exemption certificates filed electronically by employees on or after January 2, 1997.

(ii) Special rule for certain Forms W–4.
In the case of an electronic system that precludes the filing of Forms W–4 required on commencement of employment and Forms W–4 claiming more than 10 withholding exemptions or exemption from withholding, the requirements of paragraph (c)(2)(iii) of this section will be treated as satisfied if the Form W–4 is filed electronically before January 1, 1999.

§ 31.3402(g)–1 Supplemental wage payments.
(a) In general and withholding on supplemental wages in excess of $1,000,000—
(1) Determination of supplemental wages and regular wages—(i) Supplemental wages. An employee’s remuneration may consist of regular wages and supplemental wages. Supplemental wages are all wages paid by an employer that are not regular wages. Supplemental wages include wage payments made without regard to an employee’s payroll period, but also may include payments made for a payroll period. Examples of wage payments that are included in supplemental wages include reported tips (except as provided in paragraph (a)(1)(v) of this section), overtime pay (except as provided in paragraph (a)(1)(iv) of this section), bonuses, back pay, commissions, wages paid under reimbursement or other expense allowance arrangements, nonqualified deferred compensation includible in wages, wages paid as noncash fringe benefits, sick pay paid by a third party as an agent of the employer, amounts that are includible in gross income under section 409A, income recognized on the exercise of a nonstatutory stock option, wages from imputed income for health coverage for a nondependent, and wage income recognized on the lapse of a restriction on restricted property transferred from an employer to an employee. Amounts that are described as supplemental wages in this definition are supplemental wages regardless of whether the employer has paid the employee any regular wages during either the calendar year of the payment or any prior calendar year. Thus, for example, if the only wages that an employer has ever paid an employee are payments of noncash fringe benefits and income recognized on the exercise of a nonstatutory stock option, such payments are classified as supplemental wages.

(ii) Regular wages. As distinguished from supplemental wages, regular wages are amounts that are paid at a regular hourly, daily, or similar periodic rate (and not an overtime rate) for the current payroll period or at a predetermined fixed determinable amount for the current payroll period. Thus, among other things, wages that vary from payroll period to payroll period (such as commissions, reported tips, bonuses, or overtime pay) are not regular wages, except that an employer may treat tips as regular wages under paragraph (a)(1)(v) of this section and an employer may treat overtime pay as regular wages under paragraph (a)(1)(iv) of this section.

(iii) Amounts that are not wages subject to income tax withholding. If an amount of remuneration is not wages subject to income tax withholding, it is neither...
regular wages nor supplemental wages. Thus, for example, income from the disqualifying dispositions of shares of stock acquired pursuant to the exercise of statutory stock options, as described in section 421(b), is not included in regular wages or supplemental wages.

(iv) Optional treatment of overtime pay as regular wages. Employers may treat overtime pay as regular wages rather than supplemental wages. For this purpose, overtime pay is defined as any pay required to be paid pursuant to federal (Fair Labor Standards Act), state, or local governmental laws at a rate higher than the normal wage rate of the employee because the employee has worked hours in excess of the number of hours deemed to constitute a normal work week or work day.

(v) Optional treatment of tips as regular wages. Employers may treat tips as regular wages rather than supplemental wages. For this purpose, tips are defined as including all tips which are reported to the employer pursuant to section 6053.

(vi) Amount to be withheld. The calculation of the amount of the income tax withholding with respect to supplemental wage payments is provided for under paragraph (a)(2) through (a)(7) of this section.

(2) Mandatory flat rate withholding. If a supplemental wage payment, when added to all supplemental wage payments previously made by one employer (as defined in paragraph (a)(3) of this section) to an employee during the calendar year, exceeds $1,000,000, the rate used in determining the amount of withholding on the excess (including any excess which is a portion of a supplemental wage payment) shall be equal to the highest rate of tax applicable under section 1 for such taxable years beginning in such calendar year. This flat rate shall be applied without regard to whether income tax has been withheld from the employee's regular wages, without allowance for the number of withholding allowances claimed by the employee on Form W–4, “Employee’s Withholding Allowance Certificate,” without regard to whether the employee has claimed exempt status on Form W–4, without regard to whether the employee has requested additional withholding on Form W–4, and without regard to the withholding method used by the employer. Withholding under this paragraph (a)(2) is mandatory flat rate withholding.

