

Severance Pay

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Jacob asks:

My daughter's was just informed that her firm is moving to another state. She she will not be moving with them and she has worked for them for over ten years, they are going to give her severance pay. I would greatly appreciate your help with the following questions:

1. Does her employer have to deduct Federal/State withholding tax and social security and Medicare from her severance paycheck?
2. If her payment were called a "bonus" instead of severance pay, would there be any difference in the deductions taken from it or in the amount of taxes she would have to pay?
3. Will her receipt of severance pay (or a bonus) affect her eligibility to apply for and receive unemployment benefits as soon as her employment ends?

Many thanks in advance for any advice you can give me on these three questions.

Jacob

My reply:

Hello Jacob! Thanks for visiting.

Severance pay is treated as a continuation of her wages; therefore, as with wages, it is mandatory that her employer withhold Federal, State, Social Security and Medicare taxes, as applicable. A bonus, is also part of a worker's wage and her employer would be required to withhold accordingly for that as well.

The potential difference between a bonus payment and severance pay is that severance pay is usually paid out on the same "schedule" that her wages were previously paid out. A bonus is usually a one time payment. If all the payments (whether severance or bonus) are paid out in the same calendar year, then the final tax due will be the same no matter if it is classified as severance pay or bonus pay. However a bonus payment may be subject to a flat 25% withholding rate, instead of the rate your daughter indicated on her W-4. The difference between these two rates may make your daughter either owe or receive a refund come tax time.

Unemployment benefits are determined on a state level. Some states allow immediate unemployment insurance benefits; others do not. It is best to discuss this with her state's unemployment office.