



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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The Honorable [REDACTED]
U. S. House of Representatives
Washington, D.C. 20515

Attention: Mr. [REDACTED]

Dear [REDACTED]:

This letter responds to your inquiry dated August 13, 2001, to the Commissioner of the Internal Revenue Service on behalf of your constituent, Mr. [REDACTED]. You ask whether Mr. [REDACTED] wages for his "extended contract" with the county school system are supplemental wages subject to income tax withholding at a flat percentage rate of 28 percent¹ and, if so, whether he can claim a refund if his gross income is subject to a lower tax rate. I am providing you the following general information, which I hope is helpful.

Generally, every employer is responsible for withholding income tax from an employee's wages actually or constructively paid. [Section 3402(a)(1) of the Internal Revenue Code]. This section provides two methods for withholding: the percentage method and the wage bracket method.

Supplemental wages are compensation paid in addition to the employee's regular wages. They include, but are not limited to, overtime pay, severance pay, commissions, and bonuses paid for the same or different payroll period or without regard to a particular payroll period. The regulations provide several procedures an employer can use to determine the amount of tax to withhold from supplemental wages.

Supplemental Wages Paid Concurrently with Regular Wages

If an employee's supplemental wages are paid concurrently with the employee's regular wages and the amounts of each are not specified, the employer determines the tax

¹Effective for wages paid after August 6, 2001, the withholding rate for supplemental wages is decreased from 28 percent to 27.5 percent.

withheld as if the supplemental wages are combined with the regular wages paid for the payroll period. [Treasury Regulation section 31.3402(g)-1(a)(2)]. If, however, the employer combines the regular and supplemental wages in one payment and the employer specifically indicates the amount of each in its payroll records, the employer can withhold federal income tax at a flat rate of 27.5 percent on the portion of the total payment representing the supplemental wage payment if tax is withheld on the regular wage portion at the appropriate rate. [Treasury Regulation section 31.4302(g)-1(a)(2)(ii) and Revenue Ruling 82-200, 1982-2 C.B. 329].

Supplemental Wages and Regular Wages Paid Separately

If the employer separately pays both regular wages and supplemental wages to an employee and withholds the appropriate income tax on the regular wages, the employer can choose one of the following methods to withhold federal income tax on the supplemental wages: (1) withhold tax from the supplemental wages at the flat rate of 27.5 percent (2) use the aggregation method as described under Treasury Regulation section 31.31.3402(g)-1(a)(2). According to this method, the employer totals the supplemental wages and the regular wages paid in the same calendar year, either for the last preceding payroll period or for the current payroll period, and determines the income tax to be withheld as if the total amount were a single payment. The employer then subtracts from this amount, the income tax already withheld from the regular wages and withholds the remaining tax from the supplemental wages.

Special Rule Where the Aggregate Exemption Exceeds Wages Paid

An employer can apply a special rule to supplemental wages paid for a period covering two or more consecutive payroll periods of no less than one week for which an employee receives other wages, and his total withholding exemptions exceed his total wages for the regular payroll period (i.e., no income tax was withheld from his regular wages). [Treasury Regulation section 31.3402(g)-1(b)]. In this situation, an employer can determine the amount of taxes to withhold on such supplemental wages as follows:

- (1) Determine the average wage for each payroll period to which the supplemental payment relates by dividing the sum of the regular and the supplemental wage payments by the number of applicable payroll periods.
- (2) Determine the withholding tax on the amount calculated in (1) as if that amount were actually paid to the employee for such payroll period, then multiply the amount by the number of payroll periods applicable.
- (3) Subtract the amount calculated in (2) from any taxes actually withheld from the employee's regular wages; the remaining amount, if any, is the amount of tax to be withheld from the employee's supplemental wage payment.

Supplemental wages are also subject to taxes under the Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA).

Refund if Employee's Wages are Subject to a Lower Rate

If an employee's wages are subject to an income tax withholding rate in excess of the employee's tax liability, the employee can claim a refund on his or her individual income tax return (Form 1040) for the year he or she received the wages.

If you would like further assistance on this matter, please contact [REDACTED], employee identification number [REDACTED], at (202) 622-6040.

Sincerely,

Jerry E. Holmes
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)