



PAUL, PLEVIN,  
SULLIVAN &  
CONNAUGHTON LLP



## **NEW CALIFORNIA WITHHOLDING LAW FOR BONUSES AND STOCK OPTIONS (January 15, 2003)**

Not surprisingly, California has passed a new tax law for 2003 that affects employers. The new law (AB 2065) regulates employers' withholding practices when they provide bonuses or non-qualified stock options (NSO) to their employees.

Prior to AB 2065, employers were allowed to withhold personal income tax (PIT) at a flat rate of 6% from any "supplemental wage" payments (e.g., bonuses, commissions, sales awards, overtime, etc.), or compute the PIT on the combined total of regular wages and any supplemental wages.

Under the new law, if an employer provides a bonus to an employee separate from the employee's regular wages (i.e. not in the same payroll check), or if an employee is granted or exercises an NSO (with a readily ascertainable fair market value), the employer has two withholding options:

1. The employer may withhold from the bonus or NSO at a flat rate of 9.3%, without accounting for the allowances claimed by the employee; or
2. The employer may use the PIT withholding schedules to compute the withholding amount based on the combined total of the regular wages from the employee's most recent wage payment and the bonus or NSO the employee is receiving. From that amount, the employer must subtract the PIT already withheld from the regular wages, and withhold the difference from the bonus or NSO.

According to the Employment Development Department (EDD), employers should begin withholding at the increased rate no later than January 1, 2003. The penalties for failing to withhold can be significant, especially when aggregated. Pursuant to the new law, if an employer fails to properly withhold the required amount it will be liable for the greater of the amount required to be withheld or \$500 per violation, unless the employer can show that the failure to withhold was due to a reasonable cause.

This E-Update was authored by [Lonny Zilberman](#). If you have any questions about this E-Update, please contact the author or any PPS&C attorney (619.237.5200).

This E-Update is offered as general information to our clients and friends. The Update is not intended as legal advice applicable to any specific situation and should not be taken as such.

---

Send comments to [info@paulplevin.com](mailto:info@paulplevin.com). Last modified 1/15/2003