

Guidance on Withholding Rules

Notice 2018-14

I. PURPOSE

This notice: (1) extends the effective period of Forms W-4, Employee's Withholding Allowance Certificate, furnished to claim exemption from income tax withholding under section 3402(n) of the Internal Revenue Code (Code) for 2017 until February 28, 2018, and permits employees to claim exemption from withholding for 2018 by temporarily using the 2017 Form W-4; (2) temporarily suspends the requirement under section 3402(f)(2)(B)¹ that employees must furnish their employers new Forms W-4 within 10 days of changes in status that reduce the withholding allowances they are entitled to claim; (3) provides that the optional withholding rate on supplemental wage payments under Treas. Reg. § 31.3402(g)-1 is 22 percent for 2018 through 2025; and (4) provides that, for 2018, withholding under section 3405(a)(4) on periodic payments when no withholding certificate is in effect is based on treating the payee as a married individual claiming three withholding allowances.

Sections 11001 and 11041 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115-97 (the "Act"), which was enacted on December 22, 2017, made significant changes to

¹ All references to sections in this document are to Code sections unless specifically provided otherwise.

income tax rates, income tax deductions and credits, and federal income tax withholding. The Internal Revenue Service (IRS) is currently working on revising Form W-4 to reflect the changes made by the Act, such as changes in available itemized deductions, increases in the child tax credit, the new dependent credit, and the repeal of dependent exemptions. As a result, the 2018 Form W-4 may not be released until after February 15, 2018.

The Act does not mandate that employees furnish new Forms W-4 for 2018 and expressly permits the IRS to administer income tax withholding under section 3402 for 2018 without regard to the changes in the withholding rules and the suspension of personal exemptions. Accordingly, and in order to minimize burden on employees and employers, the IRS and the Department of the Treasury (Treasury Department) designed the 2018 withholding tables to work with the Forms W-4 that employees have already furnished their employers. See Notice 1036, Early Release Copies of the 2018 Percentage Method Tables for Income Tax Withholding, and Publication 15 (Circular E), Employer's Tax Guide, for use in 2018. For employees with simpler tax situations, the new tables are designed to produce the correct amount of tax withholding. The revisions are also aimed at avoiding over- and under-withholding of tax as much as possible. The IRS is also working on revising the withholding calculator on www.irs.gov to reflect the changes made by the Act. When released, the modified calculator and 2018 Form W-4 can be used by employees who wish to update their withholding in response to the Act or changes in their personal circumstances in 2018. Until a new

Form W-4 is issued, employees and employers should continue to use the 2017 Form W-4.

Section II of this notice extends the effective period of Forms W-4 furnished to claim exemption from income tax withholding for 2017 to February 28, 2018, and describes the procedures by which employees may claim exemption from withholding for 2018 under section 3402(n) using the 2017 Form W-4. These procedures expire 30 days after the 2018 Form W-4 is released. They may be relied upon for actions taken in 2017 with respect to the 2018 tax year. Section III of this notice temporarily suspends the requirement that employees must furnish employers new Forms W-4 within 10 days after a change in status that results in reduced withholding allowances under section 3402(f)(2)(B) and Treas. Reg. § 31.3402(f)(2)-1. Section IV of this notice clarifies that the optional withholding rate for supplemental wages is 22 percent for taxable years beginning after December 31, 2017 and before January 1, 2026. Section V of this notice provides that, for 2018, the rules for default withholding under section 3405(a)(4) parallel the rules for prior years and treat the payee as a married individual claiming three withholding allowances.

II. GUIDANCE FOR EMPLOYEES EXEMPT FROM WITHHOLDING

Under section 3402(n), an employee may claim exemption from income tax withholding if the employee certifies on Form W-4 that (1) the employee incurred no liability for income tax for the preceding taxable year; and (2) the employee anticipates that he or she will incur no liability for income tax for the current taxable year. See also

Treas. Reg. §§ 31.3402(f)(4)-2 and 31.3402(n)-1. Under Treas. Reg. § 31.3402(f)(4)-2(c), Forms W-4 furnished to the employer claiming exemption from withholding for a taxable year are effective up to and including February 15 of the following year, and an employer may continue to rely on employees' Forms W-4 claiming exemption from withholding until February 16 of the following year. Thus, the effective period of Forms W-4 furnished to claim exemption from withholding under section 3402(n) for 2017 is scheduled to expire on February 15, 2018. As noted above, due to changes in the Code made by the Act, the IRS may not release the 2018 Form W-4 until after February 15, 2018.

