

CLIENT ALERT

Employer Q&A Regarding New 2018 IRS Individual Income Tax Withholding Requirements

MARCH 30, 2018

The Tax Cuts and Jobs Act (Act) implements sweeping reform to the Internal Revenue Code of 1986, as amended, with most changes effective January 1, 2018. Some of the biggest changes impact individual taxpayers, including: (i) changes in individual tax rates and brackets, (ii) an increase in the standard deduction, (iii) increasing the child tax credit, and (iii) the repeal of personal exemptions. Therefore, employers should understand these new rules and how they impact their payroll and related functions. Additionally, employers should consider being proactive with communication to their employees to help their employees become aware of the impact of these changes in order to maintain optimum employee morale (e.g., if an employee is inappropriately under-withheld, the employee may fairly or unfairly blame the employer). To assist with compliance regarding these changes, the Internal Revenue Service (IRS) has released [Notice 1036](#), the [IRS Withholding Calculator](#) (note this calculator is intended for use by employees) and a new Form W-4—all of which are referenced below.

In order to assist employers in understanding the new individual income tax withholding requirements, we have prepared the following Q&A:

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Which legal requirements should employers be aware of?

1. [Withholding Tables](#): Per Notice 1036, employers were required to ensure that the new 2018 withholding tables and procedures were implemented into the applicable payroll procedures, as soon as possible, but not later than **February 15, 2018**.
2. [2018 Form W-4 Requirement](#): **Starting March 30, 2018**, employers are required to use and maintain the new 2018 Form W-4 on a go forward basis.
3. [Form W-4 Processing Requirements](#): The IRS provides that employers are required to implement any new Form W-4 submitted to the employer by an employee no later than the start of the first payroll period ending on or after the 30th day from the date the employer receives it.

What should employers do in light of this new guidance?

1. By February 15, 2018, all employers should have made sure they are properly reporting and withholding on wages pursuant to Notice 1036 and timely processing all Forms W-4.
2. By March 30, 2018, employers should update all new hire packets and other policies or procedures where a Form W-4 is provided to employees or received from employees with the new 2018 Form W-4.
3. Once the above is ready to go, many employers are finding that drafting clear and helpful communications to educate their employee regarding the new withholding rules may provide an optimal balance of meeting legal obligations and optimizing employee morale.

How can the Form W-4 be collected and received?

Employers may receive paper copies of Forms W-4 or receive Forms W-4 via an electronic system that complies with Treas. Reg. 31.3402(f)(5)-1(c). Employers should not take action on verbal Form W-4 requests.

What about a state Form W-4 (or their equivalent)?

Employers should check each state they are required to withhold in to see if there are any updates in terms of what forms are available and when and how those forms may be administered (e.g., not all states may allow for an electronic Form W-4).

Which employees are most at-risk for being under-withheld?

The IRS expects that some employees may have more complicated tax situations than others and therefore, face the possibility of being under-withheld. For example, (i) employees who itemized their deductions in the past, (ii) have two or more jobs in their household, or (iii) have dependents age 17 or over are especially encouraged to review their tax situations via the IRS Withholding Calculator.

Why should all employees perform a withholding check-up?

By law, an estimated tax penalty usually applies when a taxpayer pays too little of their total tax during the year. The penalty is calculated based on the interest rate charged by the IRS on unpaid tax. For most people, avoiding the penalty means ensuring that at least 90 percent of their total tax liability is paid during the year, either through income-tax withholding or by making quarterly estimated tax payments with certain exceptions. The penalty is discussed in detail in IRS Publication 505, which is expected to be available on IRS.gov in early spring,

Who has to submit a new Form W-4?

The new withholding tables are designed to minimize the burden to the taxpayer as much as possible and will work with the 2017 (or prior) Forms W-4 that workers have already submitted to their employers to claim withholding allowances. However, the IRS still revised the Form W-4 worksheets and the IRS Withholding Calculator to more accurately reflect the new law and provide employees information to determine whether they need to adjust their withholding. Employees should use the IRS Withholding Calculator to check if they need to adjust their withholding. If they need to adjust their withholding, they should fill out a new Form W-4, and submit this Form W-4 to their employer's HR or payroll department (or as otherwise directed by the employer) at their earliest convenience.

What is the correct flat supplemental rates to use for equity awards and annual cash bonuses in light of the new lower tax rates?

Notice 1036 provides rules for the 2018 supplemental wage withholding, as follows (employers should refer to IRS guidance for additional details):

1. Less than \$1 million supplemental wages: The new supplemental rate on an employee who receives \$1 million or less in supplemental wages is a flat 22%.
2. Over \$1 million supplemental wages: The new supplemental rate on an employee who receives more than \$1 million of supplemental wages during the calendar year is a flat 37%.

Note that under the pre-existing IRS guidance, the employer does not have the option of withholding at any other flat rates other than that provided by the IRS in Notice 1036. Note that this prohibition includes withholding at a flat rate higher than the prescribed flat rate, which is important to understand for employers trying to avoid adverse accounting implications under ASC 718.

With all of this being said, employers that do use the W-4 method—which is an option only if there is less than \$1 million of supplemental wages—for withholding on supplemental wages, may continue to use this method, but these employers should make sure those withholding procedures are updated for Notice 1036.

Wow, this is a lot. Will there be a test?

We do not currently plan on drafting any tests. However, should you need assistance regarding the new withholding rules, please feel free to reach out to your local Winston & Strawn benefits and executive compensation contact.

Winston Takeaway:

Employers should review their payroll procedures and make sure they have implemented the new withholding requirements and are prepared to provide or maintain the 2018 Forms W-4 by March 30, 2018. Since the IRS is being proactive with reaching out to the public regarding the new withholding rules it inures to the employer's benefit to be proactive with their legal obligations and to provide effective employee communication.

5 Min Read

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