

under paragraph (i)(4) of this section)/75u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1998 CFC has 100u of general limitation earnings, 0 of passive limitation earnings (100u of foreign personal holding company income — 100u inclusion), and a (50u) deficit in shipping limitation earnings.

Example 2. (i) The facts are the same as in Example 1 with the addition of the following facts. In 1999, CFC distributes 150u to A. CFC has 100u of previously-taxed earnings and profits described in section 959(c)(2) attributable to 1998, all of which is passive limitation earnings and profits. Under section 959(c), 100u of the 150u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining 50u is deemed to be made from earnings and profits described in section 959(c)(3). The entire dividend distribution of 50u is treated as made out of CFC's general limitation earnings and profits. See section 904(d)(3)(D).

(ii) For purposes of computing post-1986 undistributed earnings under section 902 with respect to the 1999 dividend of 50u, the shipping limitation accumulated deficit of (50u) reduces general limitation earnings and profits of 100u to 50u. Thus, 100% of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the 1999 dividend of 50u (50u dividend/50u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1999 CFC has 50u of general limitation earnings (100u opening balance—50u distribution), 0 of passive limitation earnings, and a (50u) deficit in shipping limitation earnings.

(6) *Effective date.* This paragraph (i) applies to taxable years of a controlled foreign corporation beginning after March 3, 1997.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: December 11, 1996.

Donald C. Lubick,

Assistant Secretary of the Treasury.

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26 CFR Parts 31 and 602

[TD 8706]

RIN 1545-AR67

Electronic Filing of Form W-4

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to Form W-4, Employee's Withholding Allowance Certificate. The final regulations authorize employers to establish electronic systems for use by employees in filing their Forms W-4. The regulations provide employers and

employees with guidance necessary to comply with the law. The regulations affect employers that establish electronic systems and their employees.

EFFECTIVE DATE: These final regulations are effective January 2, 1997.

FOR FURTHER INFORMATION CONTACT: Karin Loverud, (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1435. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent is 20 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On April 15, 1994, a notice of proposed rulemaking [EE-45-93] containing proposed regulations relating to Form W-4, Employee's Withholding Allowance Certificate, was published in the Federal Register (59 FR 18057).

On December 21, 1994, temporary regulations (TD 8577) clarifying the existing proposed regulations were published in the Federal Register (59 FR 65712). A notice of proposed rulemaking (EE-45-93) cross-referencing the temporary regulations was published in the Federal Register for the same day (59 FR 65740).

Written comments responding to these notices were received. Public hearings were requested and were held on July 15, 1994, and November 7, 1995.

After consideration of all the comments, the proposed regulations under section 3402(f) are adopted as revised by this Treasury decision. The comments and revisions are discussed below.

Explanation of Revisions and Summary of Comments

1. Relationship between paper and electronic Forms W-4

A withholding exemption certificate (Form W-4) may be in either paper or electronic form. Therefore, an employee will furnish a Form W-4 to the employer either on paper or electronically. To clarify that an electronic Form W-4 has the same status as a paper Form W-4, the final regulations make minor revisions to § 31.3402(f)(5)-1, Form and contents of withholding exemption certificates. Further, the final regulations appear as § 31.3402(f)(5)-1(c), rather than in a separate regulations section limited to electronic forms.

2. Electronic filing by all employees.

The existing proposed and temporary regulations require employers that establish electronic systems to provide employees with the option of filing paper or electronic Forms W-4. Several commentators requested that employers be allowed to adopt systems under which all employees file Forms W-4 electronically. These commentators stated that a system under which all employees file electronically would reduce employer burden in terms of costs and time (for example, eliminate maintenance of duplicative paper and electronic systems). Similarly, it would reduce employee burden in terms of time and choosing a filing option.

The IRS and Treasury want to assist in reducing burdens on both employers and employees and to make it as easy as possible for employers to adopt less burdensome systems. The final regulations permit an employer to adopt a system under which all employees file Forms W-4 electronically. The IRS and Treasury expect, however, that an employer will make a paper option reasonably available upon request to any employee who has a serious objection to using the electronic system or whose access to, or ability to use, the system may be limited (for example, as a result of a disability). The paper option would be satisfied, for example, if the employer informs employees how they can obtain a paper Form W-4 and where they should submit the completed paper Form W-4. The IRS and Treasury also expect that employers will comply with all applicable law

governing the workplace and terms and conditions of employment, such as the Americans with Disabilities Act (42 U.S.C. 12112(a)). Compliance with these regulations does not guarantee that a system for filing Forms W-4 electronically is in compliance with those applicable laws.