To provide additional time for employers and employees to implement the procedures in this notice, the Treasury Department and the IRS have determined that 2017 Forms W-4 claiming exemption from withholding under section 3402(n) for 2017 may be treated as effective through February 28, 2018. The 2017 Forms W-4 claiming exemption from withholding for 2017 are not effective for wage payments made after February 28, 2018.

With respect to any claim for exemption from withholding for 2018 (whether renewing a claim from 2017 or making a new claim), the IRS will allow employees to claim exemption using the 2017 Form W-4 until 30 days after the 2018 Form W-4 is released in one of the following ways: (1) modifying the 2017 Form W-4 by striking "2017" in the text on Line 7 of the Form W-4 and entering "2018" in its place and signing the form in 2018; (2) modifying the 2017 Form W-4 by entering "Exempt 2018" on Line 7

of the 2017 Form W-4 and signing the form in 2018; (3) using the 2017 Form W-4 without modification and signing the form in 2018, provided that the employer establishes and communicates to employees a procedure under which an employee signs and furnishes the 2017 Form W-4 in 2018 to certify both that the employee incurred no income tax liability for 2017 and that the employee anticipates that he or she will incur no income tax liability for 2018 and thus claims exemption from withholding for 2018; or (4) any method substantially similar to (1)–(3) that clearly conveys in writing an employee’s intent to certify his or her exemption from withholding for 2018.

Employers that have established electronic systems for furnishing withholding allowance certificates under Treas. Reg. § 31.3402(f)(5)-1(c) may make alterations to their electronic systems to substantially conform with options (1)–(4) above. An employer must keep records of all Forms W-4 furnished to the employer by its employees. See Treas. Reg. § 31.6001-5(a)(13). If an employer uses options (3) or (4) above, the employer must clearly identify 2017 Forms W-4 furnished by employees to claim exemption from withholding in 2017 and those furnished to claim exemption from withholding in 2018. Employees and employers may also rely on these procedures for 2017 Forms W-4 that employees signed and furnished in 2017 to claim exemption from withholding for 2018.

Employees are reminded to furnish employers Forms W-4 in good faith and claim exemption from withholding for 2018 only if they did not have tax liability in 2017 and do not anticipate any tax liability in 2018. Any alteration or unauthorized addition to a 2017

Form W-4, other than the ones described in this notice to indicate the certificate is for exemption in 2018, will cause the altered 2017 Form W-4 to be invalid. See Treas. Reg. § 31.3402(f)(2)-1(e). Moreover, any oral or written statement clearly indicating that an employee's Form W-4 is false that is made by the employee to the employer on or before the date on which the employee furnishes the Form W-4 also will cause the employee's Form W-4 to be invalid. See Treas. Reg. § 31.3402(f)(2)-1(e). Employees who claimed exemption from withholding for 2017 and are renewing claims for exemption from withholding for 2018 need to furnish their Forms W-4 claiming exemption from withholding for 2018 by February 28, 2018, under the revised rule of this notice. Employees who claim exemption from withholding for 2018 using the 2017 Form W-4 as permitted by this notice do not need to furnish a 2018 Form W-4 after the 2018 Form W-4 is released.

III. TEMPORARY SUSPENSION OF 10-DAY REQUIREMENT TO FURNISH NEW FORMS W-4 TO EMPLOYERS

Section 3402(f)(2)(B) and Treas. Reg. § 31.3402(f)(2)-1(b) provide that if a change in status occurs that reduces the number of withholding allowances to which employees are entitled, employees must, within 10 days, furnish the employer with a new Form W-4 claiming the proper number of withholding allowances.

The Treasury Department and the IRS have determined that employees experiencing a change in status that causes a reduction in the number of withholding

allowances are not required to furnish employers new withholding allowance certificates until 30 days after the 2018 Form W-4 is released. Moreover, because the 2018 withholding tables are designed to work with the Forms W-4 that employees have already furnished their employers, employees who have a reduction in the number of withholding allowances solely due to the changes made by the Act are not required to furnish employers new withholding allowance certificates during 2018. However, employees may update their withholding at any time in response to the Act. Employees who choose to update their withholding may use the 2017 Form W-4 instead of the 2018 Form W-4 to report changes in withholding allowances until 30 days after the 2018 Form W-4 is released. Likewise, new hires may continue to claim allowances by using the 2017 Form W-4 until 30 days after the 2018 Form W-4 is released. Employees who furnish new Forms W-4 using a 2017 Form W-4 do not need to furnish a 2018 Form W-4 after the 2018 Form W-4 is released.

