

CASE NO. 65919-7-I

COURT OF APPEALS, DIVISION I  
STATE OF WASHINGTON

JOHN MURPHEY, A Washington Resident, and MURPHEY AND  
WESTCOTT d/b/a J&L Enterprises,

Appellants,

vs.

CHARLES D. GRASS, CPA & ASSOCIATES, P.S., A Professional  
Corporation,

Respondent.

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Appellants' Strict Reply Brief

Mark D. Kimball, WSBA No. 13146  
Mark@mdklaw.com  
James P. Ware, WSBA No. 36799  
James@mdklaw.com  
MDK Law Associates  
10900 NE 4<sup>th</sup> St., Suite 2030  
Bellevue, WA 98004  
(425) 455-9610

Attorneys for Appellants John Murphey  
and Murphey and Westcott

**ORIGINAL**

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## I. ARGUMENT.

### A. Grass's Belief that the Appeals Division of the Department of Revenue is Separate and Distinct from the Department of Revenue is Contrary to the Plain Language of RCW § 82.32.160 and RCW § 82.01.040.

Central to the disagreement of the parties as to when Murphey suffered “damage” or “injury” is Grass’s mistaken belief that the Appeals Division of the Department of Revenue is somehow separate and distinct from the Department itself. Grass’s erroneous belief is evidenced not only by its use of the phrase “Tax Appeals Court” (which implies that the Appeals Division is wholly independent of the Department) but also because it states throughout its Responsive Brief that the Department of Revenue issued its assessments in 2006. Based upon these assertions, Grass states that if this court were to follow the holding in **International Engine Parts, Inc. v. Feddersen and Co.** the Court would find that Murphey’s claim accrued in 2006 because “the Department of Revenue issued its final assessments on February 28, 2006<sup>1</sup> and June 1, 2006, making the assessments subject to an appeal.” (Responsive Brief, p. 9 fn.

4) Further, Grass uses its mistaken belief to assert that the holding in **Huff**

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<sup>1</sup> Grass is incorrect that the Notice of Assessment for John Murphey individually was completed on February 28, 2006. In fact, February 28, 2006 was simply the first draft that was later amended by the auditor on May 15, 2006 and again on October 2, 2010. (CP 112-15) These edits by the auditor prior to the petition to the Appeals Division further illustrates that a Notice of Assessment is not considered a binding assessment until the Department deems it final. Because Murphey petitioned to the Appeals Division, the assessment was not deemed final until the Department finished its review in February 2009.

**v. Roach** shows that Murphey suffered damage in 2006 and knew the amount of damages in 2009. (Resp. Br., at p. 9) Grass appears to believe that a notice of assessment constitutes the Department of Revenue's final assessment. Further, Grass appears to believe that if a party challenges the notice pursuant to RCW § 82.32.160, the entity that reviews the notice of assessment is not the Department itself but rather a separate and distinct entity.

As discussed below, Grass's position is incorrect and results in the mistaken belief the Department rendered its final decisions in 2006 instead of when it actually rendered its final decisions in February 2009.

Ultimately, the parties do not dispute that Murphey's claims accrued when the Department issued the final assessments. However, Grass mistakenly believes that the final assessments were issued when Murphey received proposed notices of assessment. Grass's stance does not comport with applicable law and appears to be the source of its mistaken belief that Murphey suffered damage in 2006.

**1. An Assessment is Considered a Final Assessment when the Department of Revenue Concludes its Review.**

The Appeals Division of the Department of Revenue is not a separate agency that conducts an independent review of a final assessment. To the contrary, the Appeals Division is simply a division within the Department

of Revenue that reviews challenged notices of assessment before the Department issues a final assessment and demands payment. RCW § 82.32.160 affords a taxpayer issued with a notice of assessment a procedure through which to have the Department of Revenue review the assessment before the Department considers the assessment final. Importantly, an administrative appeal automatically prevents the assessments from becoming final until Department acts on the appeal. **W.R. Grace & Co. v. Department of Revenue**, 137 Wn.2d 580, 587, 973 P.2d 1011 (1999). Therefore, an assessment under review by the Appeals Division is not “final” because the Department has yet to render its final decision. Because the Appeals Division is a division of the Department, its role must be examined as such. Further, the ruling of the Appeals Division clearly stated when the assessments became final and binding. (CP 121, 128) Here, the Appeal Division rendered its decision and the assessments became final in February 2009, not 2006 as Grass asserts.

When the Appeals Division reviews a notice of assessment, it is not reviewing a final assessment that is due and owing. Rather, it is reviewing the factual and legal accuracy of a notice of assessment in order to correct potential errors before it becomes a final assessment. RCW § 82.32.160 clearly states that there are two ways that a notice of assessment is converted into a final and enforceable assessment: (1) by the Appeals

Division issuing its ruling on the taxpayer's request for correction; and (2) if the taxpayer does not challenge the notice of assessment within 30 days of its receipt. Here, Murphey gave timely notice of his intent to challenge the notice of assessment and the Department issued its final ruling on its request in February 2009. Therefore, the Department of Revenue issued its final assessment in February 2009 and Murphey was well within the statute of limitations when it filed this action.

**2. Grass Mistakenly Believes that Murphey's  
Position is that an Appeal of a Final Assessment  
Tolls the Statute of Limitations.**

Throughout its Responsive Brief Grass mistakenly states that Murphey seeks to have this Court rule that an appeal of a final assessment tolls the statute of limitations. To be explicitly clear, Murphey does not assert that an appeal of a final assessment tolls the statute of limitations. Rather, Murphey's position is that a claim accrues, and the statute of limitations commences, when the final assessment is issued. Prior to that point in time, any "damage" or "injury" is merely speculative because the Department of Revenue has yet to issue a final assessment. If Murphey's position was that appeal of a final assessment tolls the statute of limitation, then Murphey would have asserted that its damages accrued in October 2009 when the Board of Tax Appeals issued its decision. To the contrary

though, Murphey's position is that its claims accrued when the Department of Revenue issued its final assessment in February 2009.

Grass's use of the phrase "Tax Appeals Court" to refer to the Appeals Division is inadvertently misleading and appears to be the source of Grass's confusion. The phrase implies that the Appeals Division is not a division of the Department but rather a separate court to which a taxpayer appeals after the Department issues the final assessment. However, that is simply not true. As outlined in WAC § 458-20-100, the Appeals Division is simply a division of the Department of Revenue that reviews "actions of the department or of its officers and employees in the assessment or collection of taxes." WAC § 458-20-100; see also RCW § 82.01.040(4). "Tax Appeals Court" as a shorthand phrase more aptly refers to the Board of Tax Appeals. The Board of Tax Appeals is a separate entity to which taxpayers may petition to seek review of a final assessment. RCW § 82.03.190 ("Any person having received...a notice of determination made under RCW 82.32.160...may appeal by filing...a notice of appeal with the board of tax appeals...") Again, Murphey does not allege that an appeal of a final assessment to the Board of Tax Appeals would toll the statute of limitations as that is contrary to applicable law.

