



[4830-01-p]

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

### 26 CFR Parts 31 and 35

[REG-100320-20]

RIN 1545-BP69

### Income Tax Withholding on Certain Periodic Retirement and Annuity Payments Under Section 3405(a)

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document sets forth a proposed regulation that provides rules for Federal income tax withholding on certain periodic retirement and annuity payments to implement an amendment made by the Tax Cuts and Jobs Act. This proposed regulation would affect payors of certain periodic payments, plan administrators that are required to withhold on such payments, and payees who receive such payments.

**DATES:** Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. Requests for a public hearing must be submitted as prescribed in the “**Comments and Requests for a Public Hearing**” section.

**ADDRESSES:** Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at [www.regulations.gov](https://www.regulations.gov) (indicate IRS and REG–100320-20) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited

personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG-100320-20), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulation, Kara M. Soderstrom of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317-5234; concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document sets forth a proposed amendment to the Employment Tax Regulations (26 CFR Parts 31 and 35) under section 3405 of the Internal Revenue Code (Code). This proposed regulation would update certain provisions of §35.3405-1T to conform to a change to section 3405(a)(4) made by section 11041(c)(2)(G) of the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (TCJA). Prior to amendment by TCJA, section 3405(a)(4) provided that, in the case of any periodic payment for which a withholding certificate is not in effect, the amount withheld from the periodic payment (the default rate of withholding) is determined by treating the payee as a married individual claiming three withholding exemptions. As amended by TCJA,

section 3405(a)(4) provides that the default rate of withholding on periodic payments is determined under rules prescribed by the Secretary. Section 35.3405-1T reflects the rule under section 3405(a)(4) prior to amendment by TCJA.

## 1. Statutory and Regulatory Framework

Section 3405 provides Federal income tax withholding rules for payments of pensions, annuities, and certain other deferred income (retirement and annuity payments). Retirement and annuity payments that are subject to withholding under section 3405 include periodic payments, nonperiodic distributions, and eligible rollover distributions.

The Treasury Department and the IRS have issued several sets of regulations under section 3405 that provide guidance regarding withholding on periodic payments, nonperiodic distributions, and eligible rollover distributions. On October 14, 1982, the Treasury Department and the IRS issued §35.3405-1T (TD 7839) (47 FR 45868), which provides general rules addressing withholding requirements and specific rules addressing withholding on periodic payments and nonperiodic distributions (other than eligible rollover distributions), notice and election procedures, and reporting and recordkeeping requirements. On September 22, 1995, the Treasury Department and the IRS issued §31.3405(c)-1 (TD 8619) (60 FR 49215), which provides rules for withholding on eligible rollover distributions, as defined in section 402(f)(2)(A) (generally referring to distributions from plans qualified under section 401(a), section 403(a) plans, section 403(b) tax-sheltered annuity plans, or section 457(b) plans maintained by a governmental employer that are eligible to be rolled over to an IRA (an individual retirement account or individual retirement annuity) or another eligible retirement plan).

On February 8, 2000, the Treasury Department and the IRS issued §35.3405-1 (TD 8873) (65 FR 6007), which provides rules regarding the medium through which notices required under section 3405 may be provided. On May 31, 2019, proposed §31.3405(e)-1 was published in the **Federal Register** (84 FR 25209) to propose rules applicable to periodic payments and nonperiodic distributions (other than eligible rollover distributions) that are to be delivered outside the United States and its possessions.

## 2. Definition of Periodic Payment

While the guidance described in Section 1 of this Background relates to all types of payments and distributions subject to withholding under section 3405, this proposed regulation addresses only the change made by section 11041(c)(2)(G) of TCJA to section 3405(a)(4), and therefore applies only to certain periodic payments.

A periodic payment is defined in section 3405(e)(2) as “a designated distribution which is an annuity or similar periodic payment.” Subject to certain exceptions,<sup>1</sup> a designated distribution generally is defined in section 3405(e)(1)(A) as any distribution or payment from or under an employer deferred compensation plan, an individual retirement plan (as defined in section 7701(a)(37)), or a commercial annuity. For this purpose, an employer deferred compensation plan is defined in section 3405(e)(5) as any pension, annuity, profit-sharing, or stock bonus plan or other plan deferring the receipt of compensation, and a commercial annuity is defined in section 3405(e)(6) as