3. *Electronic Forms W-4*

Several commentators recommended that electronic systems be allowed for all Forms W-4 without exception. The prior proposed and temporary regulations specifically exclude (1) Forms W-4 required upon commencement of employment (initial Form W-4), and (2) Forms W-4 required to be furnished to the IRS by employers because more than 10 withholding exemptions are claimed or, if the employee is expected to earn more than \$200 per week, exemption from withholding is claimed.

Initial Form W-4. Section 3402(f)(2)(A) of the Internal Revenue Code (Code) requires a new employee to furnish the employer with a signed withholding exemption certificate. Section 6061 requires all Forms W-4 to be signed. See discussion below under "5. Signature Under Penalties of Perjury" and § 301.6061-1(b), which states that the Secretary may prescribe in forms, instructions, or other appropriate guidance the method of signing any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations. The final regulations permit electronic systems to include Forms W-4 required upon commencement of employment.

Forms W-4 claiming more than 10 exemptions or exemption from withholding. Section 31.3402(f)(2)-1(g) requires employers to submit to the IRS copies of certain Forms W-4 furnished to them by their employees. The Forms W-4 required to be submitted are those on which the employee claims either (1) more than 10 withholding exemptions, or (2) exemption from withholding (and the employee is expected to earn more than \$200 per week).

Under § 31.3402(f)(2)-1(g)(5), if the IRS determines that a Form W-4, a copy of which was submitted to the IRS, is defective, the IRS will notify in writing both the employer and the employee. (The notice is referred to as a "lock-in letter.") A Form W-4 is defective if (1) the IRS determines that the Form W-4 contains a materially incorrect statement, or (2) following communication with the employee, the IRS lacks sufficient information to determine whether the certificate is correct. The lock-in letter issued by the

IRS advises the employer that the employee either is not entitled to claim exemption from withholding or is not entitled to claim more withholding exemptions than the number specified by the IRS in the notice, or both. If the employee subsequently files a new Form W-4, the employer may withhold on the basis of that new Form W-4 only if the new Form W-4 is consistent with the lock-in letter. The employer must continue to withhold on the basis of that advice until the IRS revokes in writing its lock-in letter.

The final regulations permit electronic systems to include Forms W-4 on which employees claim more than 10 withholding exemptions or exemption from withholding. However, the IRS and Treasury expect that electronic systems, alone or in conjunction with the rest of an employer's payroll system, will ensure compliance with the advice contained in a lock-in letter. For instance, an electronic system can ensure compliance with a lock-in letter by prohibiting an employee for whom a lock-in letter was issued from filing any electronic Form W-4 or prohibiting the employee from claiming more withholding exemptions than the number specified in the IRS notice. Additionally, an employer may choose to require any employee to file a paper Form W-4 if the employee wishes to claim more than 10 withholding exemptions or exemption from withholding.

4. *Submission of Certain Forms W-4 to IRS*

Section 31.3402(f)(2)-1(g) requires employers to submit to the IRS copies of Forms W-4 on which the employee claims either more than 10 withholding exemptions or exemption from withholding (and the employee is expected to earn more than \$200 per week). Generally, the copies are sent quarterly to the IRS along with the employer's Form 941, Employer's Quarterly Federal Tax Return. Copies can also be submitted earlier and more often to the employer's IRS service center.

Employers that establish electronic systems will satisfy the requirement of § 31.3402(f)(2)-1(g) if they furnish the Form W-4 information on magnetic media. Before using magnetic media, employers must submit Form 4419, Application for Filing Information Returns Magnetically/Electronically, to request authorization. Rev. Proc. 92-80 (1992-2 C.B. 465) contains specifications for filing Forms W-4 on magnetic tape and on 5¼- and 3½-inch magnetic diskettes. Electronic

transmission of Form W-4 information to the IRS is not yet available.

5. *Signature Under Penalties of Perjury*

Section 6061 of the Code requires that any return, statement, or other document required to be made under any provision of the Code or regulations be signed. Section 6065 requires that any such document contain or be verified by a written declaration that it is made under the penalties of perjury. These requirements apply to all Forms W-4, including those filed electronically, and are reflected in § 31.3402(f)(5)-1(c)(iii) of the final regulations.

Although sections 6061 and 6065 apply to all Forms W-4, the IRS and Treasury are concerned that some electronic systems established under the temporary regulations may not include a signature under penalties of perjury. The final regulations, therefore, include guidance on the perjury statement and the electronic signature.