Because Grass confuses the Appeals Division with something akin to the Board of Tax Appeals, Grass erroneously believes that Murphey is

confusing “damage” with “damages”. (Resp. Br. at p. 9) Grass believes that Murphey’s position is that its claims did not accrue until it knew the monetary value of its injury. Again, Grass is mistaken. Murphey’s position is that it did not suffer injury (i.e. “damage”) until the assessment became final. The assessment became final in February 2009. Prior to that time, Murphey had not suffered an injury because the assessment was not final but rather undergoing internal review by the Department. Once the Department finalized the assessment, Murphey suffered an injury and its claims accrued.

**B. Murphey did not Suffer “Damage” Sometime Before the Department of Revenue Issued its Final Assessment.**

In its brief, Grass alleges that “Murphey candidly admits that he discovered Grass’s alleged error and the harm caused by them in 2005 or 2006...” and that “Murphey set forth the dates when Grass’s alleged malpractice, and its harm, was discovered in his Complaint, his Brief before the Board of Tax Appeals, and his Opposition to Grass’s Motion for Summary Judgment.” (Resp. Br. at pp. 6-7)(emphasis ours) Grass’s statements appear to be based upon its belief that Murphey’s claims related to the failure to maintain accurate records constitutes an injury separate from the assessments. Again, Grass is mistaken. Murphey does not admit it suffered injury prior to 2009 and the statements bulleted in

Grass's brief do not state the contrary. (Resp Br., pp. 7-8) As noted both at oral argument for Grass's Motion for Summary Judgment (RP 23, lines 5-16) and in its Appellate Brief, Murphey's claims related to Grass's failure to maintain adequate records stem from the fact that the auditor noted that Murphey failed to maintain adequate records in compliance with WAC § 458-20-254 which was a contributing factor to the notices of assessment. (CP 103, 110) Therefore, it is not simply that Murphey felt that Grass lacked an acceptable record keeping regimen but rather its failures relate directly to Murphey's claims.

Further, Murphey does not confuse "damage" with "damages". Murphey clearly has set forth that it suffered an injury (i.e. "damage") when the Department issued the final assessment. Prior to that point in time, any notion of damage was merely speculative and could not serve as the basis for a cause of action. The Notices of Assessment issued in 2006 do not constitute a final assessment as Grass believes. **Huff v. Roach's** relevance to this matter is limited to its general holding that a claim accrues when a party either knows or should have known that it has suffered an injury even if the monetary value of the injury is unknown. **Huff v. Roach**, 125 Wn. App. 724, 106 P.3d 268 (2005). Grass mistakenly believes that "Murphey's appeal to the Tax Appeals Court offered the potential to modify the amount of his "damages", Murphey

knew he had been “damaged” in 2005, or no later than 2006.” (Resp. Br. at p. 10) Unlike the specific issue in **Huff**, there are no concerns that Murphey did not file its petition with the Appeals Division or its appeal to the Board of Tax Appeals within the prescribed period of time and continued to challenge the notice of assessment. **Huff**, 125 Wn. App. at 727 (stating that even though the Huffs knew their claims were barred by the statute of limitations, they elected to continue to file suit and pursue them). Here, Murphey knew it was injured when the Department issued its final assessment in February 2009 and filed suit within a year of suffering its injury. Grass’s misguided view of the Appeals Division has caused Grass to misunderstand Murphey’s position and misconstrue when Murphey suffered “damage”.

In this case, the monetary value of the injury was not known until the Board of Tax Appeals issued its decision in October 2009. However, Murphey suffered an injury in February 2009 when the Department rendered its final assessment and at that point in time its claims accrued. Even under Grass’s analysis and rationale, once Grass’s confusion as to the function of the Appeals Division is remedied, there remains no legal or factual dispute that Murphey suffered its injury, and its claims accrued, in February 2009. As Grass notes, Murphey suffered injury when the Department of Revenue issued final assessments for unpaid taxes.

However, Grass is mistaken in its assertion that the assessments were issued in 2006.

**C. Janicki Logging is Inapposite to this Matter as  
Murphey Timely Petitioned the Appeals Division and  
the Department Issued its Final Assessment in February  
2009.**

Grass's reliance on **Janicki Logging** is misplaced because Murphey's petitions to the Appeals Division were timely and therefore the assessments were not finalized until the Appeals Division concluded its review in February 2009. In **Janicki Logging** counsel, Schwabe, for Janicki Logging failed to file an appeal to the U.S. Court of Claims within the prescribed 12 month period and the Court dismissed the claim because it lacked jurisdiction over the matter. **Janicki Logging & Const. Co. v. Schwabe, Williamson & Wyatt, P.C.**, 109 Wn. App. 655, 658, 37 P.3d 309 (2001). As a result, Janicki Logging could not challenge the final administrative decision of the U.S. Forest Service which awarded Janicki Logging less damages than it believed it suffered. *Id.* Schwabe represented Janicki Logging for years throughout various appeals that concluded with the Federal Circuit affirming the Court of Claims dismissal of Janicki Logging's appeal for failure to file its appeal within the prescribed 12 month period. *Id.* at 569. In finding that Janicki Logging's claims were barred by the three year statute of limitations, this

Court noted that Janicki had knowledge that it had suffered an injury when the Court of Claims dismissed its appeal as time barred and not after Janicki Logging exhausted its ability to appeal the Court of Claims' dismissal. Id. at 660-61. Grass relies on the holding in **Janicki Logging** because Grass believes "Murphey knew he had been damaged by Grass's accounting errors when the Department of Revenue issued its assessment, just as Janicki knew it had been damaged when the Court of Claims dismissed its claims." (Resp. Br. at p. 13). Grass's position is based upon its misunderstanding of the role of the Appeals Division and confusion of the when the final assessments were issued by the Department.

First, **Janicki Logging**'s holding is only slightly germane to the issues at bar because Murphey did not file untimely petitions to the Appeals Division. As a result the Appeals Division has jurisdiction to review the notices of assessment. Had Murphey's petitions been untimely, then the assessments would have become final in 2006 because after the 30 day petition period a notice of assessment becomes final and binding. RCW § 82.32.160. However, that is not the case here. Murphey's petitions to the Appeals Division were timely and the Department of Revenue issued the final assessments in February 2009.

Additionally, Murphey does not allege that review of the Department's final decision by the Board of Tax Appeals. In **Janicki**

**Logging**, the appeal to the Court of Claims was of the US Forest Services final determination. **Janicki Logging**, 109 Wn. App. at 660-61.

Accordingly, Janicki Logging had exhausted any administrative review available and the issue was that it failed to appeal the final decision to the Court of Claims. In support of its argument, Janicki Logging stated that appeal of a final decision by the Forest Service tolls the statute of limitation. Id. Murphey disagrees with Janicki Logging's analysis. Rather Murphey's position is that once the Department issued its final determinations (i.e. the final assessments) Murphey's claims accrued because then it had knowledge of its injury. Murphey's appeal to the Board of Tax Appeals neither tolled the statute of limitation nor did it impact when it commenced. Once the Department issued its final assessments Murphey was injured, its claims accrued, and the statute of limitations commenced. Again, this occurred in February 2009.

