

# Meeting the W-4 challenge: Key issues for electronic and paper-based W-4s.

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Whether they work at Fortune 500 companies or the small business down the street, HR professionals are well-acquainted with the Employee's Withholding Allowance Certificate, more commonly known as the W-4 form. The U.S. Internal Revenue Service (IRS) requires all employers to have their employees fill one out. But common as it is, the form presents many pitfalls for the unwary.

In recent years, the IRS has laid out rules that allow employers to handle W-4s electronically. The electronic W-4 presents its own set of challenges, which we will treat in some detail. But first, it is important to address a few of the key issues related to conventional, paper-based W-4s.

Those pitfalls start with determining who is an employee. The IRS recognizes four categories of workers: independent contractors, common-law employees, statutory employees and non-statutory employees. The distinctions are important. Generally speaking, the IRS only requires employers to withhold federal income tax from the paychecks of "common law employees."

The IRS considers a worker to fall into the "common law" category if the employer has the "right to control what will be done and how it will be done." It's that ability to "control the details of how the services are performed" that decides where a worker falls. This means that someone who has a lot of freedom to come and go or to set his own hours or to telecommute must fill out a W-4 form as long as the employer has the final say in how the work is done.

At times, companies must also withhold taxes from the paychecks of leased workers and statutory employees. Leased workers are those people who are provided by one organization to work for another entity. In such cases, the company getting the benefit of the work contracts with the leasing business, which retains the right to hire, fire and direct the worker's service. In these cases, the leasing company must provide the W-4 form and withhold the employment taxes. This requirement generally applies to any company that hires temps from staffing firms.

Employers must present new hires with the W-4 form when they begin work for the company. It is effective the first pay period and remains in effect until the employee submits a different one. The original W-4 becomes effective with the first pay period. If the employee simply substitutes a new W-4 form for an older one, the changed withholding takes effect no later than the start of the first pay period on the 30th day from the date the replacement form was received. If the new W-4 has a different effective date (such as January 1 of the coming year), the employer must not change the amounts being withheld until the date set by the new form.

If an employee fails to fill out a W-4 form, the employer should treat the worker as if he is single and has no withholding allowances. Employees are allowed to claim fewer exemptions than they have, but they are not allowed to claim more than they are entitled to claim. The employee is also allowed to have a set dollar amount withheld in addition to the normal amount of withholding.

If an employee had no tax liability the previous year and expects none in the current year, he can claim he is exempt from federal taxes. Such an exemption lasts for only one year. The employee must claim the exemption each year by filing a new W-4 form by February 15. Employees who miss that due date and submit no new form are treated as if they are single and have no withholding. If they have previously submitted a W-4 form other than the one claiming the exemption, the employer can use the information on the old form to determine how much in taxes to withhold.

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Although there are exceptions to the rule, federal income taxes must be withheld on the wages of nonresident alien employees. There is a surcharge that must be taken out in addition to the normal withholding. The surcharge depends on the frequency of the payroll period:

Payroll period	Add this much more to the dollars withheld
Weekly	\$ 51.00
Biweekly	\$ 102.00
Semimonthly	\$ 110.00
Monthly	\$ 221.00
Quarterly	\$ 663.00
Semiannually	\$ 1,325.00
Annually	\$ 2,650.00
Daily or misc.	\$ 10.20

Other rules also apply to nonresident aliens when completing a W-4 form:

1. They are not allowed to claim exemption from withholding.
2. They must request withholding as if they were single, no matter their true marital status.
3. Unless the employee is a resident of Canada, Mexico, or Korea, they can claim only one allowance.
4. They must write "nonresident alien" or "NRA" above the dotted line on Line 6 of the form. Employers who have an electronic W-4 system must provide a place for nonresident aliens to enter their status (NRA or nonresident alien).

IRS rules for electronic W-4s

The IRS allows employers to establish an electronic system to accept and process W-4 forms, in either the English or the Spanish version [Forma W-4(SP), Certificado de Exención de la Retención del(la) Empleado(a)]. Employers who set up an electronic system for W-4s do not have to keep a paper version of the form.

The IRS has set five requirements that must be met by employers who set up electronic systems for W-4 forms:

1. The employer must make sure that the information on the form is exactly what the employee sent. The system must have a fail-safe mechanism to be "reasonably certain" that the person who is providing the information and who is on the system is the employee and not someone else. The system must keep track of every time an employee accesses it to submit a form or a change.
2. The information on the paper form must be duplicated on the electronic version.
3. The system must allow the form to be signed electronically, and that signature must be the final entry when the information is submitted.

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**Federal Form W-4** [Help](#)

- This is your current W-4 Withholding Allowance that was effective on 08/19/2002.
- You may make changes to your current withholding allowances by changing the Form W-4 below.
- Before saving your changes, you will be required to re-enter your Personal Identification Number (PIN). This will verify that you have requested changes to your Form W-4 and will serve as your electronic signature.
- After you have made your new selections, click "Save".
- Click "Cancel" to return to the Main Menu without saving any changes.

Form **W-4** **Employee's Withholding Allowance Certificate** **2007**  
Department of the Treasury Internal Revenue Service  
▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.

1 Type or print your first name and middle initial: ANN B Last name: ASAMPLE 2 Your social security number: 123 : 45 : 6789  
Home address (number and street or rural route): 3  Single  Married  Married, but withhold at higher Single rate.

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.  
**Employee's signature** **Re-enter your Login PIN as your electronic signature**  
(Form is not valid unless you check this.) ▶  I Agree  Date: 8/15/2007

- Last year I had a right to a refund of all Federal income tax withheld because I had no tax liability and
- This year I expect a refund of all Federal income tax withheld because I expect to have no tax liability.

If you meet both conditions, select "Exempt" here . . . . .  Exempt  Not Exempt

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.  
**Employee's signature** **Re-enter your Login PIN as your electronic signature**  
(Form is not valid unless you check this.) ▶  I Agree  Date: 8/15/2007

- The signature line on the W-4 must note that the document is signed under penalty of perjury and has to have the same language found on the original paper format. The electronic form or the system must make sure the employee is told that he "must make the declaration contained in the perjury statement and that the declaration is made by signing the Form W-4."
- The employer must provide a hard copy of the W-4 form to the IRS if the agency requests one. The hard copy must be accompanied by a statement saying that "to the best of [the employer's] knowledge," the electronic form was filled out and submitted by the employee named on the form. The hard copy of the electronic does not have to be an exact replica of the original paper form but must provide the same information, including the perjury statement.
- The IRS imposes the same recordkeeping requirements on electronic forms as on paper ones.

Sometimes the IRS identifies employees who withhold too little money from their paychecks. If the IRS deems this to be a "serious under-withholding problem," it will issue a "lock-in" letter. Lock-in letters tell the employer the maximum number of withholding allowances that employee is allowed to claim.

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If, however, the employee who is the subject of a lock-in letter wants to reduce the amount withheld by increasing the allowances above that specified in the notice, or wants to claim he is exempt from paying taxes, the employee must fill out a new W-4 form. He must then submit that and a written statement to support his claims to the IRS.

However, employees who are the subject of lock-in letters are allowed to claim more withholding (fewer allowances) than specified in the lock-in notice. To do so, the employee must submit a new W-4 form. If the form is valid, the employer should withhold at the new rate. The employer should ignore any other type of W-4 submitted by the employee and withhold based on the lock-in letter. That means an employer with an electronic W-4 system must manually check each electronic W-4 submitted by an employee subject to a lock-in letter, or must include a method for preventing employees from submitting an electronic W-4 that exceeds the limits of the lock-in letter.

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