For certain Forms W-4, the final regulations treat the signature-under-penalties-of-perjury-statement requirement as satisfied until January 1, 1999. This special rule applies only if the system precludes the electronic filing of Forms W-4 required upon commencement of employment and Forms W-4 claiming more than 10 withholding exemptions or exemption from withholding. Moreover, the special rule applies only to Forms W-4 filed electronically before the earlier of (1) January 1, 1999, or (2) the first date on which the employer's electronic system permits the filing of Forms W-4 required upon commencement of employment or Forms W-4 claiming more than 10 withholding exemptions or exemption from withholding.

The IRS and Treasury will consider written comments pertaining to the provisions relating to signatures under penalties of perjury. Submissions should be sent to: CC:DOM:CORP:R (TD 8706), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (TD 8706), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC.

6. Employer Retention of Forms W-4 and Predecessor and Successor Employers

One commentator requested guidance concerning the period for which paper Forms W-4 are required to be retained under § 31.6001-1(e) after the employer establishes an electronic system and in predecessor-employer/successor-employer situations. Electronic Forms W-4 have the same status as paper Forms W-4. Therefore, guidance that applies to paper Forms W-4 also applies to electronic Forms W-4. For further information, see Rev. Proc. 91-59 (1991-2 C.B. 841) (information regarding the retention of records using a variety of automatic data processing systems); and section 5 of Rev. Proc. 96-60 (1996-53 I.R.B.) (predecessor/successor situations).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the notice of proposed rulemaking preceding the regulations was issued prior to March 29, 1996, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Karin Loverud, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social Security, Unemployment compensation.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 602 are amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 is amended by adding an entry for section 31.3402(f)(5)-1 to read as follows:

Authority: 26 U.S.C. 7805 * * * Section 31.3402(f)(5)-1 also issued under 26 U.S.C. 3402 (i) and (m). * * *

Par. 2. Section 31.3402(f)(5)-1 is amended as follows:

- 1. Headings are added to paragraphs (a) and (b).
2. The fourth sentence of paragraph (a) is revised.
3. Paragraph (c) is added.
4. The authority citation which follows the end of the section is removed.

The revisions and additions read as follows:

§ 31.3402(f)(5)-1 Form and contents of withholding exemption certificates.

(a) Form W-4. * * * Blank copies of paper Forms W-4 will be supplied to employers upon request to the Internal Revenue Service. * * *

(b) Invalid Form W-4. * * *

(c) Electronic Form W-4—(1) In general. An employer may establish a system for its employees to file withholding exemption certificates electronically.

(2) Requirements—(i) In general. The electronic system must ensure that the information received is the information sent, and must document all occasions of employee access that result in the filing of a Form W-4. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and filing the Form W-4 is the employee identified in the form.

(ii) Same information as paper Form W-4. The electronic filing must provide the employer with exactly the same information as the paper Form W-4.

(iii) Jurat and signature requirements. The electronic filing must be signed by the employee under penalties of perjury.

(A) Jurat. The jurat (perjury statement) must contain the language that appears on the paper Form W-4. The electronic program must inform the employee that he or she must make the declaration contained in the jurat and that the declaration is made by signing the Form W-4. The instructions and the language of the jurat must immediately follow the employee's income tax withholding selections and immediately precede the employee's electronic signature.

(B) Electronic signature. The electronic signature must identify the

employee filing the electronic Form W-4 and authenticate and verify the filing. For this purpose, the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper Form W-4. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the employee's Form W-4 submission.

(iv) Copies of electronic Forms W-4.

Upon request by the Internal Revenue Service, the employer must supply a hardcopy of the electronic Form W-4 and a statement that, to the best of the employer's knowledge, the electronic Form W-4 was filed by the named employee. The hardcopy of the electronic Form W-4 must provide exactly the same information as, but need not be a facsimile of, the paper Form W-4.

(3) Effective date—(i) In general. This paragraph applies to all withholding exemption certificates filed electronically by employees on or after January 2, 1997.

(ii) Special rule for certain Forms W-4. In the case of an electronic system that precludes the filing of Forms W-4 required on commencement of employment and Forms W-4 claiming more than 10 withholding exemptions or exemption from withholding, the requirements of paragraph (c)(2)(iii) of this section will be treated as satisfied if the Form W-4 is filed electronically before January 1, 1999.

§ 31.3402(f)(5)-2T [Removed]

Par. 3. Section 31.3402(f)(5)-2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In § 602.101, paragraph (c) is amended by:

- 1. Removing the entry for 31.3402(f)(5)-2T from the table.
2. Revising the entry for 31.3402(f)(5)-1 to read as follows:

§ 602.101 OMB Control numbers.