Grass's reliance on **Janicki Logging** is misplaced and stems from Grass's erroneous belief the Appeals Division is not a branch of the Department of Revenue. As noted in Murphey's Appellate Brief, the Appeals Division has absolute authority to either adopt the field auditor's position or wholly reject it. In so doing the Appeals Division is not reversing a judgment like an appellate court or the Board of Tax Appeals but rather its actions may cause the taxpayer to never suffer any injury

because the Department would not be issuing an assessment against the taxpayer. In **Janicki Logging** had the Federal Circuit reversed the Court of Claims dismissal it would not have changed the fact that Janicki Logging had an adverse ruling lodged against it. In this case though, had the Appeals Division rejected the field auditor's position, Murphey would not have suffered any injury. To use the words of the **Janicki Logging** Court, Murphey would not have had an adverse ruling that would have given it notice it suffered an injury.

Grass believes that the Department of Revenue issued its assessments in 2006 and the "Tax Appeals Court" reviewed the Department's assessments. (Resp. Br. at p. 13) That is not what occurred in this matter. Similar to Grass's analysis of **Huff v. Roach**, once Grass's confusion as to the role of the Appeals Division is remedied, both Murphey and Grass's analysis of the facts and case law yield the same result: Murphey suffered injury in February 2009 when the Department of Revenue issued its final assessment. Further, both Murphey and Grass agree that appeals of the final assessments to the Board of Tax Appeals did not toll the statute of limitations because the appeal concerned the monetary value of the damage but the damage occurred when the Department issued its final assessment.

**D. Grass is Incorrect in its Belief that the Negligent Filing of Federal Taxes is Indistinguishable from Grass's Negligent Filing of State Tax Returns.**

Murphey's claims related to amounts lienied by the IRS and the final assessments issued by the Department of Revenue are separate and distinct causes of action because there exists no causal link between the negligent acts that led to the IRS lien and the negligent acts that led to the assessments issued by the Department.<sup>2</sup> Grass's assertion that Murphey is attempting to "cherry pick among different aspects of damage..." fails to recognize that the acts that caused the assessments by the Department are wholly unrelated to the acts that caused the IRS to issue its levy. (Resp. Br. at p. 19) Grass appears to believe that the requirements imposed by the IRS and the Department are one in the same. However, Grass is incorrect.

Simply because Murphey's complaint organizes its causes of action as "Breach of Fiduciary Duty" and "Breach of Contract" instead of "Federal Taxes" and "State Taxes" does not alter the fact that the acts that led to the IRS lien and the Department's assessments are wholly unrelated. The filing period for the federal returns – namely, "941" returns at the federal level - are different than state filing periods; the applicable tax

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<sup>2</sup> Grass erroneously believes that Murphey is attempting to trifurcate its claims into state taxes, federal taxes, and hiring a new accountant. As noted in Section B, Grass's failure to maintain accurate records in compliance with Washington law contributed to the assessments issued by the Department.

code is wholly different; the taxing authority to whom payments are remitted are different; and the statutory mechanisms to challenge assessed taxes, penalties, and interest are different, and the penalties for failing to pay the . Murphey's claims for the negligent filing of state tax returns are based upon a duty that is wholly separate than the duty related to Grass's negligent filing of federal 941 returns. First, employer's submit quarterly form 941's and payments to report withholdings for federal income taxes, social security, and medicare. 26 USC § 3402(a)(1); see also 26 USC § 3406. As these are withholdings from an employee's wages, the employer is liable for the withholdings. 26 USC § 3403. The amount of each withholding is defined by computational charts and graphs created by the Secretary of Treasury. 26 USC § 3402(a)(1). Failure to remit withholdings subjects an employer to fines, interest on the underpaid withholdings and, if willful, potential federal felony charges. 26 USC § 3509; 26 USC § 3402; 26 USC § 7202. Accordingly, Grass's actions that caused the IRS lien are that it failed to report and timely remit withholdings from wages Murphey paid to the IRS. The process Grass negligently failed to follow is dictated by the United States Code and regulations prescribed by the Secretary of Treasury.

In contrast the Department of Revenue's assessments are based upon the alleged failure to report state sales tax, use tax, and a failure to

maintain accurate records. (CP 101-11). The Department's assessment has nothing to do with an employer's requirement to withhold federal income taxes from wages it pays. Further, the assessments are wholly unrelated to any failure to remit withholdings to the IRS. Importantly, the acts or inactions by Grass that led to the Department's assessments stand alone are in no way overlap with the acts or inactions that led to the IRS lien.

Grass mistakenly believes that Murphey is attempting to carve out specific damages. (Resp. Br. at p. 18) Rather Murphey's position is that the negligent acts that led to the IRS lien are wholly distinct and separate from the negligent acts that led to the Department's assessments. Accordingly, simply because Murphey concedes that his claims for failure to timely file and remit payment to the IRS does not impact the fact that Murphey's claims for failure to file, remit payment, and maintain records in accordance with Washington State law accrued in February 2009.

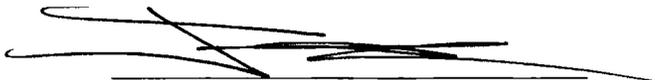
## **II. CONCLUSION.**

Grass incorrectly asserts that the Appeals Division's role is to review assessments after the Department of Revenue has made its final determination on the assessment. Accordingly, Grass asserts, the Appeals Division is a "Tax Appeals Court" and should be treated as such. Grass's position is contrary to the applicable law and is the root of the parties'

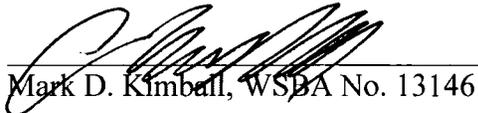
disagreement in this matter. Neither party disputes that Murphey suffered injury when the Department issued its final and binding assessments. Neither party disputes that when Murphey filed an appeal to challenge the final and binding assessments issued by the Department that the appeal process did not toll the statute of limitations. Rather, the only dispute is when the Department issued the final and binding assessments. The Department issued the final and binding assessments in February 2009, not in 2006 as Grass alleged. Accordingly, Murphey's claims accrued in February 2009, it filed this complaint within the three year statute of limitations and the lower court's order that dismissed Murphey's claims as barred by the three year statute of limitations should be reversed.

Respectfully submitted this 23<sup>rd</sup> day of March 2011.

MDK Law Associates  
MARK DOUGLAS KIMBALL, P.S.  
Attorneys for Appellants John Murphey and Murphey and Westcott



James P. Ware, WSBA No. 36799

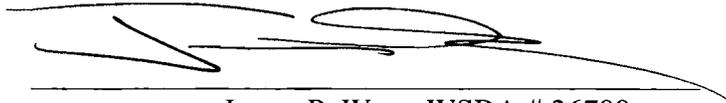


Mark D. Kimball, WSBA No. 13146

**Proof of Service**

The undersigned certifies that on March 24, 2011 arrangements were made for service of a true and correct copy of the within and foregoing Reply Brief upon the Respondent via counsel through messenger service, at their address of record, with provision for delivery no later than March 24, 2011.

