

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(f)(2)–1: *Withholding exemption certificates.*

T.D. 9196

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

Withholding Exemptions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations providing guidance under section 3402(f) of the Internal Revenue Code (Code) for employers and employees relating to the Form W–4, “*Employee’s Withholding Allowance Certificate.*” These regulations provide rules for the submission of copies of certain withholding exemption certificates to the IRS, the notification provided to the employer and the employee of the maximum number of withholding exemptions permitted, and the use of substitute forms. The text

of the temporary regulations also serves as the text of the proposed regulations (REG–162813–04) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. The amendments to the final regulations provide cross-references to the temporary regulations.

DATES: These regulations are effective April 14, 2005.

FOR FURTHER INFORMATION CONTACT: Margaret A. Owens, (202) 622–0047 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations do not impose any new information collection. The Office of Management and Budget (OMB) previously approved the information collection requirements concerning Form W–4 contained in the regulation under section 6001 (§31.6001–5; OMB Control No. 1545–0798) and in the regulation under section 3402 (§31.3402(f)(2)–1; OMB Control No. 1545–0010) under the provisions of the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.* Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 3402(f)(2)(A), every employee is required to furnish his or her employer with a signed withholding exemption certificate on or before commencing employment. Regulations prescribe

the form of the certificate as the Form W–4. The maximum number of withholding exemptions to which an employee is entitled depends upon the employee’s marital status, the employee’s filing status, the number of the employee’s dependents, the number of exemptions claimed by the employee’s spouse (if any) on a Form W–4, and the amount of the employee’s estimated itemized deductions, tax credits, and certain other deductions from income. A Form W–4 may be in either paper or electronic form.

Section 31.3402(f)(2)–1(g) of the existing regulations requires employers to submit copies of certain questionable Forms W–4 to the IRS. Employers must submit a copy of each Form W–4 on which an employee claims more than 10 withholding exemptions. Employers must also submit a copy of each Form W–4 on which the employee claims a complete exemption from withholding for the taxable year if the employer reasonably expects, when the Form W–4 is received, that the employee’s wages from that employer will usually be \$200 or more per week.

In addition, the existing regulations provide that, upon written request from the IRS, employers are required to submit to the IRS copies of withholding exemption certificates which are received from employees or groups of employees identified by the IRS in the written request.

The existing regulations provide that the IRS may notify an employer that a named employee is not entitled to claim a complete exemption from withholding and is not entitled to claim a total number of withholding exemptions more than the maximum number specified by the IRS in the notice. The IRS will issue such notice if the IRS finds that the withholding

exemption certificate contains a materially incorrect statement or if the IRS finds, after written request to the employee for verification of the statements on the certificate, that the IRS lacks sufficient information to determine if the certificate is correct. In these cases, the employer must withhold tax based on the maximum number of withholding exemptions specified in the notice from the IRS unless otherwise notified by the IRS. However, if the employee furnishes a new certificate that claims a number of withholding exemptions less than the number specified in the written notice to the employer, the employer must withhold tax based on that certificate.

Under the existing regulations, if the employee furnishes a new withholding exemption certificate that claims complete exemption from withholding or claims a number of withholding exemptions more than the maximum number specified by the IRS in the notice, the employee must submit the new withholding exemption certificate and a written statement to support the claims made by the employee on the new certificate to the IRS or to the employer, who must then submit them to the IRS. The employer must disregard this new certificate until the IRS notifies the employer to withhold tax based on the new certificate.

Explanation of Provisions

The temporary regulations change the procedures for submitting copies of Forms W-4 to the IRS and allow the IRS to issue a notice specifying the maximum number of withholding exemptions permitted without first obtaining a copy of the withholding exemption certificate from the employer.

The temporary regulations also clarify that a substitute withholding exemption certificate developed by the employer may be used in lieu of the prescribed Form W-4, if the employer also provides the worksheets contained in the Form W-4 in effect at that time. The temporary regulations also provide that employers may refuse to accept a substitute form developed by an employee and that the employee submitting such form will be treated as failing to furnish a withholding exemption certificate.

As noted in the *Background* portion of this preamble, §31.3402(f)(2)-1(g) of the

existing regulations sets forth rules for employers to submit copies of certain questionable Forms W-4 to the IRS. The Treasury Department and the IRS want to relieve employers of the burden of submitting copies of certain questionable Forms W-4 and want to more effectively address withholding noncompliance by using information already provided to the IRS. Under the temporary regulations, employers are no longer required to submit a copy of any Form W-4 on which an employee claims more than 10 withholding exemptions. In addition, under the temporary regulations, employers are no longer required to submit a copy of any Form W-4 on which an employee claims complete exemption from withholding for the taxable year if the employer reasonably expects, when the Form W-4 is received, that the employee's wages from that employer will usually be \$200 or more per week. Instead, an employer must submit a copy of any currently effective withholding exemption certificate only if directed to do so in a written notice to the employer from the IRS or if directed to do so under any published guidance. As under existing regulations, the written notice may direct the employer to submit copies of Forms W-4 for certain employees. The temporary regulations also authorize the IRS to provide specific criteria for those Forms W-4 that must be submitted either in a written notice to an employer or by published guidance.

