occurs in the case of a disposition of the stock or securities in the transferee (or the transferee's parent in the case of a triangular reorganization described in section 368(a)(1)(C) or a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or (E)). Where this paragraph (c)(6)(i) applies, the transferor's branch profits tax liability for the taxable year in which the section 381(a) transaction occurs shall be determined under § 1.884–1, taking into account all the adjustments in U.S. net equity that result from the transfer of U.S. assets and liabilities to the transferee pursuant to the section 381(a) transaction, without regard to any provisions in this paragraph (c). If an event described in paragraph (c)(6)(i)(A), (B), or (C) of this section occurs after the close of the taxable year in which the section 381(a) transaction occurs, and if additional branch profits tax is required to be paid by reason of the application of this paragraph (c)(6)(i), then interest must be paid on that amount at the underpayment rates determined under section 6621(a)(2), with respect to the period between the date that was prescribed for filing the transferor's income tax return for the year in which the section 381(a) transaction occurs and the date on which the additional tax for that year is paid. Any such additional tax liability together with interest thereon shall be the liability of the transferee within the meaning of section 6901 pursuant to section 6901 and the regulations thereunder.

(c)(6)(ii) through (f) [Reserved]. For further guidance, see § 1.884–2T(c)(6)(ii) through (f).

(g) * * * Paragraphs (c)(6)(i)(B), (C), and (D), are applicable for tax years beginning after December 31, 1986, except that such paragraphs are applicable to transactions occurring after the date these regulations are published as final regulations in the **Federal Register** in the case of reorganizations described in sections 368(a)(1)(A) and 368(a)(2)(D) or (E).

Par. 12. In § 1.884–2T, paragraphs (c)(6)(i)(B), (C), and (D) are revised to read as follows:

§ 1.884–2T Special rules for termination or incorporation of a U.S. trade or business or liquidation or reorganization of a foreign corporation or its domestic subsidiary (Temporary).

* * * * *

(c) * * *

(6) * * *

(i) * * *

(B), (C), and (D) [Reserved]. For further guidance, see § 1.884–2(c)(6)(i)(B), (C), and (D).

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 05–201 Filed 1–4–05; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[REG–152945–04]

RIN 1545–BD96

Flat Rate Supplemental Wage Withholding

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations amending the regulations that provide for the flat rate of withholding applicable to calculating the amount of income tax withholding on supplemental wages. The proposed amendment to the regulations reflects changes in the law made by the Revenue Reconciliation Act of 1993, the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the American Jobs Creation Act of 2004. Under the American Jobs Creation Act of 2004, the optional flat rate for withholding on supplemental wages will generally remain at 25 percent for payments made after December 31, 2004, but may change if income tax rates change. However, the 2004 Act also provides that, after 2004, if an employee receives supplemental wages in excess of one million dollars from an employer in a calendar year, the excess of the supplemental wages over one million dollars is subject to mandatory income tax withholding at the highest income tax rate. The highest income tax rate is currently 35 percent. In determining whether an employer has reached the one million dollar threshold for an employee, supplemental wage payments from all businesses under common control and from agents will be taken into account.

DATES: Written or electronic comments and requests for a public hearing must be received by April 5, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–152945–04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submission may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–152945–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC or sent electronically, via the IRS Internet site at *http://www.irs.gov/regs* or via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS and REG–152945–04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, A. G. Kelley, (202) 622–6040; concerning submission of comments, Treena Garrett, (202) 622–3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Employment Tax Regulations distinguish between regular wages paid for a payroll period and supplemental wages for purposes of income tax withholding. Although the regulations do not give a comprehensive definition of the term ''supplemental wages,'' the regulations provide that supplemental wages include ''* * * bonuses, commissions, and overtime pay, paid for the same or a different period, or without regard to a particular period.'' Regulations and revenue rulings have provided other examples. See § 31.3401(a)–1(b)(8)(i)(*b*)(*2*) of the regulations (sick pay paid by an agent of the employer); § 31.3401(a)–4(c) of the regulations (wages paid under reimbursement and other expense allowance arrangements); Rev. Rul. 67–257)1967–2 C.B. 359) (income recognized on exercise of nonqualified stock option); Rev. Rul. 67–131 (1967–1 C.B. 291) (lump sum payment of accumulated annual leave); and Rev. Rul. 66–294 (1966–2 C.B. 459) (lump sum vacation payment, overtime pay, lump sum retroactive pay, sick pay paid separately from regular pay).

Section 31.3402(g)–1 of the regulations provides the current rules for withholding income tax from a payment of supplemental wages. Two procedures have been generally available to the employer with respect to such supplemental wage payments. Under the first procedure (the aggregate procedure), employers calculate the amount of withholding due by aggregating the amount of supplemental wages with the regular wages paid for the current payroll period or for the most recent payroll period this year, and treating the aggregate as if it were a single wage payment for the regular payroll period.