Dated: March 24, 2011

A handwritten signature in black ink, appearing to read 'James P. Ware', is written over a horizontal line.

James P. Ware, WSBA # 36799  
MDK Law Associates  
(425) 455-9610

**26 USC § 3402**

LEXSTAT 26 USC § 3402

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\*\*\* CURRENT THROUGH PL 111-383, APPROVED 1/7/2011 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE C. EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX  
CHAPTER 24. COLLECTION OF INCOME TAX AT SOURCE  
SUBCHAPTER A. WITHHOLDING FROM WAGES

**Go to the United States Code Service Archive Directory**

26 USCS § 3402

§ 3402. Income tax collected at source [Caution: See prospective amendment note below.].

(a) Requirement of withholding.

(1) In general. Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall--

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter [26 USCS §§ 3401 et seq.] and to reflect the provisions of chapter 1 [26 USCS §§ 1 et seq.] applicable to such periods.

(2) Amount of wages. For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one personal exemption provided in section 151(b) [26 USCS § 151(b)], prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

(b) Percentage method of withholding.

(1) If wages are paid with respect to a period which is not a payroll period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to compute the tax to be deducted

and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(c) Wage bracket withholding.

(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of table for an annual payroll period prescribed pursuant to subsection (a).

(d) Tax paid by recipient. If the employer, in violation of the provisions of this chapter [26 USCS §§ 3401 et seq.], fails to deduct and withhold the tax under this chapter [26 USCS §§ 3401 et seq.], and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

(e) Included and excluded wages. If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

(f) Withholding exemptions.

(1) In general. An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself unless he is an individual described in section 151(d)(2) [26 USCS § 151(d)(2)];

(B) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption;

(C) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c) [26 USCS § 151(c)] for the taxable year under subtitle A [26 USCS §§ 1 et seq.] in respect of which amounts deducted and withheld under this

chapter [26 USCS §§ 3401 et seq.] in the calendar year in which such day falls are allowed as a credit;

(D) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance; and

(E) a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the Secretary) unless (i) he is married (as determined under section 7703 [26 USCS § 7703]) and his spouse is an employee receiving wages subject to withholding or (ii) he has withholding exemption certificates in effect with respect to more than one employer.

For purposes of this title, any standard deduction allowance under subparagraph (E) shall be treated as if it were denominated a withholding exemption.

(2) Exemption certificates.

(A) On commencement of employment. On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

(B) Change of status. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to him, the employee shall within 10 days thereafter furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is greater than the number of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day.

(C) Change of status which affects next calendar year. If on any day during the calendar year the number of withholding exemptions to which the employee will be, or may reasonably be expected to be, entitled at the beginning of his next taxable year under subtitle A [26 USCS §§ 1 et seq.] is different from the number to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary may by regulations prescribe, furnish the employer with a withholding exemption certificate relating to the number of withholding exemptions which he claims with respect to such next taxable year, which shall in no event exceed the number to which he will be, or may reasonably be expected to be, so entitled.

(3) When certificate takes effect.

(A) First certificate furnished. A withholding exemption certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(B) Furnished to take place of existing certificate.

(i) In general. Except as provided in clauses (ii) and (iii), a withholding exemption certificate furnished to the employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

(ii) Employer may elect earlier effective date. At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

(iii) Change of status which affects next year. Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

(4) Period during which certificate remains in effect. A withholding exemption certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

(5) Form and contents of certificate. Withholding exemption certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

(6) Exemption of certain nonresident aliens. Notwithstanding the provisions of paragraph (1), a nonresident alien

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individual (other than an individual described in section 3401(a)(6)(A) or (B) [26 USCS § 3401(a)(6)(A) or (B)]) shall be entitled to only one withholding exemption.

(7) Exemption where certificate with another employer is in effect. If a withholding exemption certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding exemption which he has claimed under such first certificate.

(g) Overlapping pay periods, and payment by agent or fiduciary. If a payment of wages is made to an employee by an employer--

- (1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or
- (2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or
- (3) with respect to a period beginning in one and ending in another calendar year, or
- (4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] shall be determined in accordance with regulations prescribed by the Secretary under which the withholding exemption allowed to the employee in any calendar year shall approximate the withholding exemption allowable with respect to an annual payroll period.

(h) Alternative methods of computing amount to be withheld. The Secretary may, under regulations prescribed by him, authorize--

- (1) Withholding on basis of average wages. An employer--
  - (A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,
  - (B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and
  - (C) to deduct and withhold upon any payment of wages to such employee during such quarter (and, in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.
- (2) Withholding on basis of annualized wages. An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by--
  - (A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,
  - (B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and
  - (C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.
- (3) Withholding on basis of cumulative wages. An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to--
  - (A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,
  - (B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,
  - (C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,
  - (D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax

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deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

(4) Other methods. An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

(i) Changes in withholding.

(1) In general. The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

(2) Treatment as tax. Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.].

(j) Noncash remuneration to retail commission salesman. In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter [26 USCS §§ 3401 et seq.] with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

(k) Tips. In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a) [26 USCS § 6053(a)], and only to the extent that the tax can be deducted and withheld by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) [26 USCS § 6053(a)] to which paragraph (16)(B) of section 3401(a) [26 USCS § 3401(a)] is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than \$ 20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) [26 USCS § 3102(c)(2)] or section 3202(c)(2) [26 USCS § 3202(c)(2)]) minus any tax required by section 3102(a) [26 USCS § 3102(a)] or section 3202(a) [26 USCS § 3202(a)] to be collected from such wages and funds.

(l) Determination and disclosure of marital status.

(1) Determination of status by employer. For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection [enacted March 15, 1966] indicating that the employee is married.

(2) Disclosure of status by employee. An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

(3) Determination of marital status. For purposes of paragraph (2), an employee shall on any day be considered--

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

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(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(a)).

(m) Withholding allowances. Under regulations prescribed by the Secretary, an employee shall be entitled to additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)--

(1) estimated itemized deductions allowable under chapter 1 [26 USCS §§ 1 et seq.] (other than the deductions referred to in section 151 [26 USCS § 151] and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a) [26 USCS § 62(a)] (other than paragraph (10) thereof)),

(2) estimated tax credits allowable under chapter 1 [26 USCS §§ 1 et seq.], and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) [26 USCS § 63(c)(3)] for the aged and blind) and other items as may be specified by the Secretary in regulations.

(n) Employees incurring no income tax liability. Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter [26 USCS §§ 3401 et seq.] upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee--

(1) incurred no liability for income tax imposed under subtitle A [26 USCS §§ 1 et seq.] for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A [26 USCS §§ 1 et seq.] for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

(o) Extension of withholding to certain payments other than wages.