The temporary regulations provide that the IRS may issue a notice to an employer specifying the maximum number of withholding exemptions permitted for a specific employee. The IRS may issue such a notice after determining that a copy of a withholding exemption certificate submitted to the IRS contains a materially incorrect statement or after the employee fails to respond adequately to a request for verification of the statements on the certificate.

The IRS may also issue such a notice after it determines an employee is not entitled to claim complete exemption from withholding or more than a specified number of withholding exemptions based on IRS records without first obtaining a copy of the withholding exemption certificate from the employer.

After the IRS issues a notice of the maximum number of withholding exemptions permitted, if the employee wants to claim complete exemption from withholding or

claim a number of withholding exemptions more than the maximum number specified by the IRS in the notice, the employee must submit a new withholding exemption certificate and a written statement to support the claims made by the employee on the new certificate to the IRS. To reduce burdens on employers and to more efficiently respond to the employee, the temporary regulations provide that the employee must send this new certificate and written statement directly to the IRS. The option under existing regulations to send this information to the employer for forwarding to the IRS has been removed. The employer must disregard this new certificate until the IRS notifies the employer to withhold tax based on the new certificate. However, if, at any time, the employee furnishes a certificate that claims a number of withholding exemptions less than the maximum number specified in the written notice to the employer, the employer must withhold tax based on that certificate.

The temporary regulations provide a period during which the employee can address the pending withholding adjustment by providing a new certificate and written statement to the IRS. The temporary regulations provide that the earliest the notice of the maximum number of withholding exemptions permitted may be effective is 45 calendar days after the date of the notice. The notice may specify a later effective date.

The Treasury Department and the IRS are considering additional amendments to the regulations under section 3402 to address other issues including, but not limited to, the criteria for identifying a valid withholding exemption certificate. The Treasury Department and the IRS specifically welcome comments on this issue in response to the related notice of proposed rulemaking in this issue of the Bulletin.

Effective Date

These regulations are applicable on April 14, 2005.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative

Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses of the preamble to the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Margaret A. Owens, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES

Paragraph 1. The authority citation for part 31 continues to read in part as follows:
Authority: 26 U.S.C. 7805 * * *

Section 31.3402(f)(5)–1T also issued under 26 U.S.C. 3402(i) and (m). * * *

Par. 2. Section 31.3402(f)(2)–1 is amended by revising paragraph (g) to read as follows:

§31.3402(f)(2)–1 Withholding exemption certificates.

* * * * *

(g) For further guidance, see §31.3402(f)(2)–1T(g).

Par. 3. Section 31.3402(f)(2)–1T is added to read as follows:

§31.3402(f)(2)–1T Withholding exemption certificates (temporary).

(a) through (f) [Reserved]. For further guidance, see §31.3402(f)(2)–1(a) through (f).

(g) *Submission of certain withholding exemption certificates and notice of the maximum number of withholding exemptions permitted—(1) Submission of*

certain withholding exemption certificates. (i) An employer must submit to the Internal Revenue Service (IRS) a copy of any currently effective withholding exemption certificate as directed in a written notice to the employer from the IRS or as directed in published guidance. A notice to the employer may relate either to one or more named employees; to one or more reasonably segregable units of the employer; or to withholding exemption certificates under certain specified criteria. The notice will designate the IRS office where the copies of the withholding exemption certificates must be submitted. Employers may also be required to submit copies of withholding exemption certificates under certain specified criteria when directed to do so by the IRS in published guidance. For purposes of the preceding sentence, the term published guidance means a revenue procedure or notice published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter). Alternatively, upon notice from the IRS, the employer must make withholding exemption certificates received from one or more named employees; from one or more reasonably segregable units of the employer; or from employees who have furnished withholding exemption certificates under certain specified criteria, available for inspection by an IRS employee (e.g., a compliance check).

(ii) After a copy of a withholding exemption certificate has been submitted to the IRS under this paragraph (g)(1), the employer must withhold tax on the basis of the withholding exemption certificate, if the withholding exemption certificate meets the requirements of §31.3402(f)(5)–1, unless that certificate must be disregarded based on a notice of the maximum number of withholding exemptions permitted under the provisions of paragraph (g)(2) of this section.

(2) *Notice of maximum number of withholding exemptions permitted.* (i) The IRS may notify the employer in writing that the employee is not entitled to claim a complete exemption from withholding and the employee is not entitled to claim a total number of withholding exemptions more than the maximum number of withholding exemptions specified by the IRS in the written notice. The notice will specify the IRS office to be contacted for further information. The notice of maximum number

of withholding exemptions permitted may be issued if—

(A) The IRS determines that a copy of a withholding exemption certificate submitted under paragraph (g)(1) of this section contains a materially incorrect statement or determines, after a request to the employee for verification of the statements on the certificate, that the IRS lacks sufficient information to determine if the certificate is correct; or

(B) The IRS otherwise determines that the employee is not entitled to claim a complete exemption from withholding and is not entitled to claim more than a specified number of withholding exemptions.

(ii) If the IRS provides a written notice to the employer under this paragraph (g)(2), the IRS will also provide the employer with a written notice for the employee (employee notice) that identifies the maximum number of withholding exemptions permitted and the process by which the employee can provide additional information to the IRS for purposes of determining the appropriate number of withholding exemptions. The IRS will also mail a similar written notice to the employee’s last known address. For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

(iii) If the employee is still employed by the employer, the employer must furnish the employee notice to the employee within 10 business days of receipt. If the employee is no longer employed by the employer, the employer is not required to furnish the employee notice to the employee but the employer must send a written response to the IRS office designated in the notice indicating that the employee is no longer employed by the employer.

(iv) Except as provided in paragraph (g)(2)(v) and (vi) of this section, the employer must withhold tax on the basis of the maximum number of withholding exemptions specified in the written notice received from the IRS. The employer must withhold tax in accordance with the notice as of the date specified in the notice, which shall be no earlier than 45 calendar days after the date of the notice.

(v) If a withholding exemption certificate is in effect with respect to the employee before the employer receives a notice from the IRS of the maximum number of withholding exemptions permitted

under this paragraph (g)(2), the employer must continue to withhold tax in accordance with the existing withholding exemption certificate rather than on the basis of the notice if the existing withholding exemption certificate does not claim complete exemption from withholding and claims a number of withholding exemptions less than the maximum number specified by the IRS in the written notice to the employer.

(vi) If the employee furnishes a new withholding exemption certificate after the employer receives a notice from the IRS of the maximum number of withholding exemptions permitted under this paragraph (g)(2), the employer must withhold tax on the basis of that new certificate as currently effective only if the new certificate does not claim complete exemption from withholding and claims a number of withholding exemptions less than the number specified by the IRS in the notice to the employer. If any new certificate claims complete exemption from withholding or claims a number of withholding exemptions more than the maximum number specified by the IRS in the notice, then the employer must disregard the new certificate and must continue to withhold tax on the basis of the maximum number specified in the notice received from the IRS unless the IRS by subsequent written notice advises the employer to withhold tax on the basis of that new certificate. If the employee wants to put a new certificate into effect to claim complete exemption from withholding or to claim a number of withholding exemptions more than the maximum number specified by the IRS in the notice to the employer, the employee must submit to the IRS office designated in the employee notice earlier furnished to the employee under this paragraph (g)(2) that new certificate and a written statement to support the claims made by the employee on the new certificate.

(3) *Definition of employer.* For purposes of this paragraph (g), the term *employer* includes any person authorized by the employer to receive withholding exemption certificates, to make withholding computations, or to make payroll distributions.

(4) *Effective date.* This paragraph (g) applies on April 14, 2005. The applicability of this paragraph (g) expires on or before April 11, 2008.

Par. 4. Section 31.3402(f)(5)–1 is amended by revising paragraph (a) to read as follows:

§31.3402(f)(5)–1 Form and contents of withholding exemption certificates.

(a) For further guidance, see §31.3402(f)(5)–1T(a).

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Par. 5. Section 31.3402(f)(5)–1T is added to read as follows:

§31.3402(f)(5)–1T Form and contents of withholding exemption certificates (temporary).

(a)(1) *Form W–4.* Form W–4, “*Employee’s Withholding Allowance Certificate,*” is the form prescribed for the withholding exemption certificate required to be furnished under section 3402(f)(2). A withholding exemption certificate must be prepared in accordance with the instructions and regulations applicable thereto, and must set forth fully and clearly the data therein called for. Blank copies of paper Forms W–4 will be supplied to employers upon request to the Internal Revenue Service (IRS). An employer may also download and print Form W–4 from the IRS Internet site at <http://www.irs.gov>. In lieu of the prescribed form, employers may prepare and use a form the provisions of which are identical with those of the prescribed form, but only if employers also provide employees with all the tables, instructions, and worksheets contained in the Form W–4 in effect at that time and only if employers comply with all revenue procedures relating to substitute forms in effect at that time. Employers may refuse to accept a substitute form developed by an employee and the employee submitting such form will be treated as failing to furnish a withholding exemption certificate. For further guidance regarding the employer’s obligations when an employee is treated as failing to furnish a withholding exemption certificate, see §31.3402(f)(2)–1.

(2) *Effective date.* This paragraph (a) applies on April 14, 2005. The applicability of this paragraph (a) expires on or before April 11, 2008.

(b) through (c) [Reserved]. For further guidance, see §31.3402(f)(5)–1(b) through (c).

Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

Approved March 28, 2005.

Eric Solomon,
*Acting Deputy Assistant Secretary
of the Treasury.*

(Filed by the Office of the Federal Register on April 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for April 14, 2005, 70 F.R. 19694)