

Withholding Exemptions TD 9337

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[TD 9337]

RIN 1545-BE21

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final 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." The regulations provide rules for income tax withholding when the IRS notifies the employer and the employee of the maximum number of withholding exemptions permitted. The regulations also provide rules for the use of substitute forms and preserve the IRS's ability to require the submission of certain copies of withholding exemption certificates. The regulations primarily affect taxpayers who are employers and employees.

DATES: Effective Date: These regulations are effective July 13, 2007.

Applicability Date: Except as provided in section 31.3402(f)(2)-1(g)(5), section 31.3402(f)(2)-1(g) applies on April 14, 2005. Section 31.3402(f)(2)-1(g)(2)(iii)(A), (B), and (C) and section 31.3402(f)(2)-1(g)(2)(ix) apply on October 11, 2007, except taxpayers may rely on such paragraphs for notices issued prior to such date. Section 31.3402(f)(5)-1(a)(1) applies on April 14, 2005. Section 31.3402(f)(5)-1(a)(2) applies October 11, 2007.

FOR FURTHER INFORMATION CONTACT: Ilya Enkishev, (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 regulations under section 6001 (Sec. 31.6001-5; OMB Control No. 1545-0798) and in the regulations under section 3402 (Sec. 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) of the Internal Revenue Code, every employee is required to furnish his or her employer with a signed withholding exemption certificate on or before commencing employment. The 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.

For many years, the regulations under section 3402(f) required employers to submit to the IRS a copy of each Form W-4 on which an employee claimed more than a certain number of withholding exemptions.

Employers had to also submit a copy of each Form W-4 on which the employee claimed a complete exemption from withholding for the taxable year if the employer reasonably expected, when the Form W-4 was received, that the employee's wages from that employer would usually be \$200 or more per week. The regulations also provided that the IRS could notify an employer that a named employee was not entitled to claim a complete exemption from withholding and was not entitled to claim more withholding exemptions than the number specified by the IRS in the notice. The IRS issued this notice (often called a "lock-in letter") if the IRS found that the withholding exemption certificate contained a materially incorrect statement or if the IRS found, after written request to the employee for verification of the statements on the certificate, that the IRS lacked sufficient information to determine if the certificate was correct. In these

cases, the employer was required to withhold tax based on the number of withholding exemptions specified in the notice from the IRS unless otherwise notified by the IRS.

On April 14, 2005, the Department of Treasury published temporary regulations (TD 9196) in the Federal Register (70 FR 19694) under section 3402(f) modifying the rules relating to the submission of Forms W-4 and relating to the IRS' notification of the number of withholding exemptions permitted. The Department of Treasury also published a notice of proposed rulemaking (REG-162813-04) cross-referencing the temporary regulations in the Federal Register on the same day.

Effective when published, the temporary regulations changed the procedures for submitting copies of Forms W-4 to the IRS. Specifically, under the temporary regulations employers were no longer routinely required to submit a copy of any Form W-4 on which an employee claimed more than 10 withholding exemptions. In addition, employers were no longer routinely required to submit a copy of any Form W-4 on which an employee claimed complete exemption from withholding for the taxable year if the employer reasonably expected, when the Form W-4 was received, that the employee's wages from that employer would usually be \$200 or more per week. Rather, the temporary regulations provided that employers must submit copies of Forms W-4 only if instructed to do so in published guidance or in a written notice to the employer from the IRS. At this time, the IRS has not issued any published guidance requiring the submission of Forms W-4 to the IRS.

The temporary regulations authorized the IRS to issue a notice to an employer specifying the maximum withholding exemptions permitted to be claimed by the employee without first obtaining a copy of the withholding exemption certificate from the employer. Under the temporary regulations, the IRS issued this notice to the employer with a copy for the employee. The IRS also sent another copy to the employee at the employee's last known address. The temporary regulations provided that the employer must withhold tax in accordance with the notice as of the date specified in the notice, which was required to be at least 45 calendar days after the date of the notice. If the employee wanted to claim complete exemption from withholding or claim more withholding exemptions than the number specified by the IRS in the notice, the employee must contact the IRS to provide information to support the claim. The previous, and now obsolete, regulations permitted the employee to send this information to the employer to forward to the IRS. To reduce burdens on employers and to facilitate efficient responses to the employee, the temporary regulations required the employee to contact the IRS directly.