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<sup>1</sup> Under section 3405(e)(1)(B), a designated distribution does not include any amount that is wages without regard to section 3405; the portion of a distribution or payment (excluding any distribution or payment from or under an individual retirement plan, other than a Roth IRA) which it is reasonable to believe is not includible in gross income; any amount that is subject to withholding under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations) by the person paying such amount or which would be so subject but for a tax treaty; or any distribution described in section 404(k)(2) (relating to distributions of “applicable dividends” by an employee stock ownership plan).

an annuity, endowment, or life insurance contract issued by an insurance company licensed to do business under the laws of any State. Section 35.3405-1T, Q&A a-9, provides that a periodic payment includes an annuity or similar periodic payment, whether paid by a licensed life insurance company, a financial institution, or a plan, and that an “annuity” is a series of payments payable over a period greater than one year and taxable under section 72 as amounts received as an annuity, whether or not the payments are variable in amount.

### 3. Withholding on Periodic Payments

Section 3405(a) requires the payor of any periodic payment to withhold from the payment as if the payment were wages paid by an employer to an employee, unless an individual has elected under section 3405(a)(2) not to have withholding apply, subject to the following exceptions. First, section 3405(c)(1)(A) provides that section 3405(a) does not apply in the case of any designated distribution that is an eligible rollover distribution (as defined in section 402(f)(2)(A)). Second, section 3405(e)(12) provides that no election under section 3405(a)(2) will be treated as in effect (and the provisions of section 3405(a)(4) for determining the default rate of withholding will not apply) if a payee fails to furnish the payee’s Taxpayer Identification Number (TIN) to the payor in the manner required by the Secretary or the Secretary notifies the payor before any payment or distribution that the TIN furnished by the payee is incorrect. Third, under section 3405(e)(13), no election under section 3405(a)(2) may be made with respect to certain periodic payments to be delivered outside of the United States and its possessions.

#### 4. Default Rate of Withholding on Periodic Payments and TCJA Amendment

Before amendment by TCJA, section 3405(a)(4) provided that, in the case of any periodic payment with respect to which a withholding certificate is not in effect, the amount withheld from the periodic payment is “determined by treating the payee as a married individual claiming 3 withholding exemptions.” TCJA amended section 3405(a)(4) to eliminate the requirement that the payee be treated as a married individual claiming three withholding exemptions and to provide instead that, in the case of any periodic payment with respect to which a withholding certificate is not in effect, the amount withheld from the periodic payment will be “determined under rules prescribed by the Secretary.”

#### 5. Guidance Regarding the Default Rate of Withholding on Periodic Payments

Following enactment of TCJA, the Treasury Department and the IRS issued guidance addressing the change to section 3405(a)(4). Section V of Notice 2018-14, 2018-7 I.R.B. 353, and section 10 of Notice 2018-92, 2018-51 I.R.B. 1038, provided that, for 2018 and 2019, respectively, the rules for withholding when no withholding certificate is furnished with respect to periodic payments under section 3405(a) would parallel the rules for prior years and would be based on treating the payee as a married individual claiming three withholding allowances. Similarly, section IV of Notice 2020-3, 2020-3 I.R.B. 330, provides that, for 2020, the default rate of withholding from periodic payments under section 3405(a) is based on treating the payee as a married individual claiming three withholding allowances and applying that status when referring to the applicable withholding tables and related computational procedures in the 2020

Publication 15-T, “Federal Income Tax Withholding Methods.”<sup>2</sup>

## **Explanation of Provisions**

### **1. Default Rate of Withholding on Periodic Payments**

As indicated in the Background section of the preamble, certain provisions of §35.3405-1T reflect the rule under section 3405(a)(4) prior to amendment by TCJA.<sup>3</sup> Specifically, Q&As a-10, b-3, and b-4 of §35.3405-1T each provide that the default rate of withholding on periodic payments is determined by treating the payee as married and claiming three withholding allowances. The proposed regulation would remove these three Q&As from §35.3405-1T because they prescribe the substantive default rate of withholding rule under section 3405(a)(4) prior to amendment by TCJA. The proposed regulation would not remove other Q&As in §35.3405-1T that reference the pre-TCJA rule under section 3405(a)(4) but do not require payors to withhold based upon that pre-TCJA rule (for example, the sample notice in §35.3405-1T, Q&A d-21).<sup>4</sup> The proposed regulation would update and replace the provisions of Q&As a-10, b-3, and b-4 in new §31.3405(a)-1, which provides that the default rate of withholding on periodic

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<sup>2</sup> Notice 2020-3 also provides that the Treasury Department and the IRS are considering whether the default rate of withholding from periodic payments that is in effect for 2020 will continue to be appropriate for calendar years after 2020, and requests comments on whether the adoption of a new default rate of withholding on periodic payments that applies prospectively would present any administrative challenges. One comment was received on this issue (available at: <https://www.regulations.gov/document?D=IRS-2019-0051-0004>). The commenter provides suggestions regarding the effective date and prospective application of any change to the default rate of withholding on periodic payments and suggestions regarding the applicable withholding tables for periodic payments for calendar years after 2020.