(1) General rule. For purposes of this chapter [26 USCS §§ 3401 et seq.] (and so much of subtitle F [26 USCS §§ 6001 et seq.] as relates to this chapter [26 USCS §§ 3401 et seq.]--

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter [26 USCS §§ 3401 et seq.] is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter [26 USCS §§ 3401 et seq.] is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

(2) Definitions.

(A) Supplemental unemployment compensation benefits. For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

(B) Annuity. For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

(C) Sick pay. For purposes of this subsection, the term "sick pay" means any amount which--

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is

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temporarily absent from work on account of sickness or personal injuries.

(3) Amount withheld from annuity payments or sick pay. If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter [26 USCS §§ 3401 et seq.], the amount to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

(4) Request for withholding. A request that an annuity or any sick pay be subject to withholding under this chapter [26 USCS §§ 3401 et seq.]--

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect--

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

(5) Special rule for sick pay paid pursuant to certain collective-bargaining agreements. In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay--

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

(6) Coordination with withholding on designated distributions under section 3405. This subsection shall not apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1) [26 USCS § 3405(e)(1)]).

(p) Voluntary withholding agreements.

(1) Certain federal payments.

(A) In general. If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter [26 USCS §§ 3401 et seq.], then for purposes of this chapter [26 USCS §§ 3401 et seq.] and so much of subtitle F [26 USCS §§ 6001 et seq.] as relates to this chapter [26 USCS §§ 3401 et seq.], such payment shall be treated as if it were a payment of wages by an employer to an employee.

(B) Amount withheld. The amount to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

(C) Specified federal payments. For purposes of this paragraph, the term "specified Federal payment" means--

(i) any payment of a social security benefit (as defined in section 86(d) [26 USCS § 86(d)]),

(ii) any payment referred to in the second sentence of section 451(d) [26 USCS § 451(d)] which is treated as

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insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a) [26 USCS § 77(a)], and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

(D) Requests for withholding. Rules similar to the rules that apply to annuities under subsection (o)(4) shall apply to requests under this paragraph and paragraph (2).

(2) Voluntary withholding on unemployment benefits. If, at the time a payment of unemployment compensation (as defined in section 85(b) [26 USCS § 85(b)]) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter [26 USCS §§ 3401 et seq.], then for purposes of this chapter [26 USCS §§ 3401 et seq.] and so much of subtitle F [26 USCS §§ 6001 et seq.] as relates to this chapter [26 USCS §§ 3401 et seq.], such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] from any payment to which any request under this paragraph applies shall be an amount equal to 10 percent of such payment.

(3) Authority for other voluntary withholding. The Secretary is authorized by regulations to provide for withholding--

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter [26 USCS §§ 3401 et seq.],

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter [26 USCS §§ 3401 et seq.] (and so much of subtitle F [26 USCS §§ 6001 et seq.] as relates to this chapter [26 USCS §§ 3401 et seq.]), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

(q) Extension of withholding to certain gambling winnings.

(1) General rule. Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

(2) Exemption where tax otherwise withheld. In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) [26 USCS § 1441(a)] (relating to withholding on nonresident aliens) or tax under section 1442(a) [26 USCS § 1442(a)] (relating to withholding on foreign corporations).

(3) Winnings which are subject to withholding. For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

(A) In general. Except as provided in subparagraphs (B) and (C), proceeds of more than \$ 5,000 from a wagering transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

(B) State-conducted lotteries. Proceeds of more than \$ 5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

(C) Sweepstakes, wagering pools, certain parimutuel pools, jai alai, and lotteries. Proceeds of more than \$ 5,000 from--

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

(4) Rules for determining proceeds from a wager. For purposes of this subsection--

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

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(5) Exemption for bingo, keno, and slot machines. The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

(6) Statement by recipient. Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

(7) Coordination with other sections. For purposes of sections 3403 and 3404 [26 USCS §§ 3403 and 3404] and for purposes of so much of subtitle F [26 USCS §§ 6001 et seq.] (except section 7205 [26 USCS § 7205]) as relates to this chapter [26 USCS §§ 3401 et seq.], payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

(r) Extension of withholding to certain taxable payments of Indian casino profits.

(1) In general. Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

(2) Exception. The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of--

(A) the basic standard deduction (as defined in section 63(c) [26 USCS § 63(c)]) for an individual to whom section 63(c)(2)(C) [26 USCS § 63(c)(2)(C)] applies, and

(B) the exemption amount (as defined in section 151(d) [26 USCS § 151(d)]).

(3) Annualized tax. For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) [26 USCS § 1(c)] (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c) [26 USCS § 1(c)]) on an amount of taxable income equal to the excess of--

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

(4) Classes of gaming activities, etc. For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this subsection [enacted Dec. 8, 1994], shall have the respective meanings given such terms by such section.

(5) Annualization. Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

(6) Alternate withholding procedures. At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

(7) Coordination with other sections. For purposes of this chapter [26 USCS §§ 3401 et seq.] and so much of subtitle F [26 USCS §§ 6001 et seq.] as relates to this chapter [26 USCS §§ 3401 et seq.], payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

(s) Exemption from withholding for any vehicle fringe benefit.

(1) Employer election not to withhold. The employer may elect not to deduct and withhold any tax under this chapter [26 USCS §§ 3401 et seq.] with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051 [26 USCS § 6051].

(2) Employer must furnish W-2. Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.] for purposes of section 6051 [26 USCS § 6051].

(3) Vehicle fringe benefit. For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit--

(A) which constitutes wages (as defined in section 3401 [26 USCS § 3401]), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

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\*\*\* CURRENT THROUGH PL 111-383, APPROVED 1/7/2011 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE C. EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX  
CHAPTER 24. COLLECTION OF INCOME TAX AT SOURCE  
SUBCHAPTER A. WITHHOLDING FROM WAGES

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§ 3406. Backup withholding [Caution: See prospective amendment note below.].

(a) Requirement to deduct and withhold.

(1) In general. In the case of any reportable payment, if--

- (A) the payee fails to furnish his TIN to the payor in the manner required,
- (B) the Secretary notifies the payor that the TIN furnished by the payee is incorrect,
- (C) there has been a notified payee under-reporting described in subsection (c), or
- (D) there has been a payee certification failure described in subsection (d), then the payor shall deduct and withhold

from such payment a tax equal to the product of the fourth lowest rate of tax applicable under section 1(c) [26 USCS § 1(c)] and such payment.

(2) Subparagraphs (c) and (d) of paragraph (1) apply only to interest and dividend payments. Subparagraphs (C) and (D) of paragraph (1) shall apply only to reportable interest or dividend payments.

(b) Reportable payment, etc. For purposes of this section--

(1) Reportable payment. The term 'reportable payment' means--

- (A) any reportable interest or dividend payment, and
- (B) any other reportable payment.

(2) Reportable interest or dividend payment.

