Federal Tax Withholding Changes in 2020

The Tax Reform Act of 1986 and it impacts every employee, of every employer, of every size, in every state, and every industry. Learn about federal tax withholding changes coming in 2020.

Published October 11, 2019

Note: This blog originally appeared in August, before the IRS released its second draft of Form W-2. T he following has been updated for recent developments. It may be the biggest change to knock on the door of your payroll office since **the Tax Reform Act of 1986** (for those who still remember *that*). Sure, Obamacare (now known as the Affordable Care Act) was big, but that affected large employers and full-time employees. The 2004 increase in the Federal Labor Standards Act's (FLSA) salary test threshold was big – and so is the current threshold increase to take effect 1/1/2020, but they only affect employees who meet the duties tests and earn over the old thresholds and under the new. Even size, state, and industry-specific biggies like Equal Employee Opportunity (EE0) Component 2 reporting, employer liability for Social Security taxes on tips, Pennsylvania Act 32, and New York home health care wage parity impact only limited segments of the payroll community. But 2020 Federal withholding tax is different. It impacts every employee, of every employer, of every size, in every state, and every industry. That's pretty "every". Not sure what it impacts will be on you and your workforce? Read on... *It impacts every employee, of every employer, of every size, in every state, and every indu stry. That's pretty "every".*

Background:

At the end of 2017, Congress passed the Tax Cuts and Jobs Act (TCJA), calling for – among many other things – the revision of the Federal tax withholding system. The goal was to more accurately estimate withholding throughout the year so that employees end up with smaller refunds and larger net paychecks – effectively stimulating the economy by putting more spending money into the hands of taxpayers. Since the law was enacted on December 22, 2017 it was too late for the IRS to implement withholding change for 2018, and they set their sights on 2019. But, due to the complexity of the law, the IRS delayed regulatory action until 2020. And this year, they've been very busy preparing – starting with inviting Viventium and other stakeholders to participate in a contracted study. They released the first draft 2020 Form W-4 on May 30 of this year, and the second draft on August 8 and invited comments on it and on the draft Publication 15-T which was issued on August 13. On September 3, they also released a draft Form W-4(SP) which can be given to Spanish speaking employees.

Upcoming milestones announced by the IRS:

- A final-Form W-4 (and W-4(SP)) slated for "late Fall" – probably end of November, with no significant changes other than inflation-adjusted numbers.
- A final Publication 15-T with actual withholding tables also close to year-end.
- Form W-4P for withholding from pension and annuities.

What's Going to Change:

To meet the TCJA's goal of more accurate withholding, the IRS is collecting more information on the face of the W-4, instead of referring taxpayers to the 3 worksheets of prior years. The following data items are new on the form. *Note that all are optional, except the first two:*

Mandatory:

1. **No more allowances.** The concept of withholding allowances such as Married-3, Single-2, is passé. This corresponds to the new personal tax return (Form 1040) which no longer uses personal or dependent exemptions.
2. **Three filing statuses**. Head of Household is new, until now, it was just Single and Married.

Optional:

1. **Account for multiple jobs:** If your employee has more than one job, or the spouse or other household member works, withholding will generally be too low unless Step 2 of the W-4 is completed. In this step, the IRS provides employees with three, mutually exclusive options. Employees should choose only ONE of the options.

    1. Most accurate, most private, most complex: Use the IRS estimator at https://apps.irs.gov/app/tax-withholding-estimator to figure an additional withholding amount.
    2. Somewhat less accurate, somewhat less private, but somewhat simpler: Use the Multiple Jobs Worksheet on page 3 of the form to figure an additional withholding amount.
    3. Least accurate, least private, but simplest: Check the box, which will signal employers to use a different set of tables with higher withholding. Note that this only works if there are only TWO jobs (not more) with roughly the same pay.

1. **Claim dependents:** Indicate the projected child/dependent tax credit and other credits. (That's right – even though no line is provided for other credits such as the education tax credit, the IRS wants employees to report all of those credits in this step.) This amount reduces employees' tax withholding amounts.
2. **Annual other income.** Non-wage income that would not otherwise have withholding such as interest and dividends. This amount increases employees' taxable wages for withholding computations.
3. **Annual deductions.** Anticipated deductions other than the standard deduction, derived from a worksheet which employees can complete. This amount reduces employees' taxable wages for withholding computations.

Who's Going to Change:

Will all employees in the country be required to complete a new W-4? No! Although originally a possibility, this proposal was shelved as too great an upheaval for the employment community. So, the answer to the question is a resounding, "no." Instead, any employee starting work on or after January 1, 2020 must complete the new Form W-4. Similarly, any existing employee changing his/her W-4 (e.g., for a change in marital status), must use the new form. But don't worry, if an existing employee does not submit a new form, the IRS provides you with instructions as to how to use the existing pre-2020 form under the new withholding system. Please note that even if they have no changes, existing employees may be encouraged to submit a 2020 form to initiate more accurate withholding and minimize the risk of large over- or under-payments at tax time. It's also important to educate your employees that once they do submit a 2020 form, there is no going back; they can't change their mind and say, "My accountant says my 2019 form will actually result in more accurate withholding." It's a burn-your-bridges deal – once a 2020, always a 2020 (at least until 2021.)

What About those "Exempts":

There is no longer any mention of exemption from withholding on the form, but it still is an option. To claim exemption, employees must write the word "Exempt" under Line c in Step 4. And it's still only a one-year exemption. To maintain exemption, employees must submit a new W-4 by February 16, 2021. Similarly, 2019 exemptions expire on February 17, 2020. If a 2020 W-4 is not submitted by that Monday, withholding for that employee will be calculated as Single with no further adjustments.

What About Nonresident Aliens?

As in the past, there will be additional amounts to add to the withholding for nonresident aliens. What's new is that the amounts to add will depend on which W-4 the employee submits: there is one

table for pre-2020 W-4s and a different one for 2020 forms. The IRS still plans to issue instructions about where on the form the NRA status should be indicated.

What Should I Do Now?

Our compliance experts recommend the following five action steps:

1. Familiarize yourself and your key HCM staff with the layout, content, and instructions of the draft W-4, the draft Publication 15-T, and related IRS FAQs.
2. As before, encourage employees to use the IRS Withholding Tax Estimator to perform a "paycheck checkup" and calculate their most accurate withholding.
3. If you are processing in-house using payroll software, ask your vendor about its preparedness to implement 2020 changes, and request specific timelines for new releases.
4. If you outsource to an HCM provider, inquire about their progress in supporting 2020 changes and their projected project completion date.
5. Register for our upcoming webinars on how to prepare for federal tax withholding in 2020.

    - December 19, 2019 form 2-3 PM EDT

To learn more about Viventium's seamless solutions for 2020 withholding and other legislative and regulatory developments, request a demo here . Follow Viventium on our social media channels for the latest developments on 2020 withholding. Yonina F. Shineweather, CPA, Consulting Director, Viv entium Compliance Services

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