IV. OPTIONAL FLAT RATE FOR WITHHOLDING ON SUPPLEMENTAL WAGES

Under certain circumstances, employers may withhold income tax from supplemental wage payments at an optional flat rate. See Treas. Reg. § 31.3402(g)-1. Section 904(a) of the American Jobs Creation Act of 2004 (AJCA, P.L. 108-357), which is not included in the Code, provides that for purposes of optional flat rate withholding, the “rate to be used in determining the amount to be so deducted and withheld shall not be less than 28 percent (or the corresponding rate in effect under section 1(i)(2) of the Internal Revenue Code of 1986 for taxable years beginning in the calendar year in

which the payment is made).” Accordingly, Treas. Reg. § 31.3402(g)-1(a)(7)(iii)(F) provides that employers using the optional flat rate withhold “[f]rom supplemental wages paid after December 31, 2004, by using a flat percentage rate of 28 percent (or the corresponding rate in effect under section 1(i)(2) for taxable years beginning in the calendar year in which the payment is made).” Under Treas. Reg. § 31.3402(g)-1(a)(7)(iii)(F), the optional withholding rate for supplemental wage payments made in 2005 through 2017 was 25 percent because that was “the corresponding rate in effect under section 1(i)(2).”²

The Act changed the income tax rate tables effective under section 1 by adding section 1(j) to the Code. Section 1(j)(1) provides that “[i]n the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—(A) subsection (i) shall not apply, and (B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).” Section 1(j)(2) provides the income tax rate tables that are to be applied for taxable years beginning after December 31, 2017, and before January 1, 2026. Based on the change in the rate tables under added section 1(j), the optional flat rate changed from 25 percent to 22 percent for wages paid during 2018 and the remainder of the period to which section 1(j) of the Code applies. See Notice 1036.

² Section 1(i)(2)(A) provides that the rate tables under sections 1(a), 1(b), 1(c), 1(d), and 1(e) shall be applied “by substituting ‘25%’ for ‘28%’ each place it appears”

Employers and other entities paying supplemental wages should implement the 22 percent optional flat rate for withholding on supplemental wages as soon as possible, but not later than February 15, 2018. Employers using optional flat rate withholding that withheld at a higher rate than 22 percent (for example, employers that withheld at the 2017 optional flat rate of 25 percent) may, but are not required to, correct such withholding on supplemental wages paid on or after January 1, 2018, and before February 15, 2018, under the rules applicable to corrections of overcollections of federal income tax. See Treas. Reg. §§ 31.6413(a)-1(b) and 31.6413(a)-2(c).

V. WITHHOLDING UNDER SECTION 3405 FOR PERIODIC PAYMENTS IF NO WITHHOLDING CERTIFICATE IS IN EFFECT

Under section 3405, the payor of certain periodic payments for pensions, annuities, and other deferred income generally is required to withhold from the payments as if they were wages unless an individual elects not to have withholding apply to the periodic payment. (The election is unavailable with respect to certain payments to be made outside of the United States or its possessions. See section 3405(e)(13).) The withholding election generally is made using Form W-4P, Withholding Certificate for Pension or Annuity Payments.

Under the law in effect before 2018, section 3405(a)(4) provided that, in the case of a payee entitled to periodic payments with respect to which a withholding certificate has not been furnished, the amount to be withheld from each such payment “shall be

determined by treating the payee as a married individual claiming 3 withholding exemptions.” The Act amended section 3405(a)(4) to provide that the withholding rate when no withholding certificate is furnished “shall be determined under rules prescribed by the Secretary.” See section 11041(c)(2)(G) of the Act. For 2018, the rules for withholding when no withholding certificate is furnished with respect to periodic payments under section 3405(a) will parallel the rules for prior years and be based on treating the payee as a married individual claiming three withholding allowances.

DRAFTING INFORMATION

The principal authors of this notice are A.G. Kelley and Mikhail Zhidkov of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Mikhail Zhidkov at (202) 317-4774 (not a toll-free call).