

## Withholding Certificates: Form W-4

### OVERVIEW

The amount of federal income taxes an employer must withhold from each worker's wages depends upon several factors: the amount of taxable wages paid to the employee, the worker's marital status, and the number of allowances claimed by the employee. An allowance represents an amount of wages exempt from federal income tax withholding. For 2004, the value of one allowance, on an annual basis, is \$3,100. (This amount is reduced for higher income individuals.) Since 1990, the withholding allowance value is indexed annually to reflect the effects of inflation.

Form W-4, the withholding certificate, is the document that employees use to inform their employer of their marital status and the number of withholding allowances they are claiming for federal income tax purposes. This chapter outlines the rules and procedures for claiming withholding allowances. Subsequent chapters focus on the rules and methods employers must follow in computing the proper amount of federal income tax withholding.

### WITHHOLDING ALLOWANCES AND MARITAL STATUS

#### Form W-4

On or before the first day of employment, each worker should complete a Form W-4, "Employee's Withholding Allowance Certificate." Completion of Form W-4 requires employees to provide their name, address, and social security number, and inform the employer of their marital status. In addition, employees must designate the number of withholding allowances they are claiming for federal income tax purposes. Once filled out and submitted by an employee, the Form W-4 generally becomes effective with the first payment of wages and remains in effect until the worker files a new withholding allowance certificate.

Employees may claim fewer withholding allowances than they are entitled to, but they may not claim more allowances than permitted by law. Workers who claim fewer than their permissible number of withholding allowances are not precluded from taking all of the allowances they are entitled to when they file their federal tax returns.

**Employees who hold more than one job** may not duplicate their allowance claims. Workers who hold two or more jobs with different employers may claim the allowances to which they are entitled with any of the employers, but each permitted allowance may be claimed with only one employer at a time.

**Married employees whose spouses work** may not claim the same allowances already taken by their employed husband or wife. The Internal Revenue Service recommends that the spouse with the higher earnings take all of the allowances, as this will more closely approximate the amount of tax due.

If an employee fails to complete a Form W-4 or submits one claiming more withholding allowances than entitled to, the employer must withhold on the basis of a single employee with no allowances. This yields the highest rate of withholding.

An employer may use a substitute form for the official IRS Form W-4 provided the substitute gives

the identical information as the official certificate. The employer also must provide workers with all of the tables and instructions contained on the official federal form.

**IRS encourages employers to ask each employee** at the end of each year to file a new W-4 for the following year — if there has been a change in allowances or marital status since the last W-4 was filed.

#### Electronic Systems for Forms W-4

Employers may establish systems that allow employees to submit or change their withholding allowance certificate information (Form W-4) electronically. Such a system may be used for Forms W-4 required at the beginning of employment and for W-4s submitted to modify earlier W-4s. Forms W-4 from employees claiming more than 10 withholding allowances or claiming exemption from withholding may also be submitted using an electronic system.

For any employee who has a serious objection to using the electronic system or whose access to, or ability to use, the system may be limited, employers must make reasonably available upon request the option of using a paper Form W-4. Reasonable availability is satisfied if, for example, an employer informs employees how to obtain a paper Form W-4 and where to submit it, once completed.

An employer that establishes an electronic system may require any of its employees to submit Form W-4 on paper, as long as there is a business reason for the requirement. Examples of business reasons include the infeasibility of extending the electronic system to a remote location, a preference for a paper copy of an employee's initial W-4, or wanting to process "questionable" Forms W-4 (see next paragraph) via paper.

An employer that electronically collects "questionable" Forms W-4 (W-4s from employees claiming more than 10 withholding allowances or claiming exemption from withholding) must provide the W-4 data to IRS

electronically or on magnetic media. For more information on how to transmit W-4 information to IRS electronically, see the Payroll Administration Guide Special Supplement, Rev. Proc. 99-47 (12/22/99).

**Technical requirements** of an electronic Form W-4 system include the following:

- The electronic version of the withholding allowance certificate must contain exactly the same information as the paper Form W-4. This requirement does not encompass the worksheets that accompany Forms W-4, since they are provided merely for the convenience of the employee in completing the form.

- The system must make it reasonably certain that the person accessing the system and filing the Form W-4 is the employee identified in the form.

