

STATE CONTROLLER TECHNICAL GUIDANCE

SUPPLEMENTAL WAGES

1) AUTHORITY.

U.S. Code, Title 26, §3101 Rate of Tax (Internal Revenue Code)
IRS Regulations section 31.3402(g)-1

2) PURPOSE OF THIS TECHNICAL GUIDANCE. The Office of the State Controller is providing this technical guidance to inform State Agencies and Institutions of Higher Education of tax issues related to Supplemental Wages.

3) DEFINITIONS.

a. Accountable Plan – An employer’s reimbursement or allowance arrangement must meet all three of the following rules to be an accountable plan:

1. Business Connection - The expenses must have been paid or incurred by the employee while performing services for the employer,
2. Substantiation - The employee must adequately account for the expenses within a reasonable time to the employer, and
3. Returning amounts in excess of expenses - Any excess reimbursement or allowance amount must be returned to the employer within a reasonable time.

b. Non-Accountable Plan - An employer’s reimbursement or allowance arrangement does not satisfy one or more of the requirements of an Accountable Plan.

c. 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 non-accountable plan. How you withhold on supplemental wages depends on whether the supplemental payment is identified as a separate payment from regular wages.

d. Internal Revenue Code – U.S. Code, Title 26, §§, et seq.

e. IRS Publications – Publications issued by the Internal Revenue Service, including without limitation the Internal Revenue Service cumulative bulletins.

f. IRS Regulations – The rules and regulations of the Internal Revenue Service/Department of the Treasury promulgated under the Internal Revenue Code.

4) TAXES AND SUPPLEMENTAL WAGES

Supplemental wages are subject to social security, Medicare, and FUTA taxes.

5) WITHHOLDING METHOD FOR SUPPLEMENTAL WAGES

If the employer pays 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 the employer withholds income tax from the employee's regular wages.

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- a. **Employer Withheld** - If the employer withheld income tax from an employee's regular wages in the current or immediately preceding calendar year, the employer can use one of the following:
1. **Flat Percentage** - Withhold a flat 22% (no other percentage allowed).
 2. **Aggregation** - 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 already withheld or to be 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.
- b. **Employer Did Not Withhold** - If employer did not withhold income tax from the employee's regular wages in the current or immediately preceding calendar year, use method a-2. This would occur, for example, when the value of the employee's withholding allowances claimed on Form W-4 is more than the wages.
- c. **Withholding Method for State Agencies** - State agencies shall use the aggregation method for tax withholding and withhold associated taxes. This change shall be effective January 1, 2019.

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