



Public Schools of North Carolina

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MEMORANDUM

TO: Superintendents

FROM: H. Hank Hurd

SUBJECT: Federal and State Withholding Requirements on Supplemental Pay

The following is information on the process of taxing supplemental wages based on the Internal Revenue Service guidelines. This memorandum and related attachments are available on our web site at www.ncpublicschools.org/fbs/news.htm.

The Internal Revenue Service Publication 15, *Circular E, Employers Tax Guide 7*, states that supplemental wages are compensation paid in addition to the employee's regular wages. Withholding on supplemental payments depends on whether the supplemental payment is identified as a separate payment from regular wages. If you pay supplemental wages **with** regular wages but do not specify the amount of each, withhold income tax as if the total were a single payment for a regular payroll period. If you pay supplemental wages **separately** or combine them in a single payment, (specify the amount of each), the income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages, the following would apply:

1. If you withheld income tax from an employee's regular wages you may use one of the following methods for the supplemental wages:
 - a. Withhold a flat 27% (no other percentage is allowed) or
 - b. Add the supplemental and regular wages for the most recent payroll period this year. Then figure the income tax withholding as if the total were a single payment. Subtract the tax already withheld from the regular wages and withhold the remaining tax from the supplemental wages.
2. If you did not withhold income tax from the employee's regular wages **method 1b** (detailed above) should be used. (This would occur, for example, when the value of the employee's withholding allowances claimed on Form W-4 is more than the wages.)

North Carolina Department of Revenue NC 30 also offers two options except for the percentage withheld. It states that if you pay supplemental wages separately or combine them with regular

in a single payment and specify the amount of each. The income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages or if you withhold income tax from an employee's regular wages. One of the following methods may be used if you withhold income tax from an employee's regular wages:

1. Withhold a flat 6%, or
2. Add the supplemental and regular wages for the most recent payroll period this year. Then figure the income tax as if the total were a single payment. Subtract the tax already withheld from the regular wages. If you did not withhold income tax from the employee's regular wages used method (b).

The information provided by the Internal Revenue Service and the North Carolina Department of Revenue provide some flexibility to employers. The decision on methodology used would be at the discretion of the school districts. It is my hope that the districts are not straying from applicable federal and state law. It bears mentioning that I am unaware of any inconsistencies in the calculation of taxes for supplemental wages.

I hope this information helps to satisfy any concerns you may have pertaining to the proper taxation of supplemental wages. If you have any questions, please contact Jennifer Bennett, Director of Division School Business at (919) 807-3700. Thank you.

HHH:JSB:AM

OFBS 02-001

Income Tax Withholding Tables and Instructions for Employers



New for 2002

- Effective for wages paid on or after January 1, 2002, employers whose average withholding is less than \$250 per month report and pay the withholding taxes quarterly. Employers whose withholding is an average of at least \$250 but less than \$2,000 per month report and pay the tax monthly. (See page 10)
- Standard deduction for married individuals increased to \$2,750
- New tax rate bracket of 8.25% for higher income taxpayers

The standard deduction and tax rate changes above are reflected in the tax tables contained in this book.

Includes Forms:

AS/RP 1

Registration for Sales and Use Tax
or Income Tax Withholding

Form NC-4

Employee's Withholding Allowance
Certificate

Form NC-4P

Withholding Certificate for Pension
or Annuity Payments

Issued by
North Carolina Department of Revenue
P.O. Box 25000
Raleigh, North Carolina 27640-0001

For Permanent Reference - Enter your North Carolina employer's
withholding identification number here _____

withholding of state income tax from the wages of a seaman on a vessel engaged in foreign, coastwide, inter-coastal, interstate, or noncontiguous trade. Vessels engaged in other activity do not come under the restrictions however, any seaman who is employed in coastwide trade between ports in this State may have tax withheld if the withholding is pursuant to a voluntary agreement between such seaman and his employer.

Severance wages. The first \$35,000 of severance wages paid to an employee (whether paid in one year or over several years) as a result of the employee's permanent, involuntary termination from employment through no fault of the employee is exempt from withholding.