- The system must ensure that the information received is the same information the employee sent, and it must document any occasion of employee access to the system that results in the filing of a Form W-4.

- Whether on its own or in conjunction with the rest of the employer's payroll system, there must be compliance with any IRS "lock-in" letter. A "lock-in" letter may be issued by IRS in response to a copy of a Form W-4 submitted to IRS by the employer, and it informs the employer to withhold tax from the employee's pay according to a maximum number of withholding allowances determined by IRS, until further notice.

- The perjury statement contained on the paper Form W-4 (directly above the signature) must appear in the electronic program, in the exact same wording, immediately following the withholding selections and immediately preceding the signature. The program must inform employees that they are required to make the perjury statement and that they do so with their signature.

- The electronic signature may be in any form that identifies the employee filing the form and verifies the filing, and must be the final entry in the employee's submission. Examples of electronic signature methods that meet these requirements are digitized signature pads and PIN (personal identification number) systems.

- Upon request by IRS, the employer must supply a "hard copy," or paper version, of the electronic Form W-4 and a statement that, to the best of the employer's knowledge, the electronic Form W-4 was filed by the named employee. The hard copy must contain exactly the same information as the paper Form W-4, but does not have to be a facsimile of the paper form.

In all other respects, electronic Forms W-4 are subject to the same requirements as paper Forms W-4.

### Questionable or Invalid Certificates

Employers are not responsible for verifying the number of allowances claimed by employees. However, in two situations, an employer is required to send IRS copies of withholding certificates completed by workers. An employer must send a copy of an individual worker's Form W-4 to the IRS if the employee:

- Claims more than 10 withholding allowances; or

- Claims to be totally exempt from federal income tax withholding and the employer believes the worker will earn more than \$200 a week.

In such cases, the employer should send IRS a copy of the worker's completed W-4 with its corresponding quarterly return, even if the withholding certificate no longer is in effect at the end of the quarter. If the employer wishes to submit these certificates before the quarterly return filing date, it should send them to IRS with a cover letter showing the employer's name, address, and identification number and indicating the number of certificates submitted.

Any alteration or unauthorized addition to Form W-4 makes it invalid. Impermissible alterations include crossing out any pre-printed statements on the certificate or adding anything to the pre-printed information beyond the required entries. Employers may not honor an invalid certificate and should ask the employee to complete a new Form W-4. If the employee refuses, the employer should withhold in accordance with a previously submitted valid certificate (if any), or withhold on the basis of a single employee claiming zero allowances.

### Personal Allowances

Employees can claim personal allowances (also called personal exemptions) for themselves, for their spouse, and for each dependent who is not eligible to be claimed as a dependent by another taxpayer. Dependents age 1 or older who are claimed for a withholding allowance, including dependents residing in Canada or Mexico, must have a social security number. (See the box below for an explanation of those individuals who may be claimed as dependents.)

**All dependents must have tax identification numbers to qualify for the exemption amounts.**

Employees also may be able to claim additional personal allowances in the following situations:

- **Special Withholding Allowance** — One additional allowance may be claimed by unmarried employees if they have only one job or if they have two jobs and the second one pays \$1,000 or less per year. Similarly, married employees may claim this special withholding allowance if they hold only one job and their spouse does not work, or they (or their spouse) hold a second job that pays no more than \$1,000 for the year.

- **Head of Household** — An unmarried employee entitled to head-of-household filing status may claim one additional withholding allowance. Individuals generally qualify for head-of-household status if they are unmarried and pay more than half the cost of maintaining a home for themselves and at least one dependent or other qualifying person.

- **Dependent Care** — Employees who anticipate claiming a credit on their federal tax returns for child or dependent care expenses amounting to \$1,500 or more may claim one additional withholding allowance on Form W-4.

At higher income levels, personal allowances are phased out, which increases the income tax liability for high-income individuals by 5 percent. This greater tax

liability is built into the withholding tables, and does not affect the number of personal allowances an employee may claim on Form W-4.

**A nonresident alien employee** may claim no more than one personal allowance. Thus, even if married, an employee who is a nonresident alien (or who is married to a nonresident alien) is entitled to only one withhold-

ing exemption. This restriction does not apply to residents of Canada, Mexico, Japan, or Korea. In addition, to avoid underwithholding, nonresident aliens should request withholding as if single, regardless of their marital status, and also should request that an extra \$7.60 per week be withheld from their wages.