Finally, the temporary regulations also permitted employers to give their employees a substitute withholding exemption certificate, if the employers also gave them the worksheets contained in the Form W-4 in effect at that time. The temporary regulations also authorized employers to refuse to accept a substitute form developed by an employee.

The proposed regulations were identical to the temporary regulations described in the Preamble. The publication of the proposed and temporary regulations followed a comprehensive review of withholding compliance, which found that withholding noncompliance remained a problem with some employees. In connection with the publication of the proposed and temporary regulations, the IRS developed a process to use information already reported on Forms W-2, Wage and Tax Statements, to more effectively identify and address employees with withholding compliance problems.

A public hearing on the proposed regulations was held on July 26, 2005. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the Department of Treasury adopts the proposed regulations, as modified herein, as final regulations, and removes the corresponding temporary regulations.

Summary of Comments and Explanation of Provisions

The publication of this Treasury decision follows the implementation of the IRS's new process for using information already reported on Forms W-2 to more effectively identify employees with withholding compliance problems. The modifications to the proposed regulations that are included in these final regulations reflect both consideration of the comments submitted by taxpayers and changes needed following the implementation of the new process.

The comments received were generally favorable to the changes proposed by the proposed regulations and implemented by the temporary regulations. Commentators observed that the regulations reduced burdens on employers by eliminating the requirement that employers submit questionable Forms W-4 to the IRS and the requirement that employers transmit communications from the employee to the IRS. One commentator recommended that, as an alternative to the withholding compliance program, the problem of underwithholding should be addressed by increasing the employee's estimated tax penalty if insufficient taxes are withheld and otherwise paid by the employee for the year. While tax penalties do deter some employees from submitting Forms W-4 claiming excessive withholding exemptions, the IRS has concluded that the withholding compliance program implemented under the temporary regulations is a more efficient and effective manner of deterring serious underwithholding.

Submission of Withholding Exemption Certificates

Under the temporary regulations, employers were no longer routinely required to submit copies of Forms W-4 that met the previously established criteria, often referred to as "Questionable W-4s". Rather, the temporary regulations provided

that an employer must submit a copy of any currently effective Form W-4 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.

Some commentators observed that requiring employers to submit questionable Forms W-4 to the IRS may have deterred employees from furnishing a Form W-4 claiming excessive withholding exemptions. Some employers have expressed the concern that eliminating the submission requirement will result in more employees submitting Forms W-4 claiming excessive withholding allowances. While the Department of Treasury and the IRS acknowledge the possible deterrent effect of a requirement to submit certain Forms W-4 to the IRS, they have concluded that the final regulations are a more efficient and effective manner of deterring withholding compliance problems. Accordingly, the final regulations do not require the routine submission of Forms W-4, but permit the IRS to require submission of Forms W-4 under specific criteria either by written notice or by future published guidance. The final regulations do not change an employee's obligations to provide an accurate Form W-4 to an employer and to satisfy his or her tax obligations on a timely basis. Thus, employees may be subject to penalties if they claim excessive withholding exemptions on Forms W-4 or fail to file their tax returns and pay their full tax liabilities on a timely basis.

Some commentators have suggested that if the IRS requires an employer to submit certain Forms W-4 by a written notice or published guidance, the employer should have the ability to provide the requested Forms W-4 by electronic means. The final regulations do not address this comment as the available and appropriate means for submission can be determined by the IRS in specific cases or in the context of any future published guidance requiring the submission of Forms W-4.

Valid and Invalid Withholding Exemption Certificates

In the Preamble to the proposed and temporary regulations, the Department of Treasury and IRS requested comments specifically with regard to the criteria for identifying a valid withholding exemption certificate contained in Sec. 31.3402(f)(5)-1(a)(1) of the Employment Tax Regulations. While a few comments were received, they were not likely to provide significant assistance to employers or the IRS in identifying potentially invalid withholding exemption certificates. Accordingly, these final regulations do not change the existing rules on when to treat a withholding exemption certificate as invalid.

Effect of Notice Specifying the Maximum Withholding Exemptions Permitted

The final regulations, like the temporary regulations, authorize the IRS to 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 it determines an employee is not entitled to claim 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. Alternatively, the IRS may issue such notice after it reviews a particular withholding exemption certificate and determines that the withholding exemption certificate 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.