(3) Certain persons treated as one employer—(1) Persons under common control. For purposes of paragraph (a)(2) of this section, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as one employer.

(iii) Agents. For purposes of paragraph (a)(2) of this section, any payment made to an employee by a third party acting as an agent for the employer (regardless of whether such person shall have been designated as an agent pursuant to section 3504) shall be considered as made by the employer except as provided in paragraph (a)(4)(iii) of this section.

(4) Treatment of certain items in determining applicability of mandatory flat rate withholding—(1) Optional treatment of compensation not subject to income tax withholding.

(ii) Allocation of salary reduction deferrals. In allocating salary reduction deferral amounts excludable from wages for purposes of determining whether the employer has paid $1,000,000 of supplemental wages under paragraph (a)(2) of this section, employers must allocate such salary reduction deferral amounts to the type of compensation (i.e., gross amounts of regular wage payments or gross amounts of supplemental wage payments) actually being deferred.

(iii) Optional de minimis exception for certain payments by agents. For purposes of paragraph (a)(2) of this section, if an agent makes total wage payments (including regular wages and supplemental wages) of less than $100,000 to an individual during any calendar year, an employer or other agent may disregard such payments in determining whether the individual has received $1,000,000 of supplemental wages during the calendar year, and such agent need
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not consider whether the individual has received other supplemental wages in determining the amount of income tax to be withheld from the payments. An employer may not avail itself of this exception if the employer is making payments to the employee using five or more agents and a principal effect of such use of agents is to reduce the applicability of mandatory flat rate withholding to the employee. For purposes of paragraph (a)(2) of this section, if an agent makes total wage payments of $100,000 or more to an individual during any calendar year, the entire amount of supplemental wages paid by the agent during the calendar year to the employee must be taken into account (by other agents of the employer that make total wage payments to the employee of $100,000 or more, by the agent, and by the employer for which the agent is acting) in determining whether the employee has received $1,000,000 of supplemental wages.

(iv) Treatment of supplemental wage payment exceeding $1,000,000 cumulative threshold. In the case of a supplemental wage payment that, when added to all supplemental wage payments previously made by the employer to the employee in the calendar year, results in the employee having received in excess of $1,000,000 supplemental wages for the calendar year, the employer is required to impose withholding under paragraph (a)(2) of this section only on the portion of the payment that is in excess of $1,000,000 (taking into account all prior supplemental wage payments during the year). However, an employer may subject the entire amount of such supplemental wage payment to the withholding imposed by paragraph (a)(2) of this section.

(5) Withholding on supplemental wages that are not subject to mandatory flat rate withholding. To the extent that paragraph (a)(2) of this section does not apply to a supplemental wage payment (or a portion of a payment), the amount of the tax required to be withheld on the supplemental wages when paid shall be determined under the rules provided in paragraphs (a)(6) and (7) of this section.

(6) Aggregate procedure for withholding on supplemental wages—(1) Applicability. The employer is required to determine withholding upon supplemental wages under this paragraph (a)(6) if paragraph (a)(2) of this section does not apply to the payment or portion of the payment and if paragraph (a)(7) of this section may not be used with respect to the payment. In addition, employers have the option of using this paragraph (a)(6) to calculate withholding with respect to a supplemental wage payment, if paragraph (a)(2) of this section does not apply to the payment, but if paragraph (a)(7) of this section could be used with respect to the payment.

(ii) Procedure. Provided this procedure applies under paragraph (a)(6)(i) of this section, the supplemental wages, if paid concurrently with wages for a payroll period, are aggregated with the wages paid for such payroll period. If not paid concurrently, the supplemental wages are aggregated with the wages paid or to be paid within the same calendar year for the last preceding payroll period or for the current payroll period, if any. The amount of tax to be withheld is determined as if the aggregate of the supplemental wages and the regular wages constituted a single wage payment for the regular payroll period. The withholding method used by the employer with respect to regular wages would then be used to calculate the withholding on this single wage payment and the employer would take into consideration the Form W–4 submitted by the employee. This procedure is the aggregate procedure for withholding on supplemental wages.

