



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

OFFICE OF THE CHIEF COUNSEL

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Dear

This letter responds to your request for information dated May 23, 2013, concerning whether severance pay is subject to social security tax, Medicare tax, and federal income tax withholding.

Section 31.3121(a)-1(i), 31.3306(b)-1(i), and 31.3401(a)-1(a)(5) of the Employment Tax Regulations provide that remuneration for employment, unless specifically excepted, constitutes "wages" subject to employment taxes even though at the time paid the individual is no longer an employee.

Income tax withholding

Rev. Rul. 2008-29, 2008-1 C.B. 1149, concerns income tax withholding and provides nine different examples of payments of supplemental wages for income tax withholding purposes. In situation 6 of the ruling, an employer has a severance pay plan for its employees under which an employee that is involuntarily terminated will receive severance pay based on his or her ending regular pay and the number of years the employee performed services as an employee for the employer. Rev. Rul. 2008-29 concludes, with respect to situation 6, that the severance pay is supplemental wages. Therefore, the employer must withhold income tax on the severance pay based on the rules applicable in determining income tax withholding on supplemental wages.

If a supplemental wage payment, together with other supplemental wage payments made to the employee during the calendar year, exceeds \$1,000,000, the excess is subject to withholding at 39.6% (or the highest rate of income tax for the year). The amount of withholding on supplemental wages in excess of \$1,000,000 paid to one employee during a calendar year is determined without regard to the employee's Form

W-4, Employee's Withholding Allowance Certificate, and without regard to whether income tax has been withheld from the regular wages of the employee.

The remainder of the letter concerns the rules that apply If the supplemental wages paid to the employee during the calendar year are less than or equal to \$1,000,000.

There are two procedures for withholding on supplemental wages paid to an employee that apply where the supplemental wage payment, together with other supplemental wages paid to the employee during the calendar year, does not exceed \$1,000,000. The first procedure is the aggregate procedure. Under the aggregate procedure, the employer adds the supplemental wages to the regular wages paid to the employee during a payroll period and then applies the regular income tax withholding tables to determine the amount of withholding. To be specific, if the supplemental wages are paid concurrently with regular wages, the employer adds the supplemental wages to the concurrently paid regular wages. If there are no concurrently paid regular wages, the employer adds the supplemental wages to either the regular wages paid or to be paid for the current payroll period or the regular wages paid for the preceding payroll period. The employer then determines the amount of income tax withholding as if the total of the regular wages and the supplemental wages is a single payment. Then the employer subtracts the income tax withheld from the regular wages and withholds the remaining income tax from the supplemental wages.

Another procedure, 25% flat rate withholding, can be used for supplemental wages paid to an employee that do not exceed \$1,000,000 during the calendar year, provided certain requirements are met. The employer can use this flat rate withholding to determine the amount of income tax to withhold on a supplemental wage payment if the supplemental wages are not paid concurrently with regular wages or are separately stated in the payroll records of the employer and if income tax has been withheld from regular wages of the employee during the calendar year of the payment or the preceding calendar year. If the requirements for use of this 25% flat rate withholding are satisfied, the employer can use either the aggregate procedure or this flat rate withholding in determining the amount of income tax to withhold on a payment of supplemental wages, at the option of the employer. Income tax withholding using the 25% flat rate on supplemental wages is made without reference to any payment of regular wages, without allowance for the number of withholding allowances claimed by the employee on Form W-4, and without regard to whether the employee has requested additional withholding on Form W-4.

Social Security, Medicare, and Federal Unemployment Tax Act (FUTA) tax

In addition, generally, severance pay is also subject to social security tax, Medicare tax, and FUTA tax. Rev. Rul. 71-408, 1971-2 C.B. 340, holds that dismissal payments are wages for purposes of the social security tax, Medicare tax, FUTA tax, and federal income tax withholding. See also Rev. Rul. 2004-110, 2004-2 C.B. 960 (holding that amounts paid to an employee as consideration for the cancellation of an employment

contract and relinquishment of contract rights are wages for purposes of social security tax, Medicare tax, FUTA tax, and federal income tax withholding).

The employer is required to withhold the employee portions of social security tax and Medicare tax on the severance pay and deposit the withheld amounts. The employer is also required to pay the employer portion of social security tax and Medicare tax and to pay FUTA tax on the severance pay.

Summary

In summary, severance pay is generally wages subject to social security tax, Medicare tax, FUTA tax, and income tax withholding. The employer must withhold income tax and the employee portions of social security tax and Medicare tax on such wages and pay over such withholding. The employer is also liable for the employer portion of social security and Medicare tax and for FUTA tax on such wages

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2013-1, §2.04, 2013-1 I.R.B. 7 (Jan. 2, 2013). If you have any additional questions, please contact our office at

Sincerely,

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Entities)
(Tax Exempt & Government Entities)