(A) In general. The term 'reportable interest or dividend payment' means any payment of a kind, and to a payee, required to be shown on a return required under--

- (i) section 6049(a) [26 USCS § 6049(a)] (relating to payments of interest),
- (ii) section 6042(a) [26 USCS § 6042(a)] (relating to payments of dividends), or
- (iii) section 6044 [26 USCS § 6044] (relating to payments of patronage dividends) but only to the extent such

payment is in money.

(B) Special rule for patronage dividends. For purposes of subparagraphs (C) and (D) of subsection (a)(1), the term 'reportable interest or dividend payment' shall not include any payment to which section 6044 [26 USCS § 6044] (relating to patronage dividends) applies unless 50 percent or more of such payment is in money.

(3) Other reportable payment. The term 'other reportable payment' means any payment of a kind, and to a payee, required to be shown on a return required under--

- (A) section 6041 [26 USCS § 6041] (relating to certain information at source),
- (B) section 6041A(a) [26 USCS § 6041A(a)] (relating to payments of remuneration for services),

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- (C) section 6045 [26 USCS § 6045] (relating to returns of brokers),
  - (D) section 6050A [26 USCS § 6050A] (relating to reporting requirements of certain fishing boat operators), but only to the extent such payment is in money and represents a share of the proceeds of the catch, or
  - (E) section 6050N [26 USCS § 6050N] (relating to payments of royalties).
- (4) Whether payment is of reportable kind determined without regard to minimum amount. The determination of whether any payment is of a kind required to be shown on a return described in paragraph (2) or (3) shall be made without regard to any minimum amount which must be paid before a return is required.
- (5) Exception for certain small payments. To the extent provided in regulations, the term 'reportable payment' shall not include any payment which--
- (A) does not exceed \$ 10, and
  - (B) if determined for a 1-year period, would not exceed \$ 10.
- (6) Other reportable payments include payments described in section 6041(a) or 6041A(a) only where aggregate for calendar year is \$ 600 or more. Any payment of a kind required to be shown on a return required under section 6041(a) or 6041A(a) [26 USCS § 6041(a) or 6041A(a)] which is made during any calendar year shall be treated as a reportable payment only if--
- (A) the aggregate amount of such payment and all previous payments described in such sections by the payor to the payee during such calendar year equals or exceeds \$ 600,
  - (B) the payor was required under section 6041(a) or 6041A(a) [26 USCS § 6041(a) or 6041A(a)] to file a return for the preceding calendar year with respect to payments to the payee, or
  - (C) during the preceding calendar year, the payor made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under subsection (a).
- (7) Exception for certain window payments of interest, etc. For purposes of subparagraphs (C) and (D) of subsection (a)(1), the term 'reportable interest or dividend payment' shall not include any payment--
- (A) in redemption of a coupon on a bearer instrument or in redemption of a United States savings bond, or
  - (B) to the extent provided in regulations, of interest on instruments similar to those described in subparagraph (A).
- The preceding sentence shall not apply for purposes of determining whether there is payee underreporting described in subsection (c).
- (c) Notified payee underreporting with respect to interest and dividends.
- (1) Notified payee underreporting. If--
- (A) the Secretary determines with respect to any payee that there has been payee underreporting,
  - (B) at least 4 notices have been mailed by the Secretary to the payee (over a period of at least 120 days) with respect to the underreporting, and
  - (C) in the case of any payee who has filed a return for the taxable year, any deficiency of tax attributable to such failure has been assessed,
- the Secretary may notify payors of reportable interest or dividend payments with respect to such payee of the requirement to deduct and withhold under subsection (a)(1)(C) (but not the reasons for the withholding under subsection (a)(1)(C)).
- (2) Payee underreporting defined. For purposes of this section, there has been payee underreporting if for any taxable year the Secretary determines that--
- (A) the payee failed to include in his return of tax under chapter 1 [26 USCS §§ 1 et seq.] for such year any portion of a reportable interest or dividend payment required to be shown on such return, or
  - (B) the payee may be required to file a return for such year and to include a reportable interest or dividend payment in such return, but failed to file such return.
- (3) Determination by secretary to stop (or not to start) withholding.
- (A) In general. If the Secretary determines that--
    - (i) there was no payee underreporting,
    - (ii) any payee underreporting has been corrected (and any tax, penalty, or interest with respect to the payee underreporting has been paid),
    - (iii) withholding under subsection (a)(1)(C) has caused (or would cause) undue hardship to the payee and it is

unlikely that any payee underreporting by such payee will occur again, or

(iv) there is a bona fide dispute as to whether there has been any payee underreporting,

then the Secretary shall take the action described in subparagraph (B).

(B) Secretary to take action to stop (or not to start) withholding. For purposes of subparagraph (A), if at the time of the Secretary's determination under subparagraph (A)--

(i) no notice has been given under paragraph (1) to any payor with respect to the underreporting, the Secretary shall not give any such notice, or

(ii) if such notice has been given, the Secretary shall--

(I) provide the payee with a written certification that withholding under subsection (a)(1)(C) is to stop, and

(II) notify the applicable payors (and brokers) that such withholding is to stop.

(C) Time for taking action where notice to payor has been given. In any case where notice has been given under paragraph (1) to any payor with respect to any underreporting, if the Secretary makes a determination under subparagraph (A) during the 12-month period ending on October 15 of any calendar year--

(i) except as provided in clause (ii), the Secretary shall take the action described in subparagraph (B)(ii) to bring about the stopping of withholding no later than December 1 of such calendar year, or

(ii) in the case of--

(I) a no payee underreporting determination under clause (i) of subparagraph (A), or

(II) a hardship determination under clause (iii) of subparagraph (A),

such action shall be taken no later than the 45th day after the day on which the Secretary made the determination.

(D) Opportunity to request determination. The Secretary shall prescribe procedures under which--

(i) a payee may request a determination under subparagraph (A), and

(ii) the payee may provide information with respect to such request.

(4) Payor notifies payee of withholding because of payee underreporting. Any payor required to withhold any tax under subsection (a)(1)(C) shall, at the time such withholding begins, notify the payee of such withholding.

(5) Payee may be required to notify secretary who his payors and brokers are. For purposes of this section, the Secretary may require any payee of reportable interest or dividend payments who is subject to withholding under subsection (a)(1)(C) to notify the Secretary of--

(A) all payors from whom the payee receives reportable interest or dividend payments, and

(B) all brokers with whom the payee has accounts which may involve reportable interest or dividend payments.

The Secretary may notify any such broker that such payee is subject to withholding under subsection (a)(1)(C).

(d) Interest and dividend backup withholding applies to new accounts and instruments unless payee certifies that he is not subject to such withholding.

(1) In general. There is a payee certification failure unless the payee has certified to the payor, under penalty of perjury, that such payee is not subject to withholding under subsection (a)(1)(C).

(2) Special rules for readily tradable instruments.

(A) In general. Subsection (a)(1)(D) shall apply to any reportable interest or dividend payment to any payee on any readily tradable instrument if (and only if) the payor was notified by a broker under subparagraph (B) or no certification was provided to the payor by the payee under paragraph (1) and--

(i) such instrument was acquired directly by the payee from the payor, or

(ii) such instrument is held by the payor as nominee for the payee.

(B) Broker notifies payor. If--

(i) a payee acquires any readily tradable instrument through a broker, and

(ii) with respect to such acquisition

(I) the payee fails to furnish his TIN to the broker in the manner required under subsection (a)(1)(A),

(II) the Secretary notifies such broker before such acquisition that the TIN furnished by the payee is incorrect,

(III) the Secretary notifies such broker before such acquisition that such payee is subject to withholding under

subsection (a)(1)(C), or

(IV) the payee does not provide a certification to such broker under subparagraph (C),

such broker shall, within such period as the Secretary may prescribe by regulations (but not later than 15 days

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after such acquisition), notify the payor that such payee is subject to withholding under subparagraph (A), (B), (C), or (D) of subsection (a)(1), respectively.

(C) Time for payee to provide certification to broker. In the case of any readily tradable instrument acquired by a payee through a broker, the certification described in paragraph (1) may be provided by the payee to such broker--

(i) at any time after the payee's account with the broker was established and before the acquisition of such instrument, or

(ii) in connection with the acquisition of such instrument.

(3) Exception for existing accounts, etc. This subsection and subsection (a)(1)(D) shall not apply to any reportable interest or dividend payment which is paid or credited--

(A) in the case of interest or any other amount of a kind reportable under section 6049 [26 USCS § 6049], with respect to any account (whatever called) established before January 1, 1984, or with respect to any instrument acquired before January 1, 1984,

(B) in the case of dividends or any other amount reportable under section 6042 [26 USCS § 6042], on any stock or other instrument acquired before January 1, 1984, or

(C) in the case of patronage dividends or other amounts of a kind reportable under section 6044 [26 USCS § 6044], with respect to any membership acquired, or contract entered into, before January 1, 1984.

(4) Exception for readily tradable instruments acquired through existing brokerage accounts. Subparagraph (B) of paragraph (2) shall not apply with respect to a readily tradable instrument which was acquired through an account with a broker if--

(A) such account was established before January 1, 1984, and

(B) during 1983, such broker bought or sold instruments for the payee (or acted as a nominee for the payee) through such account.

The preceding sentence shall not apply with respect to any readily tradable instrument acquired through such account after the broker was notified by the Secretary that the payee is subject to withholding under subsection (a)(1)(C).

(e) Period for which withholding is in effect.

(1) Failure to furnish TIN. In the case of any failure by a payee to furnish his TIN to a payor in the manner required, subsection (a) shall apply to any reportable payment made by such payor during the period during which the TIN has not been furnished in the manner required. The Secretary may require that a TIN required to be furnished under subsection (a)(1)(A) be provided under penalties of perjury only with respect to interest, dividends, patronage dividends, and amounts subject to broker reporting.

(2) Notification of incorrect number. In any case in which the Secretary notifies the payor that the TIN furnished by the payee is incorrect, subsection (a) shall apply to any reportable payment made by such payor--

(A) after the close of the 30th day after the day on which the payor received such notification, and

(B) before the payee furnishes another TIN in the manner required.

(3) Notified payee underreporting described in subsection (c).

(A) In general. In the case of any notified payee underreporting described in subsection (c), subsection (a) shall apply to any reportable interest or dividend payment made--

(i) after the close of the 30th day after the day on which the payor received notification from the Secretary of such underreporting, and

(ii) before the stop date.

(B) Stop date. For purposes of this subsection, the term 'stop date' means the determination effective date or, if later, the earlier of--

(i) the day on which the payor received notification from the Secretary under subsection (c)(3)(B) to stop withholding, or

(ii) the day on which the payor receives from the payee a certification provided by the Secretary under subsection (c)(3)(B).

(C) Determination effective date. For purposes of this subsection--

(i) In general. Except as provided in clause (ii), the determination effective date of any determination under subsection (c)(3)(A) which is made during the 12-month period ending on October 15 of any calendar year shall be the

first January 1 following such October 15.

(ii) Determination that there was no underreporting; hardship. In the case of any determination under clause (i) or (iii) of subsection (c)(3)(A), the determination effective date shall be the date on which the Secretary's determination is made.

(4) Failure to provide certification that payee is not subject to withholding.

(A) In general. In the case of any payee certification failure described in subsection (d)(1), subsection (a) shall apply to any reportable interest or dividend payment made during the period during which the certification described in subsection (d)(1) has not been furnished to the payor.

(B) Special rule for readily tradable instruments acquired through broker where notification. In the case of any readily tradable instrument acquired by the payee through a broker, the period described in subparagraph (A) shall start with payments to the payee made after the close of the 30th day after the payor receives notification from a broker under subsection (d)(2)(B).

(5) 30-day grace periods.

(A) Start-up. If the payor elects the application of this subparagraph with respect to the payee, subsection (a) shall also apply to any reportable payment made during the 30-day period described in paragraph (2)(A), (3)(A), or (4)(B).

(B) Stopping. Unless the payor elects not to have this subparagraph apply with respect to the payee, subsection (a) shall also apply to any reportable payment made after the close of the period described in paragraph (1), (2), or (4) (as the case may be) and before the 30th day after the close of such period. A similar rule shall also apply with respect to the period described in paragraph (3)(A) where the stop date is determined under clause (i) or (ii) of paragraph (3)(B).

(C) Election of shorter grace period. The payor may elect a period shorter than the grace period set forth in subparagraph (A) or (B), as the case may be.

(f) Confidentiality of information.

(1) In general. No person may use any information obtained under this section (including any failure to certify under subsection (d)) except for purposes of meeting any requirement under this section or (subject to the safeguards set forth in section 6103 [26 USCS § 6103]) for purposes permitted under section 6103 [26 USCS § 6103].

(2) Cross reference. For provision providing for civil damages for violation of paragraph (1), see section 7431 [26 USCS § 7431].

(g) Exceptions.

(1) Payments to certain payees. Subsection (a) shall not apply to any payment made to--

(A) any organization or governmental unit described in subparagraph (B), (C), (D), (E), or (F) of section 6049(b)(4) [26 USCS § 6049(b)(4)], or

(B) any other person specified in regulations.

(2) Amounts for which withholding otherwise required. Subsection (a) shall not apply to any amount for which withholding is otherwise required by this title.

(3) Exemption while waiting for TIN. The Secretary shall prescribe regulations for exemptions from the tax imposed by subsection (a) during the period during which a person is waiting for receipt of a TIN.

(h) Other definitions and special rules. For purposes of this section--

(1) Obviously incorrect number. A person shall be treated as failing to furnish his TIN if the TIN furnished does not contain the proper number of digits.

(2) Payee furnishes 2 incorrect TINs. If the payee furnishes the payor 2 incorrect TINs in any 3-year period, the payor shall, after receiving notice of the second incorrect TIN, treat the payee as not having furnished another TIN under subsection (e)(2)(B) until the day on which the payor receives notification from the Secretary that a correct TIN has been furnished.

(3) Joint payees. Except to the extent otherwise provided in regulations, any payment to joint payees shall be treated as if all the payment were made to the first person listed in the payment.

(4) Payor defined. The term 'payor' means, with respect to any reportable payment, a person required to file a return described in paragraph (2) or (3) of subsection (b) with respect to such payment.

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## (5) Broker.

(A) In general. The term 'broker' has the meaning given to such term by section 6045(c)(1) [26 USCS § 6045(c)(1)].

(B) Only 1 broker per acquisition. If, but for this subparagraph, there would be more than 1 broker with respect to any acquisition, only the broker having the closest contact with the payee shall be treated as the broker.

(C) Payor not treated as broker. In the case of any instrument, such term shall not include any person who is the payor with respect to such instrument.

(D) Real estate broker not treated as a broker. Except as provided by regulations, such term shall not include any real estate broker (as defined in section 6045(e)(2) [26 USCS § 6045(e)(2)]).

## (6) Readily tradable instrument. The term 'readily tradable instrument' means--

(A) any instrument which is part of an issue any portion of which is traded on an established securities market (within the meaning of section 453(f)(5) [26 USCS § 453(f)(5)]), and

(B) except as otherwise provided in regulations prescribed by the Secretary, any instrument which is regularly quoted by brokers or dealers making a market.

(7) Original issue discount. To the extent provided in regulations, rules similar to the rules of paragraph (6) of section 6049(d) [26 USCS § 6049(d)] shall apply.

(8) Requirement of notice to payee. Whenever the Secretary notifies a payor under paragraph (1)(B) of subsection (a) that the TIN furnished by any payee is incorrect, the Secretary shall at the same time furnish a copy of such notice to the payor, and the payor shall promptly furnish such copy to the payee.

(9) Requirement of notice to Secretary. If the Secretary notifies a payor under paragraph (1)(B) of subsection (a) that the TIN furnished by any payee is incorrect and such payee subsequently furnishes another TIN to the payor, the payor shall promptly notify the Secretary of the other TIN so furnished.

(10) Coordination with other sections. For purposes of section 31 [26 USCS § 31], this chapter [26 USCS §§ 3401 et seq.] (other than section 3402(n) [26 USCS § 3402(n)]), and so much of subtitle F [26 USCS §§ 6001 et seq.] (other than section 7205 [26 USCS § 7205]) as relates to this chapter [26 USCS §§ 3401 et seq.], payments which are subject to withholding under this section shall be treated as if they were wages paid by an employer to an employee (and amounts deducted and withheld under this section shall be treated as if deducted and withheld under section 3402 [26 USCS § 3402]).

(i) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

**26 USC § 3403**

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\*\*\* CURRENT THROUGH PL 111-383, APPROVED 1/7/2011 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE C. EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX  
CHAPTER 24. COLLECTION OF INCOME TAX AT SOURCE  
SUBCHAPTER A. WITHHOLDING FROM WAGES

**Go to the United States Code Service Archive Directory**

26 USCS § 3403

§ 3403. Liability for tax.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter [26 USCS §§ 3401 et seq.], and shall not be liable to any person for the amount of any such payment.

**26 USC § 3509**

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\*\*\* CURRENT THROUGH PL 111-383, APPROVED 1/7/2011 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE C. EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX  
CHAPTER 25. GENERAL PROVISIONS RELATING TO EMPLOYMENT TAXES AND COLLECTION OF  
INCOME TAXES AT SOURCE

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26 USCS § 3509

§ 3509. Determination of employer's liability for certain employment taxes.

(a) In general. If any employer fails to deduct and withhold any tax under chapter 24 or subchapter A of chapter 21 [26 USCS §§ 3401 et seq. or 3101 et seq.] with respect to any employee by reason of treating such employee as not being an employee for purposes of such chapter or subchapter, the amount of the employer's liability for--

(1) Withholding taxes. Tax under chapter 24 [26 USCS §§ 3401 et seq.] for such year with respect to such employee shall be determined as if the amount required to be deducted and withheld were equal to 1.5 percent of the wages (as defined in section 3401 [26 USCS § 3401]) paid to such employee.

(2) Employee social security tax. Taxes under subchapter A of chapter 21 [26 USCS §§ 3101 et seq.] with respect to such employee shall be determined as if the taxes imposed under such subchapter were 20 percent of the amount imposed under such subchapter without regard to this subparagraph.

(b) Employer's liability increased where employer disregards reporting requirements.

(1) In general. In the case of an employer who fails to meet the applicable requirements of section 6041(a), 6041A, or 6051 [26 USCS § 6041(a), 6041A, or 6051] with respect to any employee, unless such failure is due to reasonable cause and not willful neglect, subsection (a) shall be applied with respect to such employee

(A) by substituting '3 percent' for '1.5 percent' in paragraph (1); and

(B) by substituting '40 percent' for '20 percent' in paragraph (2).

(2) Applicable requirements. For purposes of paragraph (1), the term 'applicable requirements' means the requirements described in paragraph (1) which would be applicable consistent with the employer's treatment of the employee as not being an employee for purposes of chapter 24 or subchapter A of chapter 21 [26 USCS §§ 3401 et seq. or 3101 et seq.].

(c) Section not to apply in cases of intentional disregard. This section shall not apply to the determination of the employer's liability for tax under chapter 24 or subchapter A of chapter 21 [26 USCS §§ 3401 et seq. or 3101 et seq.] if such liability is due to the employer's intentional disregard of the requirement to deduct and withhold such tax.

(d) Special rules. For purposes of this section--

(1) Determination of liability. If the amount of any liability for tax is determined under this section--

(A) the employee's liability for tax shall not be affected by the assessment or collection of the tax so determined,

(B) the employer shall not be entitled to recover from the employee any tax so determined, and

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(C) sections 3402(d) [26 USCS § 3402(d)] and section 6521 [26 USCS § 6521] shall not apply.

(2) Section not to apply where employer deducts wage but not social security taxes. This section shall not apply to any employer with respect to any wages if--

(A) the employer deducted and withheld any amount of the tax imposed by chapter 24 [26 USCS §§ 3401 et seq.] on such wages, but

(B) failed to deduct and withhold the amount of the tax imposed by subchapter A of chapter 21 [26 USCS §§ 3101 et seq.] with respect to such wages.

(3) Section not to apply to certain statutory employees. This section shall not apply to any tax under subchapter A of chapter 21 [26 USCS §§ 3101 et seq.] with respect to an individual described in subsection (d)(3) of section 3121 [26 USCS § 3121] (without regard to whether such individual is described in paragraph (1) or (2) of such subsection).

**26 USC § 7202**

LEXSTAT 26 USC § 7202

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\*\*\* CURRENT THROUGH PL 111-383, APPROVED 1/7/2011 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE F. PROCEDURE AND ADMINISTRATION  
CHAPTER 75. CRIMES, OTHER OFFENSES AND FORFEITURES  
SUBCHAPTER A. CRIMES  
PART I. GENERAL PROVISIONS

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26 USCS § 7202

§ 7202. Willful failure to collect or pay over tax.

Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$ 10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.