - \$150 = \458).
4. Withhold \$458 from the second bonus payment.

Tips treated as supplemental wages. Withhold income tax on tips from wages earned by the employee or from other funds the employee makes available. If an employee receives regular wages and reports tips, figure income tax withholding as if the tips were supplemental wages. If you have not withheld income tax from the regular wages, add the tips to the regular wages. Then withhold income tax on the total. If you withheld income tax from the regular wages, you can withhold on the tips by method 1-a or 1-b discussed earlier in this section under Supplemental wages identified separately from regular wages.

Vacation pay. Vacation pay is subject to withholding as if it were a regular wage payment. When vacation pay is in addition to regular wages for the vacation period, treat it as a supplemental wage payment. If the vacation pay is for a time longer than your usual payroll period, spread it over the pay periods for which you pay it.