The IRS will send the notice both to the employer (with a copy for the employee) and to the employee directly. The final regulations provide a period during which the employee can address the pending withholding adjustment by contacting the IRS. The final regulations provide that the earliest the notice may be effective is 45 calendar days after the date of the notice. The notice may specify a later effective date.

One commentator expressed a concern held by some employers regarding the need to "warehouse" the notice for the 45-day period and suggested that instead the IRS either (1) send the notice first to the employee before involving the employer or (2) not require the employer to implement the notice until a subsequent "final" notice is sent to the employer. The final regulations retain the approach of the proposed and temporary regulations, including a delay period, to balance the need to ensure that the employee receives the notice and to provide time for the employee to discuss the appropriate withholding with the IRS. Consistent with the intent to ensure that the employee receives the notice, the final regulations also provide that if the IRS is unable to determine a last known address for the employee, the IRS will use other available information as appropriate to provide the notice to the employee.

The final regulations also clarify that the notice to an employer specifying the maximum withholding exemptions permitted for a specific employee will also specify the marital status for purposes of calculating the required withholding under the notice. Accordingly, the employer must use the maximum number of withholding exemptions permitted and marital status specified in the notice for calculating income tax withholding, unless a new withholding exemption certificate is submitted by the employee that must be honored under these final regulations. Specifically, if, at any time, the employee furnishes a withholding exemption certificate that claims a marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result from applying the marital status and number of withholding exemptions permitted in the notice, the employer must withhold tax based on that certificate. The IRS may also issue a modification notice to the employer that the employer must implement as of the date in the notice. This notice may change the marital status and/or the maximum number of withholding exemptions permitted.

Although this issue was not raised in the comments, in the course of conducting the withholding compliance program, the IRS has received questions from taxpayers asking about the implications of receiving a notice specifying the maximum number of withholding exemptions permitted and marital status when possible exclusions from withholding apply. Receipt of an IRS notice does not impose a requirement to withhold income taxes where one does not already exist. For example, under section 3401(a)(8)(A)(i) of the Code, employers do not have to withhold income taxes from payments made to employees who are United States citizens working in foreign countries if the employer reasonably believes that the payments are excluded from taxation under section 911 of the Code. Issuance of an IRS notice to an employer properly relying on this exclusion does not impose a withholding requirement on amounts covered by the exclusion. However, if withholding is required, such as on wages paid in excess of the amount excludable under section 911, or if the exclusion ceases to apply to amounts paid by the employer to the employee, the employer must withhold on the basis of the marital status and maximum number of withholding exemptions set forth in the IRS notice. An example has been added to the regulations to illustrate this point.

Employer Furnishing IRS Notice to Employee

The final regulations provide that, if the employee is still employed by the employer, the employer must furnish the notice of maximum number of withholding exemptions permitted to the employee within 10 business days of receipt. Commentators questioned whether they may furnish the employee's copy electronically. The final regulations clarify that the employer may furnish the copy of the IRS notice to the employee within the 10 required business days using any reasonable business practice. For example, an employer might provide the employee with a paper copy of the notice or might transmit a copy using a secure and reliable electronic means of communication.

Terminated, Rehired, and Seasonal Employees

The proposed and temporary regulations provided that the employer is not required to furnish the IRS employee notice to the employee if the employee is no longer employed by the employer. In such a case, 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. Some commentators have expressed concerns over application of the regulations to employees who are not currently performing services, but may resume employment in the future, such as seasonal employees or rehired employees. Specifically, the comments requested assistance in determining when an employee is "no longer employed", and asked whether an employer is required to retain an IRS notice for future implementation should an employee be rehired or resume performance of services. One commentator recommended that the employer be required to retain the notice no later than the end of the calendar year in which the employee terminates, or one year after termination.

After consideration of these comments, the final regulations modify the proposed regulations to clarify that the determination of whether the employee is employed is made as of the date of the notice, and is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for other purposes. The final regulations also specifically state that an employee who is not currently performing services is nevertheless employed for purposes of this rule if on the date of the notice (a) The employer pays wages subject to income tax withholding to the employee with respect to prior employment on or after the date specified in the notice, (b) the employer reasonably expects the employee to resume the performance of services for the employer within twelve months of the date of the notice, or (c) the employee is on a bona fide leave of absence if the period of such leave does not exceed twelve months or if the individual retains a right to reemployment with the employer by contract or under an applicable statute, such as the Family Medical Leave Act.

If the employer must furnish the notice under these final regulations, the employer must withhold based on the notice as of the date specified in the notice unless one of the regulatory exceptions applies. Specifically, the employer must withhold based on the notice unless (a) the employer receives a modification notice, (b) the employee has provided or provides a new Form W-4 that results in more withholding than would result based on the notice, (c) the employer is required to furnish the notice only because the employer reasonably expects the employee to resume the performance of services within twelve months of the date of the notice but the employee does not resume the performance of services until after such time, or (d) the employment relationship is terminated for more than twelve months. The regulations include examples to illustrate these requirements.

Notices to Other Employers

One commentator questioned whether an employer has any obligation with respect to an IRS notice issued to another employer, such as a related entity or an employer using the same entity as its "payroll agent", with respect to the same employee. The commentator also proposed that an employer be able to rely on any subsequent notices provided by the IRS with regard to an employee (for example, modifying the maximum number of withholding exemptions permitted) while the employee was employed by another employer.

The final regulations do not adopt these proposals. Other than when an employer qualifies as a "successor employer"

within the meaning of section 3121(a)(1) of the Code and Sec. 31.3121(a)(1)-1(b) of the Employment Tax Regulations and uses the alternate procedure described in Rev. Proc. 2004-53, 2004-34 I.R.B. 320, an employer's liability for withholding under section 3402 is determined separately with regard to that employer. Rev. Proc. 2004-53 provides that, under the alternative procedure, the predecessor employer must transfer to the successor employer all current Forms W-4 that were provided to the predecessor by the acquired employees and any written notices received from the IRS under Sec. 31.3402(f)(2)-1(g). The revenue procedure also provides that the successor employer must withhold amounts from the employees on the basis of the maximum number of withholding exemptions specified in any written notices from the IRS under Sec. 31.3402(f)(2)-1(g). Accordingly, the provision of an IRS notice or a subsequent IRS notice to another employer is not relevant in determining the employer's obligation to withhold income taxes under these final regulations.

Substitute Forms W-4

Some commentators have suggested that employers must refuse to accept substitute Forms W-4 developed by employees. After consideration of this comment, the final regulations provide that employers may not 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.

Effective Date

The final regulations are generally effective on April 14, 2005, the date the temporary regulations were published in the Federal Register. However, the new provisions in the final regulations that (a) specify when an employee who is not currently performing services is employed for purposes of the requirements to furnish the employee notice and withhold based on the notice, (b) require the employer to withhold based on the notice if a terminated employment relationship is resumed within 12 months, and (c) require employers to refuse to accept substitute withholding exemption certificates developed by employees apply on October 11, 2007. However, taxpayers may rely on such provisions for notices issued prior to such date.

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, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was 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 Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Department of Treasury participated in their development.

List of Subjects in 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

Adoption of Amendments to the Regulations

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Accordingly, 26 CFR part 31 is amended as follows:

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

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Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

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

Sec. 31.3402(f)(2)-1 Withholding exemption certificates.

* * * * *

(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) In general. 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 submit withholding exemption certificates. A notice to the employer to submit withholding exemption certificates 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. Alternatively, upon notice from the IRS, the employer must make available for inspection by an IRS employee 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.

(B) Published guidance. 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 Sec. 601.601(d)(2) of this chapter).

(ii) Withholding after submission of withholding exemption certificate. 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 Sec. 31.3402(f)(5)-1. However, the employer may not withhold on the basis of the withholding exemption certificate if the 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 the maximum number of withholding exemptions permitted--(i) Notice to employer. The IRS may notify the employer in writing that the employee is not entitled to claim a complete exemption from withholding or more than the maximum number of withholding exemptions specified by the IRS in the written notice. The notice will also specify the applicable marital status for purposes of calculating the required amount of withholding. 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 or otherwise provided to the IRS 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.