### Determining Dependent Status

Employees generally are allowed to claim withholding allowances for themselves, a spouse, and each dependent. The relatives listed below qualify as dependents, provided they: receive more than half of their financial support from the employee; do not file a joint return (if they are married); and are citizens or residents of the U.S., residents of Canada or Mexico, or alien children who have been adopted by and are living with a U.S. citizen abroad. In addition, dependents (other than a child, foster child, or stepchild under age 19 or a full-time student under age 24) must receive less than \$3,100 in income for 2004 (same as 2003). The following relatives (related to either spouse, if filing jointly) may be claimed for dependent allowances if they meet all of the above qualifications:

- ▶ child (natural or legally adopted);
- ▶ stepchild;
- ▶ foster child living with employee for full year;
- ▶ parent or stepparent;
- ▶ grandparent or great grandparent;
- ▶ grandchild or great grandchild;
- ▶ brother or sister;
- ▶ half-brother or half-sister
- ▶ stepbrother or stepsister;
- ▶ parent-in-law, brother-in-law, or sister-in-law;
- ▶ son-in-law or daughter-in-law;
- ▶ uncle, aunt, nephew, or niece (related by blood)

In addition, an individual who is not a relative but who lives with the employee as a member of the family for the entire year and meets the qualifications listed above may be claimed as a dependent.

### Allowances for Deductions and Credits

If employees anticipate deductions, losses, or credits that will lower their federal income tax liability, they may take additional allowances to reduce their withholding accordingly. Employees can use a worksheet that appears on Form W-4 as a simplified method for figuring the appropriate number of allowances to reflect the following itemized deductions to income:

- Qualifying home mortgage interest;
- Charitable contributions;
- State and local taxes (but not sales taxes);
- Medical expenses in excess of 7.5 percent of income;
- Miscellaneous deductions in excess of 2 percent of income.

To determine the proper number of withholding allowances, employees first must total their estimated deductions for the year. They then subtract the standard deduction from the total, but report no less than zero. (The 2004 standard deduction is \$9,700 for married employees filing jointly or qualifying widows or widowers; \$7,150 for heads of households; \$4,850 for single employees; and \$4,850 for married employees who file separate tax returns.) Any alimony payments or deductible IRA contributions are added to this remainder. Then estimated nonwage income, such as dividends or interest, is subtracted.

The amount determined from the above calculations is divided by \$3,100, the value of one withholding allowance. Any fraction is dropped. The result is the number of allowances that may be claimed for estimated deductions. A more precise method for deter-

mining the appropriate number of W-4 allowances to more closely approximate actual tax liability is contained in IRS Publication 919, "Is My Withholding Correct?" That publication includes several worksheets that account for additional factors affecting tax liability, such as a larger standard deduction for age or blindness, the phaseout of the personal exemption for higher-income individuals, and self-employment income.

### Marital Status

For withholding purposes, marital status is either single or married. Employees are considered single if they are not married or if they are unmarried heads of households, legally separated from their spouse under a divorce or separate maintenance decree, or if on any day in the calendar year the employee (or his or her spouse) was a nonresident alien.

A married employee may indicate on Form W-4 that withholding is to be computed at the higher "single" rates.

Employees who marry during the year may (but are not required to) change their marital status for withholding purposes as soon as they are married. They may not claim married status ahead of time, in anticipation of the change in status. Once married, employees also may change the number of allowances they've claimed to reflect an additional personal allowance for their spouse — provided the spouse is not claiming a personal allowance with his or her employer. Employees who divorce or who are legally separated during the year must claim a "single" marital status and

eliminate any personal allowance claimed for the spouse within 10 days.

### Death of a Spouse

If an employee's spouse dies, the surviving widow or widower (who has not remarried) is entitled to file as married and claim an allowance for the deceased spouse for the remainder of the year in which the spouse died. However, unless the employee is a qualifying widow or widower, the worker must file a new withholding certificate by December 1 of the year of the spouse's death, to be effective the following year. If December 1 falls on a Saturday, Sunday, or legal holiday, the next business day is considered as the due date. If an employee's spouse dies on or after Dec. 1, the new Form W-4 must be filed within 10 days.

**Qualifying widows and widowers** are those who were entitled to file a joint return in the year the spouse died, have not remarried, and are paying for at least half of the upkeep of the home of a dependent child or children living with them. Qualifying widows or widowers may claim married status for two full tax years following the spouse's death, but they may not claim an allowance for the spouse after the year the spouse died.

### Additional Withholding

Employees may elect to have more federal income taxes withheld from their wages than is required by law. Individuals may desire additional withholding, for example, if they have significant nonwage income, a second job, self-employment income, or a working spouse. This can be accomplished if employees claim fewer than their permitted number of allowances on Form W-4. Similarly, married employees could indicate on Form W-4 that they want withholding computed at the higher "single" rate.

Employees also may designate an additional sum of money to be withheld each payroll period. There is space on Form W-4 for this designation. An employer must honor this designation for additional withholding to the extent that the employee has sufficient wages to cover the extra withholding after deductions for all other federal, state, and local taxes.

Form W-4 contains a worksheet that employees who have two jobs and/or a working spouse can use to compute the amount of additional taxes that should be withheld to avoid underwithholding. Completion of this

worksheet is recommended for single employees who hold two or more jobs paying combined wages in excess of \$30,000, as well as for married employees who have combined earnings in excess of \$60,000 from a second job or income earned by a working spouse.

### Changing Allowances

Employees may change the number of withholding allowances claimed at any time simply by completing a new Form W-4. Employees should be reminded to file a new Form W-4 if their circumstances change in a way — e.g., a marriage, divorce, or birth of a child — that affects the number of allowances to which they are entitled. Note, however, that if a child or other dependent dies, the employee may continue to claim the dependent allowance for the balance of the year.

An employee must file a new Form W-4 within 10 days if the number of allowances decreases for reasons other than the death of a spouse or dependent — e.g., the employee is divorced, more than half the support of a dependent is assumed by someone else, or the spouse begins claiming his or her own personal withholding allowance on a separate Form W-4.

### Supplemental Unemployment Benefits

Supplemental unemployment benefits are subject to withholding for federal income taxes. The payer must use the Form W-4 in effect before the employee separated from service for calculating withholding. However, the former employee may submit to the SUB payer a new Form W-4, which must be given effect with the first benefit payment following receipt of the new withholding certificate.

### Effective Date

The first withholding certificate filed by a new employee must be given effect with the beginning of the first payroll period (or the first wage payment made if there is no such period) after the worker completes the W-4. If a worker subsequently submits another Form W-4 indicating a change in marital status or different number of allowances, the revised certificate must be put into effect no later than the first payroll period ending on or after the 30th day after the new form is filed.

A properly completed Form W-4 remains in effect until the employee submits a new certificate.

### Withholding: 90 Percent Minimum and Safe Harbor Provisions

Unless workers also pay estimated taxes quarterly, if the amount withheld from employees' wages does not equal at least 90 percent of their total federal income tax liability or 100 percent of their preceding year's liability as shown on their return (the "100 percent of last year's liability safe harbor"), the workers will be assessed penalties by IRS. Individuals with adjusted gross incomes exceeding \$150,000 must have withheld and/or pay estimated taxes equal to at least 90 percent of their total liability or 110 percent of their preceding year's liability as shown on their return in order to avoid penalties. Typically, only those employees with significant non-wage or self-employment income file estimated taxes. Therefore, for most employees, it is important that they claim an appropriate number of allowances in order to avoid penalties for insufficient withholding.

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## COMPLETE EXEMPTION FROM WITHHOLDING

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### Who is Eligible

Employees may be able to claim a total exemption from federal income tax withholding if they meet the following two conditions:

- They owed no federal income tax the previous year (or had a right to a refund of all federal income taxes withheld because they had no tax liability); and
- They anticipate owing no federal income tax during the current year (or expect a refund of any tax withheld because they have no liability).

Employees who meet these criteria may claim a complete exemption from federal income tax withholding by so indicating in the appropriate space on Form W-4.

**Employees who are claimed as dependents** on someone else's tax return are ineligible for exemption from withholding if: (1) they have nonwage income — e.g., interest, dividends, etc. — greater than \$1.00; and (2) the total of their nonwage income plus their wages exceeds \$800 for the year. This exemption from withholding applies primarily to part-time workers and students with summer jobs. However, full-time students are not automatically entitled to exemption.

**EXAMPLE:** A high school student who is claimed as a dependent on his parent's tax return expects to earn \$2,500 from a summer job and also expects to have \$20 in interest income for the year. The student cannot claim exemption from withholding because he will have more than \$1.00 of unearned income and total income of more than \$800.

Keep in mind that if an employer believes that a worker who claims to be exempt from withholding will have earnings of more than \$200 per week, it must submit a copy of the employee's Form W-4 to the IRS by the due date for the employer's quarterly return. If the IRS subsequently determines that the employee is not entitled to exemption from withholding, the agency will notify the employer and provide it with withholding instructions.

### Effective Date of Exemption

Employees may claim exemption from withholding upon hire or at any later time during the year that they come to believe they will have no income tax liability. The employer must cease withholding within 30 days of receiving the Form W-4 claiming exemption. Once employees who have been exempt from withholding realize they will incur tax liability in the current year, they must file a new Form W-4 within 10 days, revoking the exemption and indicating the appropriate number of withholding allowances claimed. If an employee properly remains exempt from withholding for the entire current year but anticipates having an income tax liability the following year, the worker must file a new Form W-4 that does not claim the exemption by December 1 of the current year.

Each Form W-4 on which an individual claims to be exempt from withholding expires February 15 of the following calendar year. To continue the exemption, the employee claiming to be exempt must file a new withholding certificate annually, by February 15 of the year in which exemption is to be claimed. If an employee fails to file a new exemption certificate and also fails to submit a Form W-4 indicating the number of withholding allowances for the current year, the employer should begin withholding as of February 15 as if the worker were single and claiming zero allowances. If February 15 falls on a Saturday, Sunday, or legal holiday, the next business day is considered as the due date. (For employees whose tax year is other than the calendar year, the exemption certificate expires on the 15th day of the second month after the end of the employee's tax year, and should that day be a Saturday, Sunday, or legal holiday, the next business day is considered as the expiration date.)

Even though an employee is exempt from withholding for federal income taxes, the worker remains subject to withholding for social security and Medicare taxes under the Federal Insurance Contributions Act.

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## OTHER WITHHOLDING CERTIFICATES

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### Pensions — Form W-4P

Taxable distributions from pension plans, profit-sharing plans, and other deferred compensation plans and annuities are subject to withholding. However, recipients of such payments may decline to have taxes withheld for any reason, regardless of the amount of the distribution. Form W-4P is used by recipients of both periodic and nonperiodic pension payments to elect not to have federal income tax withheld from these payments.

Recipients of periodic payments who opt for withholding use Form W-4P to indicate the number of allowances they are claiming and their marital status for withholding purposes. For recipients of nonperiodic distributions from pension and profit-sharing plans,

Form W-4P is used only to opt out of withholding. If withholding is to apply to these payments, the amounts to be withheld are unrelated to allowances. (See the separate chapter on pension and retirement payments in this section.)

The employer may substitute an equivalent Form W-4P without prior IRS approval, provided it contains the following information:

- Form number (W-4P);
- The number and expiration date assigned to Form W-4P by the Office of Management and Budget;
- Space for the recipient's name, address, and social security number;
- In the case of periodic payments, space to show the number of allowances and marital status;
- Space to request additional withholding;

- Space to decline withholding;
- Signature line.

In addition, the employer must provide the IRS instructions for Form W-4P or a version giving the substance of those instructions, including the appropriate cautions concerning estimated taxes and the applicable penalties for underwithholding. These instructions need not appear on the W-4P document itself.

Form W-4P remains in effect until the recipient revokes it or submits a changed certificate.

### Sick Pay — Form W-4S

If the employer makes wage payments directly to an employee who is on sick leave, those payments are treated as ordinary wages, and withholding is covered by the employee's Form W-4. However, if sick pay is paid by a third party (such as an insurance company), withholding of federal income taxes does not apply unless the recipient affirmatively requests it by completing Form W-4S.

The amount withheld pursuant to Form W-4S may not reduce the net payment below \$10. The amount withheld must be at least \$20 a week and must be in whole dollars. (For more detail, see the separate chapter on sick pay in this section.)

### Form W-4V, Voluntary Withholding on Government Payments

Recipients of certain unemployment compensation or federal government payments may wish to use Form W-4V, Voluntary Withholding Request, to initiate federal income tax withholding from such payments. Qualifying government payments for which Form W-4V can be used include:

- Unemployment compensation (including Railroad Unemployment Insurance Act payments);
- Social security benefits;
- Social security equivalent tier 1 railroad retirement benefits;
- Commodity Credit Corporation loans; and

- Certain crop disaster payments under the Agriculture Act of 1949 or Title II of the Disaster Assistance Act of 1988.

For unemployment compensation the payer is permitted to withhold 10 percent from each payment. No other percentage or amount is allowed.

For any other government payment, the recipient may choose to have the payer withhold seven percent, 10 percent, 15 percent, or 25 percent from each payment. No other percentage or amount of withholding is allowed.

### Earned Income Credit — Form W-5

Employees who are eligible for the earned income credit may request advance payments of the credit by filing Form W-5 with their employer. This form contains the employee's certification that the worker is eligible for the earned income credit and has no other certificate in effect with any other employer. It also indicates whether the employee's spouse has filed for advance payments with another employer. For 2004, employees who earn \$30,338 or more are ineligible to receive the advance earned income credit payment, and \$1,563 constitutes the maximum amount of advance earned income credit paid to an employee.

Form W-5 is effective for one calendar year only; employees must furnish a new certificate each year to continue advance payments of the earned income credit. If employees later become ineligible for the earned income credit, they must revoke their Forms W-5 within 10 days.

The first Form W-5 filed by an employee each year is effective immediately. A revised Form W-5 must be given effect no later than the first wage payment made on or after the first status determination date (January 1, May 1, July 1, or October 1) that occurs at least 30 days after the revised Form W-5 is received.

For more information on the earned income credit, see the separate chapter in this section.

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## REFERENCES

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### General References

- Internal Revenue Code Sections 151, 3402
- Regulations §31.3402
- *Circular E, Employer's Tax Guide*, IRS Publication 15
- *Employer's Supplemental Tax Guide*, IRS Publication 15-A
- *Withholding of Tax on Nonresident Aliens and Foreign Corporations*, IRS Publication 515

### Form W-4

- Form W-4 Requirement: IRC §3402(f)(2); Regs. § 31.3402(f)(2)-1
- Electronic Filing: Regs. §31.3402(f)(5)-1
- More Than One Job: IRC §3402(f)(7); Regs. § 3402(m)-1(f)(2)

- Alterations to Form: Regs. §31.3402(f)(2)-1(e); Rev. Rul. 80-68, 1980-1 CB 225
- Substitute Form: Regs. §31.3402(f)(2)-1T

### Personal Allowances

- Nonresident Aliens: IRC §3402(l)(3)(A); Regs. § 31.3402(f)(6)-1; Rev. Rul. 69-454, 1969-2 CB 193; IRS Publication 515
- Soc. Sec. No. Required for Dependents: IRC § 6109(e); IRS News Release IR-88-19, 2-2-88

### Allowances for Deductions and Credits

- General: IRC §3402(m); Regs. §31.3402(m)-1
- Alternative Method: IRS Notice 88-42, IRB 1988-15, 4-11-88

**Marital Status**

- IRC §3402(l); Regs. §31.3402(l)-1

**Additional Withholding**

- IRC §3402(i); Regs. §31.3402(i)-1 and -2
- Omnibus Budget Reconciliation Act of 1993, § 13201, 13202
- IRC §§1, 531, 541

**Changing Allowances**

- IRC §3402(f)(2)(B); Regs. §31.3402(f)(2)-1(b) and (c); Rev. Rul. 82-24, 1982-1 CB 134

**90 Percent Minimum; Safe Harbor Provisions**

- IRC §6654(d)
- Omnibus Budget Reconciliation Act of 1993, § 13214

**Effective Date**

- IRC §3402(f)(3); Regs. §31.3402(f)(3)-1

**Exemption from Withholding**

- IRC §3402(n); Regs. §31.3402(n)-1

**Other Withholding Certificates**

- Form W-4P: IRC §3402(o); Regs. §31.3402(o)-2
- Form W-4S: IRC §3402(o); Regs. §31.3402(o)-3
- Supplemental Unemployment Benefits: IRC § 3402(o); Regs. §31.3402(o)-1
- Earned Income Credit: IRC §3507(e); Regs. § 31.3507-2; IRS Publication 539