* * * * *
(c) * * *

Table with 2 columns: CFR part or section where identified and described, Current OMB Control No.
Row 1: 31.3402(f)(5)-1 1545-0010, 1545-1435

CFR part or section where identified and described	Current OMB Control No.
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<p>Approved: December 12, 1996. Margaret Milner Richardson, <i>Commissioner of Internal Revenue.</i> Donald C. Lubick, <i>Acting Assistant Secretary of the Treasury.</i> [FR Doc. 96-32669 Filed 12-31-96; 8:45 am] BILLING CODE 4830-01-U</p>	

26 CFR Part 53

[TD 8705]

RIN 1545-AU65

Requirement of Return and Time for Filing**AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing that disqualified persons and organization managers liable for Internal Revenue Code section 4958 excise taxes are required to file Form 4720. The regulations also specify the filing date for returns for the period to which the new excise taxes applied retroactively. These excise taxes are imposed on excess benefit transactions between disqualified persons, as statutorily defined, and sections 501(c)(3) and (4) organizations, except for private foundations.

DATES: These regulations are effective January 2, 1997.

For dates of applicability, see § 53.6071-1T(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Phyllis Haney, (202) 622-4290 (not a toll-free number).**SUPPLEMENTARY INFORMATION:****Background**

This document contains amendments to the Foundation and Similar Excise Taxes regulations (26 CFR part 53) under sections 6011 and 6071. These regulations provide guidance relating to the requirement of a return to accompany payment of section 4958 excise taxes and the time for filing that return. These rules were first published in Notice 96-46 (1996-39 I.R.B. 7) (September 23, 1996).

Taxpayer Bill of Rights 2, Public Law 104-168, 110 Stat. 1452 (TBOR2), enacted July 30, 1996, added section 4958 to the Code. As described more

fully below, section 4958 imposes excise taxes on excess benefit transactions. Section 4958 taxes apply retroactively to excess benefit transactions occurring on or after September 14, 1995. The taxes do not, however, apply to any benefit arising from a transaction pursuant to any written contract which was binding on September 13, 1995, and at all times thereafter before such transaction occurred.

An "excess benefit transaction" subject to tax under section 4958 is any transaction in which an economic benefit is provided by an organization described in section 501(c)(3) (except for a private foundation) or 501(c)(4) directly or indirectly to, or for the use of, any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit. A "disqualified person" is any person who was, at any time during the 5-year period ending on the date of the excess benefit transaction, in a position to exercise substantial influence over the affairs of the organization. Disqualified persons also include family members and certain entities in which at least 35 percent of the control or beneficial interest are held by persons described in the preceding sentence. An "organization manager" is any officer, director, trustee, or any individual having powers or responsibilities similar to those of any officer, director, or trustee.

Section 4958 imposes three taxes. The first tax is equal to 25 percent of the excess benefit amount, and is to be paid by any disqualified person who engages in an excess benefit transaction. The second tax is equal to 200 percent of the excess benefit amount, and is to be paid by any disqualified person if the excess benefit transaction is not corrected within the taxable period. The third tax is equal to 10 percent of the excess benefit amount, and is to be paid by any organization manager who knowingly participates in an excess benefit transaction. The maximum amount of this third tax with respect to any one excess benefit transaction may not exceed \$10,000. These regulations prescribe Form 4720 for calculating and paying the first and third taxes described above.

TBOR2 also amended section 6033(b) to require section 501(c)(3) organizations to report the amounts of the taxes paid under section 4958 with respect to excess benefit transactions involving the organization, as well as any other information the Secretary may require concerning those transactions.

Section 6033(f) also was amended to impose the same reporting requirements on section 501(c)(4) organizations. Those amendments to section 6033 only apply to organizations' returns for taxable years beginning after July 30, 1996. These and other TBOR2 amendments to the reporting requirements for section 501(c)(3) and (4) organizations are reflected on IRS Forms 990 and 990-EZ beginning with the 1996 versions.

Explanation of Provisions

The regulations provide that disqualified persons and organization managers, as defined in sections 4958(f)(1) and (2), who are liable for section 4958 excise taxes on excess benefit transactions, as defined in section 4958(c)(1), are required to file a return on Form 4720. The general rule is that returns will be due on or before the 15th day of the fifth month following the close of the disqualified person's or organization manager's taxable year. The regulations also provide that returns on Form 4720 for taxable years ending after September 13, 1995, and on or before July 30, 1996, will be due on or before December 15, 1996. See Notice 96-46 (1996-39 I.R.B. 7) (September 23, 1996).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Phyllis Haney, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements.