

MEMO# 35887

October 21, 2024

Treasury and IRS Finalize Regulations Regarding Withholding on Certain Payments from Retirement Accounts (Including Payments Delivered Outside of US)

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TO: ICI Members

Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension

Tax RE: Treasury and IRS Finalize Regulations Regarding Withholding on Certain Payments from Retirement Accounts (Including Payments Delivered Outside of US)

The IRS and Treasury Department published final regulations regarding income tax withholding on certain distributions from retirement plans and IRAs under Internal Revenue Code ("Code") section 3405(a) and (b).[\[1\]](#) The regulations codify and clarify existing guidance provided in IRS Notice 87-7, which provides guidance under Code section 3405(e)(13)(A) to payors of "designated distributions" with respect to their income tax withholding obligations.

The final regulations finalize a proposal that was issued in May 2019, and remain essentially unchanged from the proposal.[\[2\]](#)

The final regulation is applicable with respect to payments and distributions made on or after January 1, 2026, and taxpayers are permitted to apply it to earlier payments and distributions.[\[3\]](#)

Background

Code section 3405(e)(1) defines a "designated distribution" generally as any distribution or payment from or under an employer deferred compensation plan,[\[4\]](#) an individual retirement plan (as defined in Code section 7701(a)(37)), or a commercial annuity. The general rule under Code section 3405(a) and (b) is that payors of designated distributions (periodic and non-periodic) are required to withhold income tax, unless the individual has elected not to have withholding apply. However, pursuant to Code section 3405(e)(13)(A),

in the case of a distribution that is "to be delivered outside of the United States and any possession of the United States," individuals may not elect to waive withholding (with certain exceptions for certain non-US citizens).^[5]

In 2019, Treasury and IRS issued proposed regulations, consistent with Notice 87-7. In the preamble to the final regulation, Treasury notes that it did not receive any comments on the proposal, and that the final regulation only makes non-substantive minor working changes to the proposed regulation.

Final Regulation

Consistent with Notice 87-7 (and the proposed regulations), the final regulations generally provide that:

- If a payee has provided the payor with a residence address outside of the US, the payor is required to withhold income tax from designated distributions to the payee.
- If a payee has provided the payor with a residence address within the US, the payor is required to withhold income tax unless the payee has elected no withholding in accordance with the applicable provisions of Code section 3405.
- If a payee has not provided the payor with a residence address, the payor is required to withhold income tax from designated distributions. This rule includes the situation in which the payee has provided an address for the payee's nominee, trustee or agent, without also providing the payee's residence address.

In addition to codifying the guidance from Notice 87-7, the final regulations (like the proposed regulations) also address situations where the payee provides an address that is an Army Post Office (APO), Fleet Post Office (FPO), or Diplomatic Post Office (DPO), and situations where the payee provides a residence address within the US but provides payment instructions requesting delivery outside of the US.

- In the first case, APO, FPO, and DPO addresses would be treated as located within the US.^[6]
- In the second case, the regulations would impose new withholding requirements relating to payees with a residence address within the US but who provide instructions to deliver payments outside of the US. In other words, an election to waive withholding would not apply if the payee (with a US residence) instructs the payment to be sent to a financial institution or other person located outside of the US.

The final regulations also provide that these withholding rules do not apply to certain distributions, such as in the case of a US-source distribution to a nonresident alien individual from a 401(a) retirement plan.^[7]

Shannon Salinas
Associate General Counsel - Retirement Policy

Notes

^[1] The final regulation was published at 89 Fed. Reg. 84079 (October 21, 2024), available at <https://www.govinfo.gov/content/pkg/FR-2024-10-21/pdf/2024-24224.pdf>.

^[2] For a summary of the proposal, see ICI Memorandum No. 31818, dated June 21, 2019, available at <https://www.ici.org/memo31818>. The proposed rule was published at 84 Fed.

Reg. 25209 (May 31, 2019), available at <https://www.govinfo.gov/content/pkg/FR-2019-05-31/pdf/2019-11292.pdf>.

[3] The proposed regulation provided that, until a final regulation is published, taxpayers may continue to rely on Notice 87-7. It further provided that taxpayers may rely on the section of the proposed regulation relating to APO, FPO and DPO addresses until the applicability date of the final regulation.

[4] An employer deferred compensation plan is defined in Code section 3405(e)(5) as any pension, annuity, profit sharing, or stock bonus plan or other plan deferring the receipt of compensation.

[5] This rule is designed to increase tax compliance by US persons living abroad, based on evidence "that the percentage of taxpayers who fail to file returns is substantially higher among Americans living abroad than it is among those resident in the United States, and that it is often difficult for the IRS to enforce compliance by these taxpayers." 89 Fed. Reg. at 84080.

[6] In the preamble to the final regulations, IRS and Treasury explain that "enforcement of compliance by individuals receiving mail at an APO, an FPO, or a DPO address [addresses generally treated as "domestic" by the USPS] generally does not involve the same challenges as enforcing compliance by other taxpayers living abroad," in part because taxpayers using such addresses "commonly maintain a current or former employment or contractor relationship with the United States government." 89 Fed. Reg. at 84080.

[7] The regulations provide that the term "designated distribution" does not include a distribution that is subject to withholding under subchapter A of chapter 3 (or that would be subject but for a tax treaty).