<sup>3</sup> In addition to the amendment made by section 11041(c)(2)(G) of TCJA, described in the Background section of the preamble, section 11041(c)(2)(F) of TCJA amended section 3405(a)(3) and (4) (and the heading for paragraph (4)) to replace each reference to “exemption” with “allowance,” effectively replacing references to “withholding exemption certificate” with “withholding allowance certificate.” However, the Treasury Department and the IRS have determined that no updates to §35.3405-1T are required to implement section 11041(c)(2)(F) of TCJA because §35.3405-1T refers to a “withholding certificate.”

<sup>4</sup> As described in Section 2 of this Explanation of Provisions, the Treasury Department and the IRS intend to update other Q&As in §35.3405-1T in the future.

payments is determined in the manner described in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner.

This proposed §31.3405(a)-1 provides a flexible and administrable rule that leaves the communication and mechanical details of the default rate of withholding on periodic payments to be provided in applicable forms, instructions, publications, and other guidance. These materials 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. Currently, withholding on periodic payments, including the default rate of withholding, is explained in the instructions to the 2020 Form W-4P, “Withholding Certificate for Pension or Annuity Payments,” the 2020 Publication 15-T, and related publications. The 2020 Publication 15-T also provides the tables that payors use to calculate withholding on periodic payments (and the tables that employers use to calculate withholding on taxable wages).

Proposed §31.3405(a)-1 would also generally update Q&As a-10, b-3, and b-4 of §35.3405-1T to reflect relevant statutory changes and provide clarifications. Notably, in accordance with section 3405(a)(3), proposed §31.3405(a)-1 would update the rules for determining the effective date of a payee’s Form W-4P by referencing the rules under section 3402(f)(3) and the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner.<sup>5</sup> Section 3402(f)(3) provides different withholding certificate effective date rules for cases in which there is no previous

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<sup>5</sup> Thus, proposed §31.3405(a)-1 addresses the amendment of section 3402(f)(3)(B) by section 10302(a) of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (1987). The amendment to section 3402(f)(3)(B) affected the rules in Q&A b-3 of §35.3405-1T for determining the effective date of a payee’s Form W-4P.

withholding certificate in effect and cases in which a previous withholding certificate is in effect. Form W-4P effective date information is provided in the 2019 Publication 505, “Tax Withholding and Estimated Tax.”

## 2. Other Provisions of §35.3405-1T

Proposed §31.3405(a)-1 refers taxpayers to §35.3405-1T, among other regulations under section 3405, for additional guidance regarding Federal income tax withholding on periodic payments, and is intended to be read in conjunction with those other regulations. For example, proposed §31.3405(a)-1(b) provides general guidance regarding Federal income tax withholding on periodic payments, but an election of no withholding under section 3405(a)(2) may be available as described in §35.3405-1T, Q&A d-1.

While this proposed regulation would update certain Q&As in §35.3405-1T, it would not update all of the Q&As, including several Q&As that do not reflect legislative changes that became effective after the publication of §35.3405-1T. 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 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.

## **Proposed Applicability Date**

This regulation is proposed to apply to periodic payments made after December 31, 2020. Notwithstanding §35.3405-1T, taxpayers may rely on the rules set forth in this notice of proposed rulemaking, in their entirety, until the date of publication of a Treasury Decision adopting this proposed rule as a final regulation.

## **Special Analyses**

### **1. Regulatory Planning and Review**

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

### **2. Paperwork Reduction Act**

Any collection of information associated with this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review under OMB control number 1545-0074 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). In general, the collection of information is required under section 3405 of the Code. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to this proposed regulation, including estimates for how much time it would take to comply with the paperwork burdens described in OMB control number 1545-0074 and ways for the IRS to minimize the paperwork burden. An agency may not conduct or sponsor and a person is not required to respond to a collection of information unless it displays a valid OMB control number.

