VLCT NEWS REPRINT
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Ask The League

A town employee passed away recently. How do I report tax withholding properly?

The Internal Revenue Service provides guidance concerning tax withholding when an employee dies, and the guidance is different depending on the timing of the final paycheck. Final wages paid to the deceased employee's estate or legal beneficiary in the same calendar year of death are not subject to federal income tax withholding. Final pay is not considered taxable income for this purpose and is not included on the deceased's W-2 in Box 1. This amount (which may include accrued vacation time) must be reported on a Form 1099-MISC in Box 3, which is issued to the estate of the decedent or a legal beneficiary. At the same time, these earnings *are* subject to FICA (Social Security and Medicare) and FUTA (federal unemployment) taxes. Therefore, the employer must report them in the gross Social Security and Medicare wages and the amounts withheld on the deceased employee's W-2 wage and tax statement in Boxes 3-6. Again, this is if the death occurs in the same calendar year as the issuance of the final paycheck.

If the final wages are paid in a subsequent year after death, they are not subject to federal income tax withholding or FICA or FUTA taxes. They would be reported in Box 3 of the Form 1099-MISC issued to the decedents estate or beneficiary, and not on a Form W-2 to the decedent.

For further clarification regarding IRS treatment of final paychecks for deceased employees, see the instructions on Form W-2 and Form 1099-MISC; also see Internal Revenue Service Publication 15 Circular E, Employer's Tax Guide, http://www.irs.gov/pub/irs-pdf/p15.pdf.

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