

**MEMO# 32789**

September 29, 2020

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

[32789]

September 29, 2020 TO: ICI Members

Operations Committee

Pension Committee

Pension Operations Advisory Committee

Transfer Agent Advisory Committee SUBJECTS: Pension

Tax RE: IRS Finalizes Regulation on Default Withholding for Periodic Payments from Retirement Plans and Annuities

The IRS issued a final 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. The regulation implements 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.

**The final regulation is unchanged from the proposal issued in May 2020 and applies to periodic payments made after December 31, 2020.**

## 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).[\[3\]](#)

## Final Rule

The final regulation updates and replaces 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. Like the proposed regulation, the preamble to the final 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.

## **Form W-4P**

In a news release accompanying the final rule,<sup>[4]</sup> the IRS indicates that the 2021 Form W-4P will be similar to the 2020 Form W-4P. The release also states that the IRS will provide in the instructions to the 2021 Form W-4P and related publications that the default rate of withholding on periodic payments will continue to be determined by treating the taxpayer as a married individual claiming three withholding allowances.

The news release notes that in July 2020, the IRS released a draft of a redesigned 2021 Form W-4P and instructions intended to align with the redesigned Form W-4, Employee's Withholding Certificate. That draft proposed a new default rate of withholding on periodic payments that begin after December 31, 2020. As explained in the release, however, the IRS has decided to postpone issuance of the redesigned Form W-4P, based on comments received (including from ICI) regarding the time required by payors to implement the new form and a new default rate of withholding. The IRS indicates that it "will continue working closely with the tax community on the redesign of Form W-4P, with the intention of making the withholding system more accurate and transparent for taxpayers."

Elena Barone Chism  
Associate General Counsel - Retirement Policy

## **endnotes**

[1] The final regulation is *available at* <https://www.irs.gov/pub/irs-drop/td-9920.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](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 news release is available here: <https://www.irs.gov/newsroom/irs-provides-final-regulations-on-income-tax-withholding-on-certain-periodic-retirement-and-annuity-payments>.

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