### 3. Regulatory Flexibility Act

Under the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that this proposed regulation, if adopted, would not have a significant economic impact on a substantial number of small entities that are directly affected by the proposed regulation. The proposed regulation will apply to all payors of periodic payments, including small entities, and is likely to affect a substantial number of small entities. The economic impact, however, will not be significant. The primary change is to effect a TCJA legislative amendment to remove the reference in section 3405(a)(4) to a married individual claiming three exemptions as the default withholding rate and to provide, in its place, that the amount to be withheld is determined in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner. Accordingly, this rule would conform the current regulation to the statute and will not have a significant economic impact on a substantial number of small entities. Notwithstanding this certification, the Treasury Department and the IRS invite comments on any impact this rule would have on small entities.

Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Statement of Availability of IRS Documents**

IRS Notices cited in this preamble are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS web site at <http://www.irs.gov>.

## **Comments and Requests for a Public Hearing**

Before this proposed amendment to the regulations is adopted as a final regulation, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the “**ADDRESSES**” section. The Treasury Department and the IRS request comments on all aspects of the proposed regulation. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

## **Drafting Information**

The principal author of these proposed regulations is Kara M. Soderstrom, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in the development of these proposed regulations.

## List of Subjects

### 26 CFR Part 31

Employment taxes, Fishing vessels, Gambling, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

### 26 CFR Part 35

Employment taxes, Income taxes, Pensions, Reporting and recordkeeping requirements.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 35 are proposed to be amended as follows:

### PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 is amended by adding an entry for §31.3405(a)-1 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805.

\* \* \* \* \*

Section 31.3405(a)-1 also issued under 26 U.S.C. 3405(a)(4).

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Par. 2. Section 31.3405(a)-1 is added to read as follows:

§31.3405(a)-1 Questions and answers relating to Federal income tax withholding on periodic retirement and annuity payments.

(a) The following questions and answers relate to Federal income tax withholding on periodic payments under section 3405(a), as amended by section 11041(c)(2)(G) of the Tax Cuts and Jobs Act (Public Law 115-97, 131 Stat. 2054 (2017)). The withholding rules of section 3405(a) do not apply to periodic payments that are eligible rollover

distributions (as defined in section 402(f)(2)(A)). See generally section 3405(c) and §31.3405(c)-1 for Federal income tax withholding rules applicable to eligible rollover distributions. See section 3405(e)(13) for additional rules applicable to certain periodic payments under section 3405(a) and nonperiodic distributions under section 3405(b) that are to be delivered outside the United States and its possessions. For additional guidance regarding periodic payments, see §§35.3405-1 and 35.3405-1T of this chapter.

(b)(1) Q-1: How will Federal income tax be withheld from a periodic payment?

(2) A-1: In the case of a periodic payment that is subject to withholding under section 3405(a), amounts are withheld as if the payment were a payment of wages by an employer to the employee for the appropriate payroll period. If the payee has not furnished a withholding certificate, the amount to be withheld is determined in the manner described in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner. The rules for withholding when the payee has not furnished a withholding certificate apply regardless of whether the payor is aware of the payee's actual marital status or actual Federal income tax filing status.

(c)(1) Q-2: Do rules similar to those for wage withholding apply to the furnishing of a withholding certificate for periodic payments?

(2) A-2: Yes. Unless the rules of section 3405 specifically conflict with the rules of section 3402, the rules for withholding on periodic payments that are not eligible rollover distributions will parallel the rules for wage withholding. Thus, if a withholding certificate is furnished by a payee, it will generally take effect in accordance with section 3402(f)(3) and as provided in applicable forms, instructions, publications, and other

guidance prescribed by the Commissioner. If no withholding certificate is furnished, the amount withheld must be determined in the manner described in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner for withholding on periodic payments when no withholding certificate is furnished.

(d)(1) Q-3: What is the applicability date of this section?

(2) A-3: This section applies with respect to periodic payments made after December 31, 2020.

PART 35--EMPLOYMENT TAX AND COLLECTION OF INCOME TAX AT SOURCE  
REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF  
1982

Par. 3. The authority citation for part 35 continues to read in part as follows:

Authority: 26 U.S.C. 6047(e), 7805; 68A Stat. 917; 96 Stat. 625; Public Law  
97-248 (96 Stat. 623)\* \* \*

**§35.3405-1T [Amended]**

Par. 4. Section 35.3405-1T is amended by removing and reserving Q&A a-10,  
Q&A b-3, and Q&A b-4.

Sunita Lough

Deputy Commissioner for Services and Enforcement.

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