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failure is due to reasonable cause and not willful neglect.

(g) *Special rules.* (1) For purposes of subdivision (iii) of paragraph (e)(2), the last employer for whom the employee worked prior to becoming sick or disabled or for whom the employee was working at the time he became sick or disabled shall be deemed to be the employer for whom services are normally rendered, provided that such employer made contributions on behalf of such employee to the plan or system under which the employee is being paid.

(2) The application of the provisions of subparagraph (1) of this paragraph (g) may be illustrated by the following examples:

Example 1. B is employed by Company M. B becomes sick and is absent from work for 3 months. While B is absent from work, he receives sick pay from Insurance Company N pursuant to a plan established by M and to which M has made contributions on behalf of B. M is the employer for whom services are normally rendered by B.

Example 2. C is employed by Company O and is also employed on a part-time basis by Company Q. C becomes sick while at work at Qs place of business. C is absent from work for 3 months. While C is absent from work, he receives sick pay from Insurance Company P pursuant to a a plan established by O and to which O has made contributions on behalf of C. O is the employer for whom services are normally rendered by C.

Example 3. D is a member of a labor union whose members receive health and welfare benefit payments from a trust fund which is supported by the contributions of the various employers who employ the labor union's members. D has been employed by Company R for 4 days when he becomes sick and is absent from work for 3 months. While D is absent from work he receives sick pay from his union's trust fund to which R has made contributions on D's behalf. R is the employer for whom services are normally rendered by D.

(3) For purposes of paragraph (e) of this section, in the case of payments on account of sickness or accident disability made to employees by a third party insurer pursuant to a contract of insurance with a multiemployer plan which is obligated to make payments on account of sickness or accident disability to such employees pursuant to a collectively bargained agreement, if the third party insurer making the payments complies with the requirements of subdivisions (i) and (ii) of subparagraph (2) of paragraph (e) and notifies the plan of the amount of compensation paid on which tax was withheld and deposited within the time required for notification of the employer under subparagraph (2) of paragraph (e), then the plan (and not the third party insurer) shall be required to pay the tax imposed by section 3221 and to comply with the requirements of section 6051 and §§31.6051–1 and 31.6051–2 with respect to such payments unless, within 6 business days of the receipt of such notification, the plan notifies the employer for whom services are normally rendered of the amount of the compenation on which tax was withheld and deposited. If the plan provides such notice to the employer, the employer (and not the plan) shall be required to pay the tax imposed by section 3221 and to comply with the requirements of section 6051 and §§31.6051–1 and 31.6051–2 with respect to the compensation.

[T.D. 7823, 47 FR 29225, July 6, 1982, as amended by T. D. 7867, 48 FR 793, Jan. 7, 1983]

PART 34—[RESERVED]

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

Sec.

35.3405–1 Questions and answers relating to withholding on pensions, annuities, and certain other deferred income.

35.3405–1T Questions and answers relating to withholding on pensions, annuities, and certain other deferred income (temporary regulations).

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

Section 35.3405–1 also issued under 26 U.S.C. 3405(e)(10)(B)(iii).

Section 35.3405–1T also issued under 26 U.S.C. 3405(e)(10)(B)(iii).

§ 35.3405–1 Questions and answers relating to withholding on pensions, annuities, and certain other deferred income.

The following questions and answers relate to withholding on pensions, annuities, and other deferred income under section 3405 of the Internal Revenue Code of 1986, as added by section 334 of the Tax Equity and Fiscal Responsibility Tax Act of 1982 (Public Law 97–248) (TEFRA).

a–1 through d–34 [Reserved] For further guidance, see § 35.3405–1T.

d–35. Q. *Through what medium may a payor provide the notice required under section 3405 to a payee?*

A. A payor may provide the notice required under section 3405 (including the abbreviated notice described in d–27 of § 35.3405–1T and the annual notice described in d–31 of § 35.3405–1T) to a payee either on a written paper document or through an electronic medium reasonably accessible to the payee. A notice provided through an electronic medium must be provided under a system that satisfies the following requirements:

(a) The system must be reasonably designed to provide the notice in a manner no less understandable to the payee than a written paper document.