(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) Notice to employee. If the IRS provides a notice to the employer under this paragraph (g)(2), the IRS will also provide the employer with a similar notice for the employee (employee notice) that identifies the maximum number of withholding exemptions permitted and specifies the marital status to be used for calculating the required amount of withholding. The employee notice will also indicate the process by which the employee can provide additional information to the IRS for purposes of determining the appropriate number of withholding exemptions and/or modifying the specified marital status. The IRS will also mail a similar notice to the employee's last known address. For further guidance regarding the definition of last known address, see Sec. 301.6212-2 of this chapter. If the IRS is unable to determine a last known address for the employee, the IRS will use other available information as appropriate to mail the notice to the employee.

(iii) Requirement to furnish. If the employee is employed by the employer as of the date of the notice, the employer must furnish the employee notice to the employee within 10 business days of receipt. The employer may follow any reasonable business practice to furnish the copy of the notice to the employee. For purposes of this paragraph (g)(2)(iii), the determination of whether an employee is employed as of the date of the notice is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for other purposes. An employee that is not performing services for the employer as of the date of the notice is employed by the employer as of the date of the notice for purposes of this paragraph (g)(2)(iii) if--

(A) The employer pays wages with respect to prior employment to the employee subject to income tax withholding on or after the date specified in the notice;

(B) The employer reasonably expects the employee to resume the performance of services for the employer within twelve months of the date of the notice; or

(C) The employee is on a bona fide leave of absence if the period of such leave does not exceed twelve months or the

employee retains a right to reemployment with the employer under an applicable statute or by contract.

(iv) Requirement to notify the IRS. If the employer is not required to furnish the notice to the employee under paragraph (g)(2)(iii) of this section, the employer must send a written response to the IRS office designated in the notice indicating that the employee is not employed by the employer.

(v) Requirement to withhold based on the notice. If the employer is required to furnish the employee notice to the employee under paragraph (g)(2)(iii), then the employer must withhold tax on the basis of the maximum number of withholding exemptions and the marital status specified in the notice for any wages paid after the date specified in the notice, except as provided in paragraphs (g)(2)(vi), (vii), (viii), (ix), and (x) of this section. 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.

(vi) Employment resumes after twelve months. If the employer is required to furnish the employee notice to the employee only pursuant to paragraph (g)(2)(iii)(B) of this section and the employee resumes the performance of services for the employer more than 12 months after the date of the notice, then the employer is not required to withhold based on the notice.

(vii) Requirement to withhold based on an existing Form W-4. If a withholding exemption certificate is in effect with respect to the employee before the employer receives a notice 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 marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result from applying the marital status and number of withholding exemptions specified in the notice.

(viii) Modification notice. After issuing the notice specifying the maximum number of withholding exemptions permitted and the marital status, the IRS may issue a subsequent notice that modifies the original notice (modification notice). The modification notice may change the marital status and/or the number of withholding exemptions permitted. The employer must withhold based on the modification notice as of the date specified in the modification notice.

(ix) Requirement to withhold after termination of employment. If the employee is employed as of the date of the notice under paragraph (g)(2)(iii) of this section but the employer or employee terminates the employment relationship after the date of the notice, the employer must continue to withhold based on the maximum number of withholding exemptions and the marital status specified in the notice or a modification notice if any wages subject to income tax withholding are paid with respect to the prior employment after such date. Furthermore, the employer must withhold based on the notice or modification notice if the employee resumes an employment relationship with the employer within 12 months after the termination of the employment relationship. Whether the employment relationship is terminated is based on all the facts and circumstances.

(x) Requirement to withhold based on new Form W-4. The employee may furnish a new withholding exemption certificate after the employer receives a notice or modification notice from the IRS of the maximum number of withholding exemptions permitted under this paragraph (g)(2).

(A) Employee requests more withholding. If the employee furnishes a new withholding exemption certificate after the employer receives the notice or modification notice, the employer must withhold tax on the basis of that new certificate only if the new certificate does not claim complete exemption from withholding and claims a marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result under the notice or modification notice.

(B) Employee requests less withholding. If the employee furnishes a new withholding exemption certificate after the employer receives the notice or modification notice, the employer must disregard the new certificate and withhold on the basis of the notice or modification notice if the employee claims complete exemption from withholding or claims a marital status, a number of withholding exemptions, and any additional withholding that results in less withholding than would result under the notice or modification notice. If the employee wants to put a new certificate into effect that results in less withholding than that required under the notice or modification notice, the employee must contact the IRS. The employer must withhold on the basis of the notice or modification notice unless the IRS subsequently notifies the employer to withhold based 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) Examples. The following examples illustrate the rules of this section.