(7) Optional flat rate withholding on supplemental wages—(1) Applicability. The employer may determine withholding upon supplemental wages under this paragraph (a)(7) if three conditions are met—

(A) Paragraph (a)(2) of this section does not apply to the payment or the portion of the payment;

(B) The supplemental wages are either not paid concurrently with regular wages or are separately stated on the payroll records of the employer; and

(C) Income tax has been withheld from regular wages of the employee during the calendar year of the payment or the preceding calendar year.
(ii) Procedure. The determination of the tax to be withheld under paragraph (a)(7)(iii) of this section 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. Withholding under this procedure is optional flat rate withholding.

(iii) Rate applicable for purposes of optional flat rate withholding. Provided the conditions of paragraph (a)(7)(i) of this section have been met, the employer may determine the tax to be withheld—

(A) From supplemental wages paid after April 30, 1966, and prior to January 1, 1994, by using a flat percentage rate of 20 percent;

(B) From supplemental wages paid after December 31, 1993, and on or before August 6, 2001, by using a flat percentage rate of 28 percent;

(C) From supplemental wages paid after August 6, 2001, and on or before December 31, 2001, by using a flat percentage rate of 27.5 percent;

(D) From supplemental wages paid after December 31, 2001, and on or before May 27, 2003, by using a flat percentage rate of 27 percent;

(E) From supplemental wages paid after May 27, 2003, and on or before December 31, 2004, by using a flat percentage rate of 25 percent; and

(F) From supplemental wages paid after December 31, 2004, by using a flat percentage rate of 28 percent (or the corresponding rate in effect under section 1(1)(2) for taxable years beginning in the calendar year in which the payment is made).

(b) Examples. For purposes of these examples, it is assumed that the rate for purposes of mandatory flat rate withholding for 2007 is 35 percent, and the rate for purposes of optional flat rate withholding for 2007 is 25 percent. The following examples illustrate this paragraph (a):

Example 1. (i) Employee A is an employee of three entities (X, Y, and Z) that are treated as a single employer under section 52(a) or (b). In 2007, X pays regular wages to A on a monthly payroll period for services performed for X, Y, and Z. The regular wages are paid on the third business day of each month. Income tax is withheld from the regular wages of A during the year. A receives only the following supplemental wage payments during 2007 in addition to the regular wages paid by X—

(A) A bonus of $600,000 from X on March 15, 2007;

(B) A bonus of $2,300,000 from Y on November 15, 2007; and

(C) A bonus of $10,000 from Z on December 31, 2007.

(ii) In this Example 1, the $600,000 bonus from X is a supplemental wage payment. The withholding on the $600,000 payment from X could be determined under either paragraph (a)(6) or (7) of this section because income tax has been withheld from the regular wages of A. If X elects to use the aggregate procedure under paragraph (a)(6) of this section, the amount of withholding on the supplemental wages would be based on aggregating the supplemental wages and the regular wages paid by X either for the current or last payroll period and treating the total of the regular wages paid by X and the $600,000 supplemental wages as a single wage payment for a regular payroll period. The withholding method used by the employer with respect to regular wages would then be used to calculate the withholding on this single wage payment, and the employer would take into consideration the Form W–4 furnished by the employee.

(iii) In this Example 1, the $2,300,000 bonus from Y is a supplemental wage payment. To calculate the withholding on the $2,300,000 supplemental wage payment from Y, the $600,000 of supplemental wages X has already paid to A in 2007 must be taken into account because X and Y are treated as the same employer under section 52(a) or (b). Thus, the withholding on the first $400,000 of the payment (i.e., the cumulative supplemental wages not in excess of $1,000,000) is computed separately from the withholding on the remaining $1,900,000 of the payment (i.e., the amount of the cumulative supplemental wages in excess of $1,000,000). With respect to the first $400,000, the withholding could be computed under either paragraph (a)(6) or (a)(7) of this section, Y would withhold on the $400,000 component at 25 percent (pursuant to paragraph (a)(7)(iii)(F) of this section), which would result in $100,000 tax withheld. The remaining $1,900,000 of the bonus would be subject to mandatory flat rate withholding at the maximum rate of tax in effect under section 1 for 2007 (35%) without regard to the Form W–4 submitted by A. The amount withheld from the $1,900,000 would be $665,000. The withholding on the first component and the withholding on the second component then would
be added together to determine the total income tax withholding on the supplemental wage payment from Y. Alternatively, under paragraph (a)(4)(iv) of this section, Y could treat the entire $2,900,000 bonus payment as subject to mandatory flat rate withholding at the maximum rate of tax (35%), in which case the amount to be withheld would be 35 percent of $2,900,000, or $805,000.

(iv) The $10,000 bonus paid from Z is also a supplemental wage payment. To calculate the withholding on the $10,000 bonus, the $2,900,000 in cumulative supplemental wages already paid to A in 2007 by X and Y must be taken into account because X, Y, and Z are treated as a single employer. The entire $10,000 bonus would be subject to mandatory flat rate withholding at the maximum rate of tax in effect under section 1 for 2007. The income tax required to be withheld on this payment would be 35 percent of $10,000 or $3,500.

Example 2. Employees B and C work for employer M. Each employee receives a monthly salary of $3,000 in 2007. As a result of the withholding allowances claimed by B, there has been no income tax withholding on the regular wages M pays to B during either 2007 or 2006. In contrast, M has withheld income tax from regular wages M pays to C during 2007. Together with the monthly salary check paid in December 2007 to each employee, M includes a bonus of $2,000, which is the only supplemental wage payment each employee receives from M in 2007. The bonuses are separately stated on the payroll records of M. Because M has withheld no income tax from B’s regular wages during either the calendar year of the $2,000 bonus or the preceding calendar year, M cannot use optional flat rate withholding provided under paragraph (a)(7) of this section to calculate the income tax withholding on B’s $2,000 bonus. Consequently, M must use the aggregate procedure set forth in paragraph (a)(6) of this section to calculate the income tax withholding due on the $2,000 bonus to B. With respect to the bonus paid to C, M has the option of using either the aggregate procedure provided under paragraph (a)(6) of this section or the optional flat rate withholding provided under paragraph (a)(7) of this section to calculate the income tax withholding due.

Example 3. (i) Employee D works as an employee of Corporation R. Corporations R and T are treated as a single employer under section 52(a) or (b). R makes regular wage payments to Employee D of $200,000 on a monthly basis in 2007, and income tax is withheld from those wages. R pays D a bonus for his services as an employee equal to $3,000,000 on June 30, 2007. Unrelated company U pays D sick pay as an agent of the employer R and such sick pay is supplemental wages pursuant to §31.3402(a)-1(b)(4)(i)(B)(2). U pays D $50,000 of sick pay on October 31, 2007. Corporation T decides to award bonuses to all employees of R and T, and pays a bonus of $100,000 to D on December 31, 2007. D received no other payments from R, T, or U.

(ii) In chronological summary, D is paid the following wages other than the regular monthly wages paid by R:

(A) June 30, 2007—$3,000,000 (bonus from R);

(B) October 31, 2007—$50,000 (sick pay from U); and

(C) December 31, 2007—$100,000 (bonus from T).

(iii) In this Example 3, each payment of wages other than the regular monthly wage payments from R is considered to be supplemental wages for purposes of withholding under §31.3402(g)-1(a)(2). The amount of regular wages from R is irrelevant in determining when mandatory flat rate withholding on supplemental wages must be applied.

