

TAX QUESTIONS ON BUYOUTS (VSIP)

Many, if not most, employees have questions regarding the impact a buyout has on their taxes. OPM has worked in cooperation with the Internal Revenue Service to provide the following general information on taxes.

It is critical to note that information provided here is general in nature and in no way is intended to apply to every employee's situation. Employees are urged to seek the assistance of a trained and experienced tax advisor or personal financial counselor on any matters related to the employee's income, finances, taxes, or retirement.

1. Is the Buyout taxable income or a special one-time payment with different tax consequences? Buyouts are included as an item of gross income and are considered as fully taxable income under IRS tax laws. Section 451(a) of the Internal Revenue Code provides that the amount of any item of gross income must be included in the gross income for the taxable year in which it is received by the taxpayer. Thus, a buyout is taxable in the year of payment, regardless of the year in which the buyout is authorized, unless the employee is required to repay the buyout in the same tax year. The buyout is not a special one-time payment with different tax consequences.

2. What happens to the taxes I paid if I have to repay the entire amount of the buyout? The employee is entitled to recover taxes withheld or paid based on the receipt of a buyout.

Do I file an amended tax return? Recovering taxes paid on a repaid buyout depends on when repayment occurs. Below are two examples. In either case, the employee is not entitled to file an amended return for that tax year because of the concept of annual accounting.

"I got a buyout in February 2006 and returned to work in June 2006."

If an employee receives a buyout and is required to repay the buyout in the SAME tax year, the buyout is not included in the employee's wages for federal income tax withholding purposes. It is not reflected on Form W-2 as "wages, tips, other compensation," as "social security wages," or as "Medicare wages." Any income tax and FICA employee tax withheld on the buyout should be repaid or credited to the employee by the agency paying the buyout.

"I got a buyout in November 2006 and was hired by another agency in April 2007."

In this case, the employee was required by law to repay the entire amount of the buyout to the agency that paid it and repayment must be made prior to beginning the second job. The employee may take a loss deduction (under section 165 of the Code) for the amount repaid in the 2007 tax year. The employee MAY NOT file an amended tax return for 2006 because the employee received the income in 2006 and was required to pay taxes on it then as earned wages.

3. How much will my buyout be after taxes?

Tax deductions from buyout payments - Voluntary separation incentive payments are considered supplemental wages and are treated similarly to cash awards, bonuses, and allowances for withholding purposes. Most agencies automatically withhold the following taxes from supplemental payments:

All Employees

Federal Income Tax	NFC withholds a flat 25% of the buyout payment for Federal income tax. In some cases, this may be higher than your normal withholding rate and you may want to reexamine your tax planning for withholding purposes.
State Income Tax (when applicable)	Agencies make deductions based on a specified rate for supplemental payments or the applicable standard rate.
Local Income Tax (when applicable)	Agencies make deductions based on a specified rate for supplemental payments or the applicable standard rate.

CSRS Employees

Medicare	1.45%
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FERS Employees and CSRS Offset Employees

OASDI	(Old Age Survivor Disability Insurance) 4.2% subject to annual tax limitations
Medicare	1.45%

OTHER DEDUCTIONS

Where applicable, agencies may also make deductions for certain types of indebtedness. Following are some circumstances in which deductions for debts may be made:

- The balance of any commercial garnishment plus supplemental fees or court-ordered interest related to the garnishment.
- The balance of any child support/alimony arrearage when included in the court order.
- The balance of any debt owed to the agency.

EXAMPLES:

CSRS EMPLOYEE

Buyout Amount		\$25,000.00
Payroll Deductions		
Federal Tax (25%)	\$6,250.00	
State Tax (4%)	1,000.00	
(when applicable)		
Local Tax (1%)	250.00	
(when applicable)		
Medicare (1.45%)	362.50	
 Total Deductions	 7,862.50	
 Payment After Deductions		 \$17,137.50

FERS AND CSRS OFFSET EMPLOYEES

Buyout Amount		\$25,000.00
Payroll Deductions		
Federal Tax (25%)	\$ 6,250.00	
State Tax (4%)	1,000.00	
(when applicable)		
Local Tax (1%)	250.00	
(when applicable)		
Medicare (1.45%)	362.50	
OASDI (4.2%)	1,050.00	
 Total Deductions	 8,912.50	
 Payment After Deductions		 \$16,087.50