The second procedure for withholding on supplemental wages (the flat rate procedure) allows employers to disregard the amount of regular wages paid to an employee as well as the allowances claimed by an employee on Form W–4, ''Employee's Withholding Allowance Certificate,'' and use a flat percentage rate specified in the regulations in calculating the amount of withholding. This second procedure of withholding on supplemental wages is generally available only if (1) the employer has withheld income tax from regular wages paid the employee, and (2) the supplemental wages are either (a) not paid concurrently with regular wages or (b) separately stated on the payroll records of the employer. See Rev. Rul. 82–200 (1982–2 C.B. 239). Under the current regulations, if the supplemental wage payment satisfies the conditions necessary for use of the flat rate, the decision whether to use the flat rate rather than the aggregate procedure is discretionary with the employer. Section 31.3042(g)–1(a)(2), last modified in 1966, states that, for wages paid after April 30, 1966, the flat percentage rate on supplemental wages is 20 percent. Later statutory changes have changed the applicable rate and the regulation is being amended to reflect those changes.

Section 13273 of Public Law 103–66 (the Revenue Reconciliation Act of 1993; 107 Stat. 542) provides that the rate under section 31.3402(g)–1 ''shall not be less than 28 percent.'' This change was effective for payments made after December 31, 1993., The Conference Report in connection with this change states that the provision ''increases the applicable withholding rate on supplemental wage payments to 28 percent.'' H.R. Rep. No. 103–111, 103d Cong., 1st Sess. 701 (1993).

Section 101(c)(11) of Public Law 107–16 (the Economic Growth and Tax Relief Reconciliation Act of 2001; 115 Stat. 44) amended section 13273 of the Revenue Reconciliation Act of 1993 by striking ''28 percent'' and inserting ''the third lowest rate of tax applicable under section 1(c) of the Internal Revenue Code of 1986.'' Section 101(d)(2) of Public Law 107–16 provides that the change made by section 101(c)(11) shall apply to ''amounts paid after the 60th day after the date of enactment of this Act.'' Public Law 107–16 was enacted into law on June 7, 2001. The third lowest rate of tax applicable under section 1(c) for purposes of section 13273 of the Revenue Reconciliation Act of 1993 was 27.5 percent. Consequently, the withholding rate for supplemental wages paid after August 6, 2001, and on or before December 31, 2001, was 27.5 percent. For 2002 the third lowest rate of tax applicable under section 1(c) was 27 percent. As a result of the enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108–27) on May 28, 2003, the third lowest rate of tax applicable under section 1(c) of the Internal Revenue Code (Code) for 2003 and 2004 is 25 percent.

Section 904(a) of Public Law 108–357, 118 Stat. 1418 (the American Jobs Creation Act of 2004) provides that, generally, for payments after December 31, 2004, the flat rate for withholding on supplemental wage rate ''shall not be less than 28 percent (or the corresponding rate in effect under section 1(i)(2) of the Internal Revenue Code of 1986 for taxable years beginning in the calendar year in which the payment is made).'' For 2005, the corresponding rate in effect under section 1(i)(2) is 25 percent.

Section 904(b) of the American Jobs Creation Act of 2004 also established a mandatory flat rate of withholding on supplemental wages to the extent that the employee's total supplemental wages paid by the employer exceed one million dollars during the calendar year. Section 904(b) provides that ''[n]otwithstanding subsection (a), if the supplemental wage payment, when added to all such payments previously made by the employer to the employee during the calendar year, exceeds $1,000,000, the rate used with respect to such excess shall be equal to the maximum rate of tax in effect under section 1 of such Code for such taxable years beginning in such calendar year.'' The maximum rate of tax in effect under section 1 of the Code is currently 35 percent. Section 904(b)(2) also provides that all persons treated as a single employer under subsection (a) or (b) of section 52 of the Code shall be treated as a single employer for purposes of this provision. This new mandatory withholding on supplemental wages in excess of one million dollars is effective with respect to payments made after December 31, 2004.

This provision is described in the Conference Report as follows: ''Under the Senate amendment, once annual supplemental wage payments to an employee exceed $1 million, any additional supplemental wage payments to the employee in that year are subject to withholding at the highest income tax rate (35 percent for 2004 and 2005), regardless of any other withholding rules and regardless of the employee's Form W–4.'' H.R. Rep. No. 108–475 at 785–6 (2004).

This provision for withholding on supplemental wages in excess of one million dollars was originally included as part of S. 2424, 108th Cong., 2d Sess. (2004). The legislative history in connection with S. 2424 provided as follows with respect to the reasons for change: ''The Committee believes that because most employees who receive annual supplemental wage payments in excess of $1 million will ultimately be taxed at the highest rate, it is appropriate to raise the withholding rate on such payments so that withholding more closely approximates the ultimate tax liability with respect to these payments.'' S. Rep. No. 108–266 at 105 (2004).

In a conforming amendment, the 2004 Act repealed section 13273 of the Revenue Reconciliation Act of 1993.