Example 1. Employer U receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee A. Employee A is not currently performing any services for Employer U. However, Employer U is continuing to make certain wage payments to Employee A. Employer U must furnish the employee notice to Employee A within 10 business days of receipt and must withhold based on the notice on any wages paid to Employee A on or after the date specified in the notice.

Example 2. Employer V receives a notice in October of Year 1 from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee B. Employee B has not performed

services for Employer V since August of Year 1. However, since Employee B has performed services for Employer V for several years on a seasonal basis, Employer V reasonably expects Employee B to resume the performance of services for Employer V in June of Year 2, a date that is within 12 months of the date of the notice. Employer V is required to furnish the notice to Employee B within 10 business days of receipt. Employee B does not resume the performance of services until June of Year 3.

Employer V is not required to withhold based on the notice.

Example 3. Employer W receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee C. Employee C began a 4-month unpaid maternity leave of absence three weeks before Employer W received the notice. Employer W must furnish the employee notice to Employee C within 10 business days of receipt. When Employee C resumes performing services when her maternity leave ends, Employer W must withhold based on the notice.

Example 4. Employer X receives a notice from the IRS in Year 1 that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee D. Employer X must furnish the employee notice to Employee D within 10 business days of receipt and withhold based on the notice. In Year 2, Employee D terminates the employment relationship. Employee D applies for a different position with Employer X and resumes employment 10 months after having left her previous position with Employer X. Since Employer X rehired Employee D within 12 months after the termination of employment, Employer X must withhold based on the notice.

Example 5. Employer Y receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee E. Employer Y must furnish the employee notice to Employee E within 10 business days of receipt. After receipt of this notice, Employee E contacts the IRS and establishes that he is entitled to claim a higher number of withholding exemptions. Employer Y receives a modification notice from the IRS that changes the maximum number of withholding exemptions permitted for Employee E. Employer Y must withhold tax based on the modification notice as of the date specified in such notice.

Example 6. Employer Z pays remuneration to Employee F, a United States citizen, for services performed in Country M. Employer Z receives a notice from the IRS in Year 1 that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee F. Employer Z must furnish the employee notice to Employee F within 10 business days of receipt. Employer Z reasonably believes all the remuneration paid to Employee F in Year 1 is excluded from Employee F's gross income under section 911 of the Internal Revenue Code. Since section 3401(a)(8)(B) excludes such remuneration from wages for income tax withholding purposes, Employer X does not have to withhold on such remuneration, notwithstanding the maximum number of exemptions permitted and marital status specified in the notice. In Year 2, Employee F returns to the United States to perform services. Employer Z does not reasonably believe any part of Employee F's remuneration paid in Year 2 is excluded from Employee F's gross income under section 911. Rather, Employer Z reasonably believes that remuneration paid to Employee F in Year 2 is subject to income tax withholding. Employer Z must withhold on the remuneration paid to Employee F based on the notice.

(5) Effective/applicability date. Except as provided in this paragraph (g)(5), paragraph (g) applies on April 14, 2005. Paragraphs (g)(2)(iii)(A), (B), and (C) and paragraph (g)(2)(ix) apply on October 11, 2007, except taxpayers may rely on such paragraphs for notices issued prior to such date.

Sec. 31.3402(f)(2)-1T [Removed]

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Par. 3. Section 31.3402(f)(2)-1T is removed.

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

Sec. 31.3402(f)(5)-1 Form and contents of withholding exemption certificates.

(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 that is called for therein. 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.

(2) Employers are prohibited from accepting 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 Sec. 31.3402(f)(2)-1.

(3) Effective/applicability date. Paragraph (a)(1) applies on April 14, 2005. Paragraph (a)(2) applies to any substitute withholding exemption certificate furnished to an employer on or after October 11, 2007.

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Sec. 31.3402(f)(5)-1T [Removed]

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Par. 5. Section 31.3402(f)(5)-1T is removed.

Kevin Brown,
Deputy Commissioner for Services and Enforcement.