

MEMO# 32492

May 28, 2020

IRS Proposes Regulation on Default Withholding for Periodic Payments from Retirement Plans and Annuities

[32492]

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TO: ICI Members
Operations Committee
Pension Committee
Pension Operations Advisory Committee
Transfer Agent Advisory Committee
SUBJECTS: Pension
Tax RE: IRS Proposes Regulation on Default Withholding for Periodic Payments from Retirement Plans and Annuities

The IRS published a proposed regulation^[1] under section 3405(a) of the Internal Revenue Code (Code), relating to federal income tax withholding on certain periodic retirement and annuity payments, to implement an amendment made by the Tax Cuts and Jobs Act (TCJA). The TCJA amended Code section 3405(a)(4) in 2017 to change the determination of the default withholding rate applicable to periodic payments from pensions and annuities.

Background

When the payee of a pension or annuity has not made a withholding election by completing Form W-4P (Withholding Certificate for Pension or Annuity Payments), then the payor of a pension or annuity must apply a default withholding rate. Previously, the default withholding rate for periodic payments was specified in Code section 3405(a)(4).^[2] The TCJA amended this section to provide that the default rate “shall be determined under rules prescribed by the Secretary.” Earlier this year, in Notice 2020-3, the IRS provided interim guidance indicating that for 2020, the rule for default withholding on periodic payments will continue to parallel the rule for prior years (based on treating the payee as a married individual claiming three withholding allowances and applying that status to the applicable withholding tables and related computational procedures in the 2020 Publication 15-T).^[3]

Proposal

The proposed regulation would update and replace three provisions of Employment Tax Regulation § 35.3405-1T (Q&As a-10, b-3, and b-4) with a new § 31.3405(a)-1, providing that the default rate of withholding on periodic payments is determined in the manner

described in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner.^[4] The preamble to the proposed regulation explains that this approach (providing the communication and mechanical details of the default rate of withholding through such guidance) provides a more flexible and administrable rule that can be updated quickly as needed (for legislative changes or other reasons) to provide payors and plan administrators processing payments adequate time to program their systems to withhold the proper amount of income tax. The preamble notes that withholding on periodic payments, including the default rate of withholding, currently is explained in the instructions to the 2020 Form W-4P, the 2020 Publication 15-T, and related publications.

The regulation is proposed to apply to periodic payments made after December 31, 2020, but taxpayers may rely on the proposed rules until a final regulation is published. Comments on the proposal are due by July 27, 2020.

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endnotes

[1] The proposed regulation is available at <https://www.govinfo.gov/content/pkg/FR-2020-05-27/pdf/2020-10679.pdf>.

[2] Prior to amendment, section 3405(a)(4) provided that the default withholding rate for periodic payments “shall be determined by treating the payee as a married individual claiming 3 withholding exemptions.”

[3] See ICI Memorandum No. 32151, dated January 16, 2020, available at https://www.ici.org/my_ici/memorandum/memo32151. For 2018 and 2019, IRS Notices 2018-14 and 2018-92 provided rules parallel to those in place for prior years, treating the payee as a married individual claiming three withholding allowances.

[4] The preamble to the proposed regulation explains that the proposal would not update all Q&As in § 35.3405-1T—including several other Q&As that do not reflect subsequent legislative changes. For example, the description in § 35.3405-1T, Q&A d-1, of an election of no withholding has not been updated to reflect that an election may not be available due to the restrictions set forth in section 3405(e)(12) (failure to provide correct TIN) or 3405(e)(13) (certain payments to be delivered outside of the United States and its possessions). The preamble indicates that the current priority of the Treasury Department and the IRS is to address the provisions of § 35.3405-1T that were impacted by TCJA. In the future, the Treasury Department and the IRS intend to update the provisions of § 35.3405-1T to reflect all statutory changes since the initial promulgation of the temporary regulation.

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