Explanation of Provisions

The proposed regulations change the optional flat rate of withholding on supplemental wages to provide that the 20 percent rate applies only to supplemental wages paid prior to January 1, 1994. The rate of 28 percent applies to supplemental wages paid after December 31, 1993, and on or before August 6, 2001. The Revenue Reconciliation Act of 1993, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2003, provides that the supplemental withholding rate shall not be less than the third lowest rate of tax applicable under section 1(c) for wages paid after August 6, 2001, and before January 1, 2005. Consistent with this amendment, the regulations provide that the rate of 27.5 percent applies to supplemental wages paid after August 6, 2001, and on or before December 31, 2001, the rate of 27 percent applies to wages paid after December 31, 2001, and on or before May 27, 2003, and the rate of 25 percent applies to wages paid after May 27, 2003, and on or before, December 31, 2004. Although the Jobs and Growth Tax Relief Reconciliation Act of 2003 provided that the third lowest rate of tax under section 1(c) after December 31, 2002, would be 25 percent, this provision was not enacted into law until May 28, 2003. Thus, at the time of payments of supplemental wages made after December 31, 2002, and prior to May 28, 2003, the third lowest rate of tax under section 1(c) was 27 percent. This provision is consistent with the general principle that the employment taxation of wage payments is determined based on the rates in effect at the date the wages are paid. *United States* v. *Cleveland Indians Baseball Co.,* 532 U.S. 200 (2001).

To track the statutory language of the American Jobs Creation Act of 2004, the regulation provides that, for wages paid after December 31, 2004, the flat rate for

supplemental wages is generally 28 percent (or the corresponding rate in effect under section 1(i)(2) * * * for taxable years beginning in the calendar year in which the payment is made). Under current law, the corresponding rate in effect under section 1(i)(2) for taxable years beginning in 2005 is 25 percent. Thus, for 2005, the optional flat rate for supplemental wages under $1 million in a given taxable year is 25 percent. The optional flat rate will remain at 25 percent until income tax rates change.[1] However, as described below, a higher mandatory rate applies for withholding on supplemental wages in excess of one million dollars.

The regulation provides that if a supplemental wage payment, together with all other supplemental wage payments paid by an employer to an employee during the calendar year, exceeds one million dollars, the withholding rate on the supplemental wages in excess of one million dollars shall be equal to the maximum rate of tax in effect under section 1 for taxable years beginning in such calendar year. Under current law, the maximum rate of tax in effect for taxable years beginning in 2005 is 35 percent. Thus, in 2005, the mandatory flat rate for supplemental wages in excess of $1 million in a given taxable year is 35 percent. The mandatory rate will remain at 35 percent until income tax rates change.[2]

These proposed regulations also clarify which wages are classified as supplemental wages. Under the proposed regulations, supplemental wages include any payment of wages by an employer that is not regular wages. Regular wages are defined as amounts paid by an employer for a payroll period either at a regular hourly rate or in a predetermined fixed amount. Wages that vary from payroll period to payroll period based on factors other than the amount of time worked, such as commissions, tips, and bonuses, are supplemental wages if they are paid in addition to regular wages. See Rev. Rul. 82–46 (1982–1 C.B. 158). However, if an employee receive only one type of compensation from an employer, that type of compensation will be regular wages even if the type of compensation is something that would normally be classified as supplemental wages. For example, if an employee receives only stock options as compensation from the employer and receives no other wages (including no includible fringe benefits that are wages), then the income on the exercise of the options would generally be regular wages, rather than supplemental wages.

The definitions of supplemental wages and regular wages were developed based on the historical usage of the term in regulations and revenue rulings. Examples are included in the regulations to illustrate the application of the definitions to specific scenarios. The IRS welcomes comments on whether this definition of supplemental wages is appropriate.

When determining whether payments are regular wages or supplemental wages, and furthermore, whether the supplemental wages paid by an employer to an employee in a given taxable year exceed $1 million, an employer (the first employer) must consider wage payments made to the employee by any other person treated as a single employer with the first employer under section 52(a) or 52(b). Furthermore, if an employer enlists a third party to make a payment to an employee on the employer's behalf, the payment will be considered as made by the employer even though it may have been delivered to the employee by the third party.

The new mandatory withholding rate on supplemental wages can apply to a full payment or only a portion of a payment. The maximum rate withholding applies only to the excess of supplemental wages over one million dollars received by an employee from an employer, taking into consideration all payments of supplemental wages made by an employer to an employee. All payments of supplemental wages are considered in determining this threshold regardless of whether the payments were subjected to flat rate withholding. The amount of regular wages paid to the employee has no relevance in determining whether the new mandatory withholding rate applies. Also, if a payment to an employee from an employer is not ''wages'' as defined under section 3401(a), such payment has no effect on whether the million dollar threshold for mandatory flat rate withholding has been reached.

If a particular supplemental wage payment results in an employee exceeding the million dollar supplemental wage threshold, mandatory flat rate withholding will apply to the extent that the payment together with other supplemental wage payments made to the employee previously during the year is an excess of one million dollars. However, to the extent that such a supplemental wage payment does not exceed one million dollars when combined with the other previous supplemental wage payments, the mandatory flat rate does not apply, and withholding may be calculated on that portion of the payment under the rules generally applicable to other supplemental wage payments.

Withholding on regular wages of the employee will continue to be calculated under the method used by the employer with respect to regular wages after the employee has reached the million dollar supplemental wage threshold.

The regulations also clarify that the mandatory flat rate applies regardless of the withholding method used by the employer with respect to regular wages. The regulations also clarify that mandatory flat rate withholding applies even if the employee receiving the supplemental wages in excess of $1 million has a Form W–4 asserting exempt status pursuant to section 3402(n). Moreover, the regulations also clarify that mandatory flat rate withholding applies to noncash remuneration paid to a retail commission salesperson (section 3402(j)) to the extent that such remuneration constitutes supplemental wages and exceeds $1 million in a given taxable year.

Examples of how the withholding would be calculated under the mandatory flat rate are included in the regulation. Among other things, the examples illustrate that because the higher rate is mandatory, where an employer provides net bonuses (i.e., after withholding) at a specified level, the total of the amount of such net bonuses and the gross up for withholding that are in excess of $1 million of supplemental wages will be subject to the higher rate.

The proposed regulations also clarify that, generally, where an employer has paid an employee supplemental wages that are cumulatively one million dollars or less for a given taxable year, the flat rate of withholding on supplemental wages can be used only if (1) income tax has been withheld from the employee's regular wages and (2) the supplemental wages are either not paid concurrently with regular wages of the employer if paid concurrently with regular wages, are separately stated on the payroll records of the employer.

The proposed regulations do not change the Federal Insurance

[1] Under current law, section 1(i)(2) will not be applicable to taxable years beginning after December 31, 2010, pursuant to the sunset provisions contained in section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16; 115 Stat. 150). See also section 107 of Public Law 108–27 (117 Stat. 755). Absent legislative action, the optional flat rate will change to 28 percent in 2011.

[2] Under the sunset provision in section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001, the mandatory flat rate will change to 39.6 percent for taxable years beginning after December 31, 2010.

Contributions Act (FICA) taxation of wages.

Proposed Effective Date

This regulation will be effective on the date published as a final regulation in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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 Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulation are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is A. G. Kelley, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 31

Employment taxes, Income taxes.

Proposed Amendment to the Regulations

Accordingly, 26 CFR is proposed to be amended as follows:

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

Paragraph 1. The authority citation to part 31 is amended by adding an entry in numerical order to read, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 31.3402(n)–1 also issued under 26 U.S.C. 6011 and 6364. * * *

Par. 2. Section 31.3401(a)–1 is amended by revising paragraph (b)(8)(i)(*b*)(*2*) as follows:

§ 31.3401(a)–1 Wages.

* * * * *

(b) * * *

(8) * * *

(i) * * *

(*b*) * * *

(*2*) Payments made by agents subject to this paragraph are supplemental wages as defined in § 31.3402(g)–1, and are therefore subject to the rules regarding withholding tax on supplemental wages provided in § 31.3402(g)–1. For purposes of those rules, unless the agent is also an agent for purposes of withholding tax from the employees' regular wages, the agent may deem tax to have been withheld form regular wages paid to the employee during the calendar year.

* * * * *

Par. 3 Section 31.3401(a)–4 is amended by revising paragraph (c) to read as follows

§ 31.3401(a)–4 Reimbursements and other expense allowance amounts.

* * * * *

(c) *Withholding rate.* Payments made under reimbursement or other expense allowance arrangements that are subject to income tax withholding are supplemental wages under § 31.3402(g)–1 if paid in addition to regular wages. Accordingly, withholding on such supplemental wages is calculated under the rules provided with respect to supplemental wages in § 31.3402(g)–1.

* * * * *

Par. 4. Section 31.3402(g)–1 is amended by:

(1) Revising paragraph (a).

(2) Adding a sentence at the beginning of paragraph (b)(1).

(3) Revising paragraph (b)(2).

The revisions and addition read as follows:

§ 31.3402(g)–1 Supplemental wage payments.

(a) *In general and withholding applicable with respect to supplemental wages in excess of $1,000,000.* (1)(i) An employee's remuneration may consist of regular wages and supplemental wages. Supplemental wages are all wages paid by an employer that are not regular wages. Supplemental wages include wage payment made without regard to an employee's payroll period, but also may include payments made for a payroll period. Examples of wage payments that are included in supplemental wages, if paid in addition to regular wages, include bonuses, overtime pay, back pay, reported tips, commissions, wages paid under reimbursement or other expense allowance, wages paid as noncash fringe benefits, sick pay paid by a third party as an agent of the employer, amounts that are includible in gross income under section 409A, and income recognized on the exercise of a nonqualified stock option.

(ii) As distinguished form supplemental wages, regular wages are amounts that are paid at a regular hourly, daily, or similar periodic rate (and not an overtime rate) for the current payroll period or at a predetermined fixed determinable amount for the current payroll period. Thus, among other things, wages that vary from payroll period to payroll period (such as commissions, tips, or bonuses) are not regular wages if paid in addition to regular wages. Any overtime pay paid in addition to regular wages would not be included in regular wages. However, if the only wages that an employee receives during a calendar year are bonuses, commissions, tips, or another type of payments that would normally be classified as supplemental wages if paid in addition to regular wages, then such wages are treated as regular wages. For example, if the only wages an employee receives are commissions paid on a monthly basis, then the payment of the commissions by the employer would be regular wages paid for a monthly payroll period.

(iii) The calculation of the amount of the income tax withholding with respect to supplemental wage payments is provided for under paragraph (a)(2) through (a)(7) of this section.

(2) If a supplemental wage payment, when added to all supplemental wage payments previously made by one employer (as defined in paragraph (a)(3) of this section) to an employee during the calendar year, exceeds $1,000,000, the rate used in determining the amount of withholding on the excess (including any excess which is apportion of a supplemental wage payment) shall be equal to the highest rate of tax applicable under section 1 for such taxable years beginning in such calendar year. This flat rate shall be applied without regard to whether income tax has been withheld from the employee's regular wages, without allowance for the

number of withholding allowances claimed by the employee on Form W–4, ''Employee's Withholding Allowance Certificate'', without regard to whether the employee has claimed exempt status on Form W–4, and without regard to the withholding method used by the employer.

(3) For purposes of paragraph (a)(2) of this section, including for purposes of determining whether any given payment is a payment of supplemental wages subject to paragraph (a)(2) of the section—

(i) All persons treated as a single employer under subsection (a) to (b) of section 52 shall be treated as one employer; and

(ii) Any payment made to an employee by a third party acting as an agent for the employer (regardless of whether such person shall have been designated as an agent pursuant to section 3504) shall be considered as made by the employer.

(4) To the extent that paragraph (a)(2) of this section does not apply to a supplemental wage payment (or a portion of a payment), the amount of the tax required to be withheld on the supplemental wages when they are paid shall be determined under the rules provided in paragraphs (a)(5) and (6) of this section.

(5)(i) The employer is required to determine withholding upon supplemental wages under this paragraph (a)(5) if paragraph (a)(2) of this section does not apply to the payment or portion of the payment and if paragraph (a)(6) of this section may not be used with respect to the payment. In addition, employers have the option of using this paragraph (a)(5) to calculate withholding with respect to a supplemental wage payment, if paragraph (a)(2) of this section does not apply to the payment, built if paragraph (a)(6) of this section could be used with respect to the payment.

(ii) Provided this procedure applies under paragraph (a)(5)(i) of this section, the supplemental wages, if paid concurrently with wages for payroll period, are aggregated with the wages paid for such payroll period. If not paid concurrently, the supplemental wages are aggregated with the wages paid or to be paid within the same calendar year for the last preceding payroll period or for the current payroll period. The amount of tax to be withheld is determined as if the aggregate of the supplemental wages and the regular wages constituted a single wage payment for the regular payroll period.

(6)(i) The employer may determine withholding upon supplemental wages under this paragraph (a)(6) if three conditions are met—

(A) Paragraph (a)(2) of this section does not apply to the payment or the portion of the payment;

(B) The supplemental wages are either not paid concurrently with regular wages or are separately stated on the payroll records of the employer; and

(C) Income tax has been withheld from the employee's regular wages.

(ii) The determination of the tax to be withheld under paragraph (a)(6)(iii) of this section is made without allowance for exemption and without reference to any payment of regular wages.

(iii) Provided the conditions of paragraph (a)(6)(i) of this section have been met, the employer may determine the tax to be withheld—

(A) From supplemental wages paid after April 30, 1966, and prior to January 1, 1994, by using a flat percentage rate of 20 percent;

(B) From supplemental wages paid after December 31, 1993, and on or before August 6, 2001, by using a flat percentage rate of 28 percent;

(C) From supplemental wages paid after August 6, 2001, and on or before December 31, 2001, by using a flat percentage rate of 27.5 percent;

(D) From supplemental wages paid after December 31, 2001, and on or before May 27, 2003, by using a flat percentage rate of 27 percent;

(E) From supplemental wages paid after May 27, 2003, and on or before December 31, 2004, by using a flat percentage rate of 25 percent; and

(F) From supplemental wages paid after December 31, 2004, by using a flat percentage rate of 28 percent (or the corresponding rate in effect under section 1(i)(2) for taxable years beginning in the calendar year in which the payment is made).

(7) The following examples illustrate this paragraph (a):

Example 1. (i) A is an employee of three entities (X, Y, and Z) that are treated as a single employer under section 52(a) or (b). In year 20XX, A receives regular wages on a monthly payroll periods paid by X for services performed for X, Y, and Z on the third business day of each month. The maximum rate of income tax under section 1 in effect for year 20XX is 35 percent, and the corresponding rate to 28 percent in effect under section 1(i)(2) for taxable years beginning in 20XX is 25 percent. Income tax is withheld from the regular wages of A during the year. A receives only the following supplemental wage payments during 20XX in addition to the regular wages paid by X—

(a) a bonus of $600,000 from X on March 15, 20XX;

(b) a bonus of $2,300,000 from Y on November 15, 20XX; and

(c) a bonus of $10,000 from Z on December 31, 20XX.

(ii) In this *Example 1,* the withholding on the $600,000 payment from X could be determined under either paragraph (a)(5) or (6) of this section because income tax has been withheld from the regular wages of A. If X elects to use the aggregate procedure under paragraph (a)(5) of this section, the amount of withholding on the supplemental wages would be based on aggregating the supplemental wages and the regular wages paid by X either for the current or last payroll period and treating the total of the regular wages paid by X and the $600,000 supplemental wages as a single payment for a regular payroll period. The withholding method used by the employer with respect to regular wages would then be used to calculate the withholding on this single wage payment, and the employer would take into consideration the Form W–4 filed by the employee.

(iii) In this *Example 1,* because the $2,300,000 bonus from Y, together with the regular wages paid by X, is treated as made from one employer, the payment is a supplemental wage payment. To calculate the withholding on the $2,300,000 supplemental wage payment from Y, it would be necessary to take into account that A has already received $600,000 of supplemental wages from X, which is treated as the same employer as Y under section 52(a) or (b). Thus, the withholding on the amount of the payment not in excess of $1,000,000 cumulative supplemental wages would need to be computed separately from the amount of the payment above $1,000,000. With respect to the first component of this supplemental wage payment, equal to $400,000, the withholding could be computed under either paragraph (a)(5) or (a)(6) of this section, because income tax has been withheld from the regular wages of the employee. If Y elected to withhold income tax using paragraph (a)(6) of this section, Y would withhold on the $400,000 component at 25 percent (pursuant to paragraph (a)(6)(ii)(F) of this section), which would result in $100,000 tax withheld. The second component of $1,900,000 would be subject to mandatory income tax withholding at the maximum rate of tax in effect under section 1 for 20XX. The income tax required to be withheld on the second component of this supplemental wage payment would be calculated without regard to the Form W–4 filed by A and would be 35 percent of $1,900,000 or $665,000. The withholding on the first component and the withholding on the second component then would be added together to determine the total income tax withholding on the supplemental wage payment from Y, or $100,000 plus $665,000 ($765,000).

(iv) The bonus paid from Z is also a supplemental wage payment, because Z, together with X, is treated as a single employer. The calculation of the withholding on the supplemental wage payment from Z to A of $10,000 would also be required to take into account that A has received prior supplemental wage payments during the year in excess of one million dollars from X and Y, because Z is treated as the same employer

as X and Y. The income tax required to be withheld on this payment would be 35 percent of $10,000 or $3,500.

Example 2. Employees B and C work for employer M. Each employee receives monthly salaries of $3,000 which are paid on the fifth business day after the end of the month. As a result of the withholding allowances claimed by B, there is no income tax withholding on the regular wages of B paid by M. In contrast, M has withheld income tax from C's regular wages paid by M. Together with the monthly salary check paid on the fifth business day of December, M includes a bonus of $2,000, which is the only supplemental wage payment received by each employee for the calendar year. The bonuses are separately stated on the payroll records of M. M must calculate the income tax withholding required to be made with respect to the bonus paid to B by using the procedure set forth in paragraph (a)(5) of this section. With respect to the bonus paid to C, M has the option of using either the aggregate method provided under paragraph (a)(5) of this section or the optional flat rate provided under paragraph (a)(6) of this section to calculate the income tax withholding due.

Example 3. (i) Employee D works as an employee of Corporation R. Corporations R, S, and T are treated as a single employer under subsection (a) or (b) of section 52. Employee D receives regular wage payments of $200,000 on a monthly basis in 2005 from R and income tax is withheld from those wages. D receives a bonus for his services as an employee from R equal to $3,000,000 on June 30, 2005. Unrelated company U pays D sick pay as an agent of the employer R and such sick pay is supplemental wages pursuant to § 31.3401(a)–1(b)(2). D receives sick pay of $50,000 on October 31, 2005. Corporation T decides to award bonuses to all employees of R, S, and T, and pays a bonus of $100,000 to D on December 31, 2005. D received no other payments from U, P, or T.

(ii) In chronological summary, D receives the following wages other than the regular monthly wages paid by R:

June 30, 2005—$3,000,000 (bonus from R)
October 31, 2005—$50,000 (sick pay from U)
December 31, 2005—$100,000 (bonus from T)

(iii) In this *Example 3,* each payment of wages other than the regular monthly wage payments from R is considered to be supplemental wages for purposes of withholding under § 31.3402(g)–1(a)(2) because, pursuant to § 31.3402(g)–1(a)(3), the payments are treated as made by one employer. The amount of regular wages from R is irrelevant in determining when maximum rate withholding on supplemental wages applies.

(iv) Because income tax has been withheld on the regular wages of the employee, income tax may be withheld on $1,000,000 of the $3,000,000 bonus paid on June 30, 2005, under either paragraph (a)(5) or (6) of this section. If R elects to withhold income tax at the flat rate provided under paragraph (a)(6)(ii)(F), withholding would be calculated at 25 percent of the $1,000,000 portion of the payment, or $250,000.

(v) Income tax withheld on the following supplemental wage payments (or portion of a payment) as follows is required to be calculated at the maximum rate in effect under section 1(c), or 35 percent in 2005—

(A) $2,000,000 of the $3,000,000 bonus paid by R on June 30, 2005;

(B) $50,000, the sick pay paid on October 31, 2005; and

(C) $100,000, the bonus paid by T on December 31, 2005.

Example 4. (i) Employer J has decided it wants to grant its employee B a $1,000,000 net bonus (after withholding). Employer J has withheld income tax from the regular wages of the employee. B has received no other supplemental wage payments during the year. The mandatory flat rate in effect in the year in which the payment is made is 35 percent, and the optional flat rate in effect is 25 percent.

(ii) This *Example 4* requires grossing up the wage payment to determine the gross wages necessary to result in a net payment of $1,000,000. If the employer elected to use the flat rate applicable to supplemental wages, the first $1,000,000 of the wages would be subject to 25 percent withholding. However, any wages above that would be subject to mandatory 35 percent withholding. The withholding applicable to the first $1,000,000 (i.e., $250,000) would thus be required to be grossed-up at a 35 percent rate to determine the gross wage amount above $1,000,000. Thus, the wages above $1,000,000 would be equal to $250,000 divided by .65 (computed by subtracting .35 from 1) or $384,615.38. Thus the total withholding with respect to the payment if Employer J elected the flat rate with respect to the first $1,000,000, would be $384,615.38 and the total supplemental wage payment, taking into account income tax withholding only (and not Federal Insurance Contributions Act taxes), to B would be $1,384,615.38.

(8) For provisions relating to the treatment of wages that are not subject to paragraph (a)(2) of this section and that are paid other than in cash to retail commission salesmen, see § 31,3402(j)–1.

(b) *Special rule where aggregate withholding exemption exceeds wages paid.* (1) This rule applies only if paragraph (a)(2) of this section does not apply to the supplemental wage payment. * * *

(2) The rules prescribed in this paragraph shall, at the election of the employer, be applied in lieu of the rules prescribed in paragraph (a) of this section except that this paragraph shall not be applicable in any case in which the payroll period of the employee is less than one week or if paragraph (a)(2) applies to the supplemental wage payment.

* * * * *

Par. 5. Section 31.3402(j)–1 is amended by adding a new sentence at the beginning of paragraph (a)(2) to read as follows:

§ 31.3402(j)–1 Remuneration other than in cash for service performed by retail commission salesman.

(a) * * *

(2) Section 3402(j) and this section are not applicable with respect to wages paid to the employee that are subject to withholding under section 31.3402(g)–1(a)(2). * * *

* * * * *

Par. 6. Section 31.3402(n)–1 is revised and the authority citation at the end of the section is removed to read as follows:

§ 31.3402(n)–1 Employees incurring no income tax liability.

(a) Notwithstanding any other provision of this subpart (except to the extent a payment of wages is subject to withholding under § 31.3402(g)–1(a)(2)), an employer shall not deduct and withhold any tax under chapter 24 upon a payment of wages made to an employee after April 30, 1970, if there is in effect with respect to the payment a withholding exemption certificate furnished to the employer by the employee which contains statements that—

(1) The employee incurred no liability for income tax imposed under subtitle A of the Internal Revenue Code for his preceding taxable year; and

(2) The employee anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

(b) To the extent wages are subject to withholding under § 31.3402(g)–1(a)(2), such wages are subject to such income tax withholding regardless of whether a withholding exemption certificate under section 3402(n) and the regulations thereunder has been furnished to the employer.

(c) For purposes of section 3402(n) and this section, an employee is not considered to incur liability for income tax imposed under subtitle A if the amount of such tax is equal to or less than the total amount of credits against such tax which are allowable to him under part iv of subchapter A of chapter 1 of the Internal Revenue Code, other than those allowable under section 31 or 39. For purposes of seciton 3402(n) and this section, ''liability for income tax imposed under subtitle A'' shall include

liability for a qualified State individual income tax which is treated pursuant to section 6361(a) as if it were imposed by chapter 1 of the Internal Revenue Code. An employee is not considered to incur liability for such a State income tax if the amount of such tax does not exceed the total amount of the credit against such tax which is allowable to him under section 6362(b)(2)(B) or (C) or section 6362(c)(4). For purposes of this section, an employee who files a joint return under section 6013 is considered to incur liability for any tax shown on such return. An employee who is entitled to file a joint return under such section shall not certify that he anticipates that he will incur no liability for income tax imposed by subtitle A for his current taxable year if such statement would not be true in the event that he files a joint return for such year, unless he filed a separate return for his preceding taxable year and anticipates that he will file a separate return for his current taxable year.