(iv) Because income tax has been withheld on D’s regular wages, income tax may be withheld on $1,000,000 of the $3,000,000 bonus paid on June 30, 2007, under either paragraph (a)(6) or (7) of this section. If R elects to use optional flat rate withholding provided under paragraph (a)(7)(iii)(F) of this section, withholding on the $50,000 of sick pay would be calculated at 25 percent of the $1,000,000 portion of the payment and would be $250,000.

(v) Income tax withheld on the following supplemental wage payments (or portion of a payment) as follows is required to be calculated at the maximum rate in effect under section 1, or 35 percent in 2007—

(A) $2,000,000 of the $3,000,000 bonus paid by R on June 30, 2007; and

(B) all of the $100,000 bonus paid by T on December 31, 2007.

(vi) Pursuant to paragraph (a)(4)(ii) of this section, because the total wage payments made by U, an agent of the employer, to D are less than $100,000, U is permitted to determine the amount of income tax to be withheld without regard to other supplemental wage payments made to the employee. Income tax withholding on the $50,000 in sick pay may be determined under either paragraph (a)(6) or (7) of this section. If U elects to withhold income tax at the flat rate provided under paragraph (a)(7)(iii)(F) of this section, withholding on the $50,000 of sick pay would be calculated at 25 percent of the $50,000 payment and would be $12,500. Alternatively, U may choose to take account of the $3,000,000 in supplemental wages paid by the employer during 2007 prior to payment of the $50,000 sick pay, and withholding on the $50,000 sick pay could be calculated applying the mandatory flat rate of 35 percent, resulting in withholding of $17,500 on the $50,000 payment.

Example 4. (i) Employer J has decided it wants to grant its employee B a $1,000,000 net bonus (after withholding) to be paid in 2007.
Employer J has withheld income tax from the regular wages of the employee. Employer J has made no other supplemental wage payments to B during the year.

(ii) This Example requires grossing up the supplemental wage payment to determine the gross wages necessary to result in a net payment of $1,000,000. If the employer elected to use optional flat rate withholding, the first $1,000,000 of the wages would be subject to 25 percent withholding. However, any wages above that, including amounts representing gross-up payments, would be subject to mandatory 35 percent withholding. The withholding applicable to the first $1,000,000 (i.e., $250,000) would thus be required to be grossed-up at a 35 percent rate to determine the gross wage amount in excess of $1,000,000. Thus, the wages in excess of $1,000,000 would be equal to $250,000 divided by .65 (computed by subtracting .35 from 1) or $384,615.38. Thus the total supplemental wage payment, taking into account income tax withholding only (and not Federal Insurance Contributions Act taxes), to B would be $1,384,615.38, and the total withholding with respect to the payment if Employer J elected optional flat rate withholding with respect to the first $1,000,000, would be $384,615.38.

(9) Certain noncash payments to retail commission salesmen. For provisions relating to the treatment of wages that are not subject to paragraph (a)(2) of this section and that are paid other than in cash to retail commission salesmen, see §31.3402(j)–1.

(10) Alternative methods. The Secretary may provide by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(i)(b) of this chapter) for alternative withholding methods that will allow an employer to meet its responsibility for the mandatory flat rate withholding required by paragraph (a)(2) of this section.

(b) Special rule where aggregate withholding exemption exceeds wages paid. (1) This rule does not apply to the extent that paragraph (a)(2) of this section applies to the supplemental wage payment. If supplemental wages are paid to an employee during a calendar year for a period which involves two or more consecutive payroll periods, for which other wages also are paid during such calendar year, and the aggregate of such other wages is less than the aggregate of the amounts determined under the table provided in section 3402(b) (1) as the withholding exemptions applicable for such payroll periods, the amount of the tax required to be withheld on the supplemental wages shall be computed as follows:

Step 1. Determine an average wage for each of such payroll periods by dividing the sum of the supplemental wages and the wages paid for such payroll periods by the number of such payroll periods.

Step 2. Determine a tax for each payroll period as if the amount of the average wage constituted the wages paid for such payroll period.

Step 3. From the sum of the amounts of tax determined in Step 2 subtract the total amount of tax withheld, or to be withheld, from the wages, other than the supplemental wages, for such payroll periods. The remainder, if any shall constitute the amount of the tax to be withheld upon the supplemental wages.

Example. An employee has a weekly payroll period ending on Saturday of each week, the wages for which are paid on Friday of the succeeding week. On the 10th day of each month he is paid a bonus based upon production during the payroll periods for which wages were paid in the preceding month. The employee is paid a weekly wage of $64 on each of the five Fridays occurring in July 1966. On August 10, 1966, the employee is paid a bonus of $125 based upon production during the five payroll periods covered by the wages paid in July. On the date of payment of the bonus, the employee, who is married and has three children, has a withholding exemption certificate in effect indicating that he is married and claiming five withholding exemptions. The amount of the tax to be withheld from the bonus paid on August 10, 1966, is computed as follows:

| Wages paid in July 1966 for 5 payroll periods | $320.00 |
| Bonus paid August 10, 1966 | $125.00 |
| Aggregate of wages and bonus | $445.00 |
| Average wage per payroll period ($445/5) | $89.00 |
| Computation of tax under percentage method: |
| Withholding exemptions (5×$13.50) | $67.50 |
| Remainder subject to tax | $21.50 |
| Tax on average wage for 1 week under percentage method of withholding (married person with weekly payroll period) | $2.45 |
| Tax on average wage for 5 weeks | $12.25 |
| Less: Tax previously withheld on weekly wage payments of $64 | None |
| Tax to be withheld on supplemental wages | $12.25 |

Computation of tax under wage bracket method:

| Tax on $89 wage under weekly wage table for married person ($2.50 per week for 5 weeks) | $12.50 |
| Less: Tax previously withheld on weekly wage payments of $64 | None |
| Tax to be withheld on supplemental wages | $12.50 |
§ 31.3402(g)–2 Wages paid for payroll period of more than one year.

If wages are paid to an employee for a payroll period of more than one year, for the purpose of determining the amount of tax required to be deducted and withheld in respect of such wages—

(a) Under the percentage method, the amount of the tax shall be determined as if such payroll period constituted an annual payroll period, and

(b) Under the wage bracket method, the amount of the tax shall be determined as if such payroll period constituted a miscellaneous payroll period of 365 days.

§ 31.3402(g)–3 Wages paid through an agent, fiduciary, or other person on behalf of two or more employers.

(a) If a payment of wages is made to an employee by an employer through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays the wages payable by another employer to such employee, the amount of the tax required to be withheld on each wage payment made through such agent, fiduciary, or person shall, whether the wages are paid separately on behalf of each employer or paid in a lump sum on behalf of all such employers, be determined upon the aggregate amount of such wage payment or payments in the same manner as if such aggregate amount had been paid by one employer. Hence, under either the percentage method or the wage bracket method the tax shall be determined upon the aggregate amount of the wage payment.

(b) In any such case, each employer shall be liable for the return and payment of a pro rata portion of the tax so determined, such portion to be determined in the ratio which the amount contributed by the particular employer bears to the aggregate of such wages.

(c) For example, three companies maintain a central management agency which carries on the administrative work of the several companies. The central agency organization consists of a staff of clerks, bookkeepers, stenographers, etc., who are the common employees of the three companies. The expenses of the central agency, including wages paid to the foregoing employees, are borne by the several companies in certain agreed proportions. Company X pays 45 percent, Company Y pays 35 percent and Company Z pays 20 percent of such expenses. The amount of tax required to be withheld on the wages paid to persons employed in the central agency should be determined in accordance with the provisions of this section. In such event, Company X is liable as an employer for the return and payment of 45 percent of the tax required to be withheld, Company Y is liable for the return and payment of 35 percent of the tax and Company Z is liable for the return and payment of 20 percent of the tax. (See §31.3504–1, relating to acts to be performed by agents.)

§ 31.3402(h)(1)–1 Withholding on basis of average wages.

(a) In general. An employer may determine the amount of tax to be deducted and withheld upon a payment of wages to an employee on the basis of the employee’s average estimated wages, with necessary adjustments, for any quarter. This paragraph applies only where the method desired to be