# Tax Rates on Payroll

Improper calculations of tax rates while working in payroll can lead to many problems with the IRS, an organization that can make your life difficult in ways we can't begin to imagine. On the other side, bad tax calculations can put your employees at risk for underpayment when they file their taxes after W-2s are issued. And woe to the payroll employee who has to face a crowd of teachers, paystubs in hand, questioning their deductions. Solid district procedures, IRS guidance, and a little help from this guide should help you out.

The biggest confusion about withholdings center around what is sometimes called "The Gift Rate" for taxes. This is a flat 25% tax rate that the employer withholds instead of using the usual tax tables to generate a calculated tax. Primarily used on "supplemental wages", this rate can work to the advantage of your payroll department because it is not only easy to set up, it's much simpler to explain than the normal tax calculations.

From IRS Publication 15 (Circular E) - http://www.irs.gov/pub/irs-pdf/p15.pdf

> 7. 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. See Regulations section 31.3402(g)-1 for additional guidance for wages paid after January 1, 2007. Also see Revenue Ruling 2008-29, 2008-24 I.R.B. 1149, available at http://www.irs.gov/irb/2008-24_IRB/ar08.html

For clarification, the Circular E goes on to give options on how taxes can be withheld on any supplemental wages.

1. If you withheld income tax from an employee's regular wages in the current or immediately preceding calendar year, you can use one of the following methods for the supplemental wages.
    a. Withhold a flat 25% (no other percentage allowed).
    b. 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 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.

Now for the English translation: You have a choice on whether to use the optional flat rate (which is 25% according to IRS Publication 15) or to use the aggregate method. What the aggregate method is telling the employer to do is add the wages together and tax the employee based on the sum of those wages if they are in the same check. IVEE already does part of this. So the question is, what about those instances where a separate check is created for Supplemental Pays? You would use the tax amount for "the most recent payroll period" as long as it's within the same calendar year. Meaning that you would use the tax amount as if you paid the Supplemental on the same check with the employee's regular pay, subtracting the amount already paid by the employee for the last pay period. So if you had an employee check for $1,200 worth of regular wages, and then cut a check for a $500 stipend, the total tax amount would be based off a lump $1,700 payment.

### Example 1:

Mary Oatblossom is a single employee with 1 exemption who makes a taxable wage of $1,200 a check. She is also the girl's softball coach and is due a $500 stipend for it.

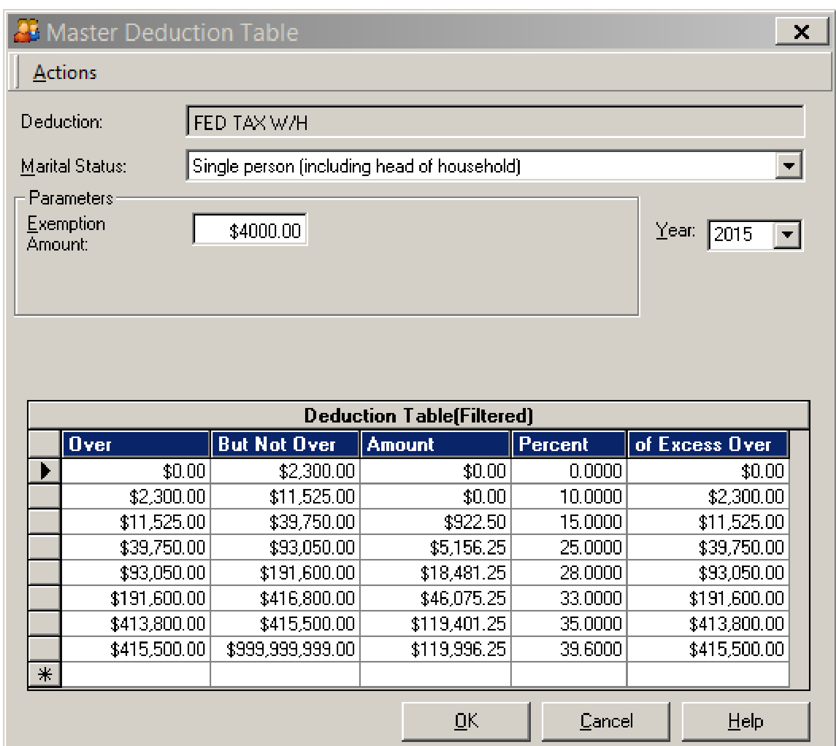
Here we will calculate the tax amounts:

**Separately:**

Since IVEE annualizes the wage amount to get the tax rate, we have to annualize each amount.

| Regular Wages | Supplemental Pay (stipend) |
|---|---|
| $1200 x 26 pays = $31,200 | $500 x 26 pays = $13,000 |
| She has 1 exemption, so we subtract $4,000 (the 2015 amount from IRS Pub 15). | |
| $31,200 - $4,000 (1 exemption) = $27,200 | $13,000 - $4,000 (1 exemption) = $9,000 |

Using the tax table you can locate which tax bracket she falls into.


Master Deduction Table

Actions

Deduction: FED TAX W/H

Marital Status: Single person (including head of household)

Parameters

Exemption Amount: $4000.00

Year: 2015

Deduction Table(Filtered)

| Over | But Not Over | Amount | Percent | of Excess Over |
|---|---|---|---|---|
| $0.00 | $2,300.00 | $0.00 | 0.0000 | $0.00 |
| $2,300.00 | $11,525.00 | $0.00 | 10.0000 | $2,300.00 |
| $11,525.00 | $39,750.00 | $922.50 | 15.0000 | $11,525.00 |
| $39,750.00 | $93,050.00 | $5,156.25 | 25.0000 | $39,750.00 |
| $93,050.00 | $191,600.00 | $18,481.25 | 28.0000 | $93,050.00 |
| $191,600.00 | $416,800.00 | $46,075.25 | 33.0000 | $191,600.00 |
| $413,800.00 | $415,500.00 | $119,401.25 | 35.0000 | $413,800.00 |
| $415,500.00 | $999,999,999.00 | $119,996.25 | 39.6000 | $415,500.00 |

OK Cancel Help

| | |
|---|---|
| $27,200 falls on line 3 | $9,000 falls within line 2 |
| For $27,200 the tax is $922.50 + 15% of any earnings over $11,525 | For $9,000 the tax is $0 + 10% of any earnings over $2,300 |
| $27,200 - $11,525 = $15,675 | $9,600 - $2,300 = $6,700 |
| $15,675 * 15% = $2,351.25 | $6,700 * 10% = $670 |
| $2,351.25 + $922.50 = $3,273.75 Total Tax | $0 + $670 = $670 Total Tax |
| Now we have to "de-annualize" the tax to get the per pay period amount. | |
| $3,273.75 / 26 pays = $125.91 Tax | $670 / 26 pays = $27.77 Tax |

So if these checks were processed separately, the total tax would be $153.68.

**Together:**

$1,200 + $500 = $1,700 Taxable Wages.

Annualize the amount…

$1,700 * 26 pays = $44,200 Annual Wages.

Take away Mary's 1 exemption…

$44,200 - $4,000 = $40,200

$40,200 falls on line 4 of the tax table above which is a tax of $5,156.25 + 25% of any earnings over $39,750.

$40,200 – $39,750 = $450

$450 * 25% = $112.50

$112.50 + $5,156.25 = $5268.75 Total Tax

Now when the salary is "de-annualizes" you can calculate the per pay period tax amount…

$5268.75 / 26 = $202.64

**Results:**

As you can see, the difference between the bundled amount and the separate amount is a pretty sizable $45.96. The other option is to use the 25% flat rate on the supplemental pay, which would have resulted in a $125 tax on the $500 stipend… Meaning a total of $250.91 in taxes if the checks were processed separately.

The process of computing the tax for the lump sum then subtracting the amount of tax paid on the last pay period and taking the difference out of the supplemental pay would be:

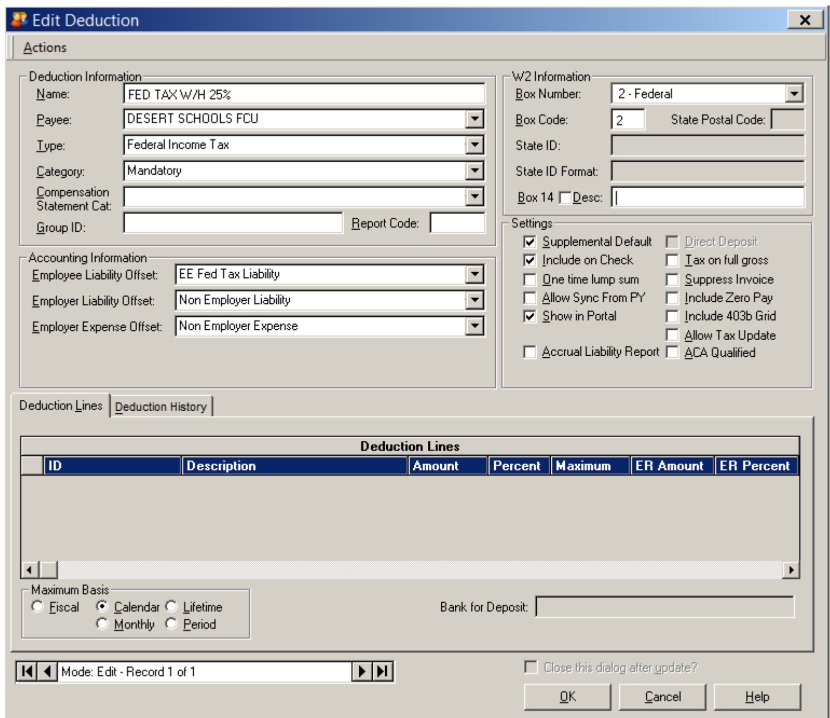
$233.73 (lump sum tax) - $130.73 (tax paid on prior pay period) = $103 (tax to be paid from stipend)

Of course, for any district on IVEE this would put an enormous burden on your Payroll Department if they had to do this for every stipend on a separate check.

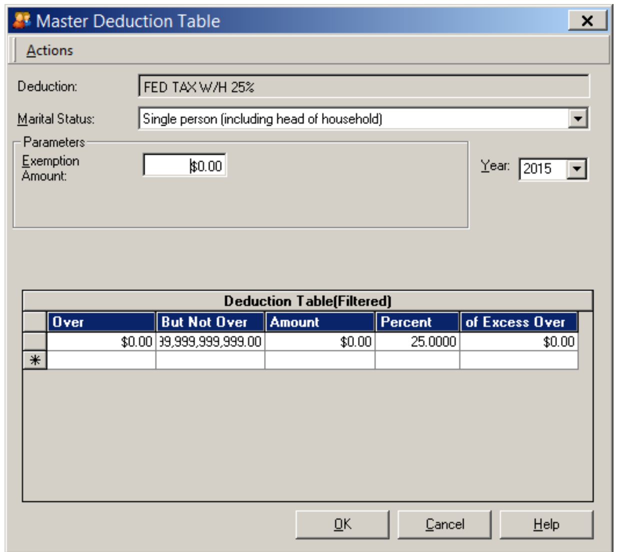
**What to do?**

The easiest thing to do would be to push employees to take the lump sum check, bundling their supplemental pays in with the regular pay. In most cases this results in the lowest amount of tax that the employee has to pay (unless their annualized taxable wages pushes them into a tax line with more than 25% withholdings). But sometimes this may not be an option (or advantageous if they are pushed into a higher tax line) so you should withhold 25% of the taxable wages.

A solution would be to set up a new deduction (*Payroll > Deductions/Benefits > Deduction/Benefit Maintenance*) with a type of "Federal Income Tax".



Once the main setup is complete, go to *Actions > Setup* and enter in a tax table like the following:




Both the Single & Married table would be filled out the same. Notice there is a $0 for the Exemption Amount. According to the IRS, the flat 25% rate "allows employers to disregard the amount of regular wages paid to an employee as well as the withholding allowances claimed by an employee on Form W-4."

Finally, when running your payroll to process this separate check, make sure that you do not have both Federal Tax deductions active on the same employee. Either deselect the funding line for the Supplemental Pay in your normal Fed Tax W/H deduction, or if this pay period is only for your 25% withholding checks, deselect the pay period in your Fed Tax W/H (*Actions > Schedule*).