(d) For rules relating to invalid withholding exemption certificates, see § 31.3402(f)(2)–1(e), and for rules relating to submission to the Internal Revenue Service of withholding exemption certificates claiming a complete exemption from withholding, see § 31.3402(f)(2)–1(g).

(e) Example 1. Employee A, an unmarried, calendar-year basis taxpayer, files his income tax return for 1970 on April 15, 1971. A has adjusted gross income of $1,200 and is not liable for any tax. He had $180 of income tax withheld during 1970. A anticipates that his gross income for 1971 will be approximately the same amount, and that he will not incur income tax liability for that year. On April 20, 1971, A commences employment and furnishes his employer an exemption certificate stating that he incurred no liability for income tax imposed under subtitle A for 1970, and that he anticipates that he will incur no liability for income tax imposed under subtitle A for 1971. A's employer shall not deduct and withhold on payments of wages made to A on or after April 20, 1971. Under § 31.3402(f)(4)–1(c), unless A files a new exemption certificate with his employer, his employer is required to deduct and withhold upon payments of wages to A made on or after May 1, 1972. Under § 31.3402(f)(3)–1(b), if A had been employed by his employer prior to April 20, 1971, and had furnished his employer a withholding exemption certificate not containing the statements described in § 31.3402(n)–1 proir to furnishing the withholding exemption certificate containing such statements on April 20, 1971, his employer would not be required to give effect to the new certificate with respect to payments of wages made by him prior to July 1, 1971 (the first status determiantion date which occurs at least 30 days after April 20, 1971). However his employer could, if he chose, make the new certificate effective with respect to any payment of wages made on or after April 20 and before July 1, 1971.

Example 2. Assume the facts are the same as in *Example 1* except that for 1970 A has taxable income of $8,000, income tax liability of $1,630, and income tax withheld of $1,700. Although A received a refund of $70 due to income tax withholding of $1,700, he may not state on his exemption certificate that he incurred no liability for income tax imposed by subtitle A for 1970.

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 05–71 Filed 1–4–05; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 117

[CGD01–04–129]

RIN 1625–AA09

Drawbridge Operation Regulations; Townsend Gut, ME

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard is proposing to temporarily change the drawbridge operation regulations for the operation of the SR 27 Bridge, at mile 0.7, across Townsend Gut, between Boothbay Harbor and Southport, Maine. This temporary rule would require the bridge to open at specific times between 6 a.m. and 6 p.m., each day, from March 1, 2005, through November 30, 2005. Additionally, this temporary rule would also allow the bridge to remain closed for four periods of four days each between March 1, 2005, and May 26, 2005. This action is necessary to help facilitate rehabilitation construction at the bridge.

DATES: Comments must reach the Coast Guard on or before March 7, 2005.

ADDRESSES: You may mail comments to Commander (obr), First Coast Guard District Bridge Branch, One South Street, Battery Park Building, New York, New York 10004, or deliver them to the same address between 7 a.m. and 3 p.m., Monday through Friday, except, Federal holidays. The telephone number is (212) 668–7165. The First Coast Guard District, Bridge Branch, maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, will become part of this docket and will be available for inspection or copying at the First Coast Guard District, Bridge Branch, 7 a.m. to 3 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Mr. John W. McDonald Project Officer, First Coast Guard District, (617) 223–8364.

SUPPLEMENTARY INFORMATION:

Request for Comments

We encourage you to participate in this rulemaking by submitting comments or related material. If you do so, please include your name and address, identify the docket number for this rulemaking (CGD01–04–129), indicate the specific section of this document to which each comment applies, and give the reason for each comment. Please submit all comments and related material in an unbound format, no larger than 8½ by 11 inches, suitable for copying. If you would like to know if they reached us, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period. We may change this proposed rule in view of them.

Public Meeting

We do not now plan to hold a public meeting. But you may submit a request for a meeting by writing to the First Coast Guard District, Bridge Branch, at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that one would aid this rulemaking, we will hold one at a time and place announced by a later notice in the **Federal Register**.

Background and Purpose

The SR 27 Bridge has a vertical clearance of 10 feet at mean high water, and 19 feet at mean low water in the closed position. The existing drawbridge operating regulations under 33 CFR 117.5 require the bridge to open on signal at all times.

The bridge owner, Maine Department of Transportation, has requested a temporary rule to allow the bridge to open at specific times of either two or three hour intervals between 6 a.m. and 6 p.m., from March 1, 2005, through November 30, 2005. The purpose of this temporary rule is to help facilitate rehabilitation construction at the bridge. Frequent unscheduled bridge openings would greatly limit the progress of the rehabilitation project.

Under this temporary rule, effective from March 1, 2005, through November 30, 2005, the SR 27 Bridge would operate as follows:

From March 1, 2005, through May 26, 2005, and from September 6, 2005, through November 30, 2005, the draw