

INTERNAL REVENUE SERVICE

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The Honorable David Obey  
U. S. House of Representatives  
Washington, D.C. 20515-4907

Dear Mr. Obey:

This letter is in reply to your inquiry dated June 14, 2000, on behalf of your constituent, Ms. [REDACTED]. Ms. [REDACTED] is concerned about the tax rate on the severance package she was given [REDACTED]. According to Ms. [REDACTED], the package was taxed by the federal government at a rate of 43 percent.

The company making the payment probably withheld social security tax, Medicare tax, and federal income tax from the payment. We will discuss the various rates that apply for purposes of withholding these taxes.

**Severance pay is subject to social security and Medicare taxes.**

Severance pay is wages for purposes of social security taxes and Medicare taxes. The employer is required to deduct the employee portions of these taxes from wages paid to employees. The employee portion of social security tax is equal to 6.2 percent of wages and applies on wages paid by an employer to an employee of up to a maximum of \$76,200 during the calendar year 2000. The employee portion of medicare tax is equal to 1.45 percent of wages and applies to all wages. Thus, 7.65 percent (6.2 percent plus 1.45 percent) of the taxes deducted from the severance pay was probably for social security and Medicare taxes.

**Severance pay is subject to federal income taxes.**

Severance pay is also included in gross income and subject to federal income taxes. When an employer pays severance pay to an employee, the employer is required to withhold federal income tax from the payment. If the severance pay was paid in a lump sum in addition to regular wages, it would usually be a supplemental wage payment. If the employer identifies the amount of the supplemental wages separately from the amount of regular wages and has withheld income tax from the employee's regular wages, the employer must withhold on supplemental wages by using one of two methods:

(1) Add the supplemental and regular wages for the most recent payroll period of the year. Then determine the income tax withholding based on treating the total as a single payment for a single payroll period. The graduated withholding tables in Circular E, Employer's Tax Guide, apply in determining the amount of the withholding. Subtract the tax already withheld from the regular wages from the income tax withholding determined for the total payment. Withhold the remaining tax from the supplemental wages.

(2) Withhold a flat 28 percent of the supplemental wages, without allowance for exemptions and without reference to any regular payment of wages.

An employer can use either method. The 28 percent flat rate for supplemental wages was established by section 13273 of the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66.

**Your constituent may be entitled to a refund of a portion of the federal income tax withheld.**

In withholding federal income tax from the severance pay, the employer may have used method (1) described above. This method can sometimes result in withholding at a higher rate than the employee's usual rate because the entire supplemental wage payment is treated as being paid in one payroll period together with the regular wages for that period. Under the graduated withholding tables, the rate of withholding increases as the amount of wages for a payroll period increases. In some cases, because of the higher withholding rate, an employee is entitled to a refund of a portion of the income tax withheld when filing Form 1040, U.S. Individual Income Tax Return.

Ultimately, an individual's federal income tax rate depends on his or her filing status and amount of income, deductions, and credits for the year, and can be determined only after he or she has the information necessary to file a Form 1040 after the close of the year.

**Your constituent may want to estimate her tax liability for 2000.**

If your constituent wants to estimate her income tax liability for 2000, she can complete, for her own use, the 2000 Estimated Tax Worksheet on page 4 of the enclosed Form 1040-ES, Estimated Tax for Individuals, using the 2000 Tax Rate Schedules on page 2. This estimate may be useful to her in tax planning for the rest of the year.

I hope this information is helpful to you in responding to your constituent. If you have further questions, please call Alfred G. Kelley (Identification Number 50-03882) at (202) 622-6040.

Sincerely,

Nancy J. Marks  
Acting Division Counsel/  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosure