



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

OFFICE OF THE CHIEF COUNSEL

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Dear

This is in reply to your letter of January 21, 2010, requesting general information concerning the options available to an employer in determining the amount of income tax to withhold on payments of a severance allowance.

Severance pay is supplemental wages, and thus employers generally have two options for determining the amount of income tax to withhold from the wages (provided the employee's supplemental wages paid by the employer do not exceed \$1,000,000 for the calendar year). The first option is that employers can withhold at a flat rate of 25 percent of the wages, without taking into account an employee's filing status or any allowances claimed by the employee on Form W-4, Employee's Withholding Allowance Certificate. This first option is available if the employer has withheld income tax from regular wages paid to the employee during the calendar year of the payment of the supplemental wages or the preceding calendar year and if the supplemental wages are separately stated on the payroll records of the employer.

A second option is available to employers in every case where the employer is paying supplemental wages (provided the employee's supplemental wages paid by the employer do not exceed \$1,000,000 for the calendar year). This option is known as the aggregate procedure. Under the aggregate procedure, the employer adds the amount of supplemental wages for the payroll period to the regular wages (if any) for the current or preceding payroll period. Then the employer determines the income tax withholding on the total based on the wage withholding tables for the payroll period, taking into consideration the allowances and filing status claimed by the employee on Form W-4. Then, the employer subtracts the amount withheld from regular wages (if any) from the

withholding on the total calculated in the previous step, and withholds the remaining amount from the supplemental wages.

The second option for withholding on supplemental wages as described above (the aggregate procedure) may result in more accurate withholding if the former employee is receiving periodic payments of severance pay each payroll period, and no other wages for each payroll period. Because under the second option the severance pay paid in periodic payments would be added to regular wages of zero for the payroll period to determine withholding, withholding on the periodic payments under the second option would result in withholding similar to the withholding that would apply if the severance pay were regular wages for the payroll period.

On the other hand, if a lump sum payment of severance pay is being made rather than a series of payments, use of the second option may produce withholding in excess of the tax liability of the employee on the pay because all the severance pay is considered paid in one payroll period. However, the comparative results of use of the first method versus the use of the second method vary with different factual situations, and the employer generally has the option of using either method.

Please note that the rate of income tax on the severance pay ultimately depends on the employee's individual tax situation and may vary significantly from the rate of income tax withholding.

If you have any questions, please call _____ at _____ (not a toll-free number).

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2 (Exempt
Organizations/Employment Tax/Government
Entities)
(Tax Exempt & Government Entities)