11. Payroll Period

See Federal Publication **15**, Circular E, Employer's Tax Guide for information on payroll period.

12. Supplemental Wages

If you pay supplemental wages separately (or combine them with regular wages in a single payment and specify the amount of each), the income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages. If you withhold income tax from an employee's regular wages, you can use one of these methods for the supplemental wages:

(a) Withhold a flat **6%**, or

(b) Add the supplemental and regular wages for the most recent payroll period this year, Then figure the income tax as if the total were a single payment. Subtract the tax already withheld from the regular wages. Withhold the remaining tax from the supplemental wages. If you did not withhold income tax from the employee's regular wages, use method (b).

If you pay an employee vacation pay in addition to regular wages, treat the vacation pay as supplemental wages.

See Federal Publication **15**, Employer's Tax Guide, for additional information on supplemental wages.

Tips treated as supplemental wages. Withhold the income tax on tips from wages or from funds the

employee makes available. If an employee receives regular wages and reports tips, figure income tax as if the tips were supplemental wages. If you have not withheld income tax from the regular wages, add the tips to the regular wages, Then withhold income tax on the total. If you withheld income tax from the regular wages, you can withhold on the tips by method (a) or (b).

13. Employee's Withholding Allowance Certificate, Form NC-4

Each new employee must furnish you with a signed North Carolina Employee's Withholding Allowance Certificate, Form NC-4. If an employee fails to furnish a withholding allowance certificate, you must withhold tax as if the employee is single with zero withholding allowances. A certificate filed by a new employee is effective upon the first payment of wages thereafter and remains in effect until a new one is furnished unless the employee claimed total exemption from withholding during the prior year. An employee claiming exemption from withholding must provide you with a new NC-4 by February 15th. If the employee does not give you a new NC-4, withhold tax as if he or she is single with zero withholding allowances. State and federal definitions of dependent, single person, married, head of household and qualifying widow(er) are the same; however, the number of allowances to which an individual is entitled will differ. Federal Withholding Allowance Certificates are not acceptable.

You are not required to determine whether the total amount of allowances claimed is greater than the total amount to which the employee is entitled. However, you should immediately advise the Department if you believe that the amount of allowances claimed by an employee is greater than the amount to which such employee is entitled.

Submission of certain withholding allowance certificates. An employer is required to submit copies of any certificates (Form NC-4) on which the employee claims more than 10 withholding allowances or claims exemption from withholding and the employee's wages would normally exceed \$200 per week, Retain the original certificate in your files.

When to submit, An employer filing quarterly withholding reports is required to submit copies of the certificates received during the quarter at the time for filing



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7. Supplemental Wages

Supplemental wages are compensation paid in addition to the employee's regular wages. They include, but are not limited to, bonuses, commissions, overtime pay, payments for accumulated sick leave, severance pay, awards, prizes, back pay and retroactive pay increases for current employees, and payments for nondeductible moving expenses. Other payments subject to the supplemental wage rules include taxable fringe benefits and expense allowances paid under a nonaccountable plan. How you withhold on supplemental payments depends on whether the supplemental payment is identified as a separate payment from regular wages.

Supplemental wages combined with regular wages. If you pay supplemental wages with regular wages but do not specify the amount of each, withhold income tax as if the total were a single payment for a regular payroll period.

Supplemental wages identified separately from regular wages. If you pay supplemental wages separately (or combine them in a single payment and specify the amount of each), the income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages:

1. If you *withheld* income tax from an employee's regular wages, you can use one of the following methods for the supplemental wages:
 - a. Withhold a flat 27% (no other percentage allowed).
 - b. Add the supplemental and regular wages for the most recent payroll period this year. Then figure the income tax withholding as if the total were a single payment. Subtract the tax already withheld from the regular wages. Withhold the remaining tax from the supplemental -wages.
2. If you *did not withhold* income tax from the employee's regular wages, use method **b** above. (This would occur, for example, when the value of the employee's withholding allowances claimed on Form W-4 is more than the wages.)

Regardless of the method you use to withhold income tax on supplemental wages, they are subject to social security, Medicare, and FUTA taxes.

Example 1. You pay John Peters a base salary on the 1st of each month. He is single and claims one withholding allowance. In January of 2002, he is paid \$1,000. Using the wage bracket tables, you withhold \$58 from this amount. In

February 2002, he receives salary of \$ 1,000 plus a commission of \$2,000, which you include in regular wages. You figure the withholding based on the total of \$3,000. The correct withholding from the tables is \$394.

Example 2. You pay Sharon Warren a base salary on the 1st of each month. She is single and claims one allowance. Her May 1, 2002, pay is \$2,000. Using the wage bracket tables, you withhold \$208. On May 14, 2002, she receives a bonus of \$2,000. Electing to use supplemental payment method **b**, you:

1. Add the bonus amount to the amount of wages from the most recent pay date ($\$2,000 + \$2,000 = \$4,000$).
2. Determine the amount of withholding on the combined \$4,000 amount to be \$664 using the wage bracket tables.
3. Subtract the amount withheld from wages on the most recent pay date from the combined withholding amount ($\$664 - \$208 = \$456$).
4. Withhold \$456 from the bonus payment.

Example 3. The facts are the same as in Example 2, except that you elect to use the flat rate method of withholding on the bonus. You withhold 27% of \$2,000, or \$540, from Sharon's bonus payment.

Tips treated as supplemental wages. Withhold income tax on tips from wages or from other funds the employee makes available. If an employee receives regular wages and reports tips, figure income tax as if the tips were supplemental wages. If you have not withheld income tax from the regular wages, add the tips to the regular wages. Then withhold income tax on the total. If you withheld income tax from the regular wages, you can withhold on the tips by method **a** or **b** above.

Vacation pay. Vacation pay is subject to withholding as if it were a regular wage payment. When vacation pay is in addition to regular wages for the vacation period, treat it as a supplemental wage payment. If the vacation pay is for a time longer than your usual payroll period, spread it over the pay periods for which you pay it.

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**INDIVIDUAL INCOME TAX
BULLETINS**

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**TAXABLE YEARS
2001 AND 2002**

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20. Severance Wages

The first \$35,000 of severance wages paid to an employee (whether paid in one year or over several years) as a result of the employee's permanent, involuntary termination from employment through no fault of the employee is exempt from withholding.

21. Supplemental Wage Payments

If an employer pays supplemental wages separately (or combines them in a single payment and specifies the amount of each), the income tax withholding method depends partly on whether the employer withholds income tax from the employee's regular wages.

If tax has been withheld on the regular wages and the supplemental amount is not paid in a single payment together with regular wages, the employer may treat the supplemental wages as wholly separate from the regular wages and apply a flat rate of 6 percent to the supplemental wage payment without making any allowance for exemptions. Otherwise, the supplemental wages are added to the regular wages for the most recent payroll period. The income tax is figured as if the regular wages and supplemental wages constitute a single payment. The tax already withheld from the regular wages is subtracted from this amount. The remaining tax is then withheld from the supplemental wages. If the employer did not withhold income tax from the employee's regular wages, the employer must add the supplemental wages to the employee's regular wages paid for the current or last preceding payroll period and withhold tax as though the supplemental wages and regular wages were one payment.

Tips treated as supplemental wages. The employer withholds the income tax on tips from wages or from funds the employee makes available. If an employee receives regular wages and reports tips, the employer figures income tax as if the tips were supplemental wages. If the employer has not withheld income tax from the regular wages, the employer adds the tips to the regular wages and withholds income tax on the total. If the employer withheld income tax from the regular wages, the employer can withhold on the tips as explained above.

22. Wage and Tax Statements

North Carolina Wage and Tax Statements, Form NC-2, are available to all employers without charge. An employer may, however, use the six part Federal Form W-2 or any other alternate forms which have been designed for his payroll equipment if they provide the same information and the same number of copies as the official form. When completed, the state copies must show the employer's North Carolina withholding identification number and must clearly designate the state tax as North Carolina tax. Statements which do not meet the above requirements will not be accepted and employees cannot be given credit for the tax withheld.