(b) At the time the notice is provided, the payee must be advised that the payee may request and receive the notice on a written paper document at no charge, and, upon request, that document must be provided to the payee at no charge.

d–36. Q. *Are there examples that illustrate the provisions of d–35 of this section?*

A. The provisions of d–35 of this section are illustrated by the following examples:

Example 1. (i) An employer deferred compensation plan (Plan A) permits participants to request distributions by e-mail. Under Plan A's system for such transactions, a participant must enter his or her account number and personal identification number (PIN); this information must match that in Plan A's records in order for the transaction to proceed. The plan administrator is the payor. If a participant requests a distribution from Plan A by e-mail, the plan administrator provides the participant with the notice required under section 3405 by e-mail. The plan administrator also advises the participant by e-mail that he or she may request the notice on a written paper document and that, if the participant requests the notice on a written paper document, it will be provided at no charge. To proceed with the distribution by e-mail, the participant must acknowledge receipt, review, and comprehension of the notice.

(ii) In this *Example 1,* the plan administrator does not fail to satisfy the notice requirement of section 3405 merely because the notice is provided to the participant other than through a written paper document.

Example 2. (i) An employer deferred compensation plan (Plan B) permits participants to request distributions through the Plan B web site (Internet or intranet). Under Plan B's system for such transactions, a participant must enter his or her account number and personal identification number (PIN); this information must match that in Plan B's records in order for the transaction to proceed. The plan administrator is the payor. A participant may request a distribution from Plan B by following the applicable instructions on the Plan B web site. After the participant has requested a distribution, the participant is automatically shown a page on the web site containing the notice required by section 3405. Although this page of the web site may be printed, the page also advises the participant that he or she may request the notice on a written paper document and that, if the participant requests the notice on a written paper document, it will be provided at no charge. To proceed with the distribution through the web site, the participant must acknowledge receipt, review, and comprehension of the notice.

(ii) In this *Example 2,* the plan administrator does not fail to satisfy the notice requirement of section 3405 merely because the notice is provided to the participant other than through a written paper document.

Example 3. (i) An employer deferred compensation plan (Plan C) permits participants to request distributions through Plan C's automated telephone system. Under Plan C's system for such transactions, a participant must enter his or her account number and personal identification number (PIN); this information must match that in Plan C's records in order for the transaction to proceed. The plan administrator is the payor. A participant may request a distribution from Plan C by following the applicable instructions on the automated telephone system. After the participant has requested a distribution, the automated telephone system reads the notice required by section 3405 to the participant. The automated telephone system also advises the participant that he or she may request the notice on a written paper document and that, if the participant requests the notice on a written paper document, it will be provided at no charge. Before proceeding with the distribution transaction,

the participant must acknowledge receipt, review, and comprehension of the notice.

(ii) In this *Example 3,* the plan administrator does not fail to satisfy the notice requirement of section 3405 merely because the notice is provided to the participant other than through a written paper document.

Example 4. (i) Same facts as *Example 3,* except that, pursuant to the system for processing such transactions, a participant who so requests is transferred to a customer service representative whose conversation with the participant is recorded. The customer service representative provides the notice required by section 3405 by reading from a prepared text.

(ii) *Conclusion.* In this *Example 4,* the plan administrator does not fail to satisfy the notice requirement of section 3405 merely because the notice is provided to the participant other than through a written paper document.

Example 5. (i) Same facts as *Example 1,* except that Participant D requested a distribution by e-mail and then terminated employment. Participant D no longer has access to e-mail.

(ii) In this *Example 5,* the plan administrator does not satisfy the notice requirement of section 3405 because the electronic medium through which the notice is provided is not reasonably accessible to Participant D. Plan A must provide the notice required by section 3405 to Participant D in a written paper document or by an electronic medium that is reasonably accessible to Participant D.

[T.D. 8873, 65 FR 6007, Feb. 8, 2000; 65 FR 17149, Mar. 31, 2000]

EFFECTIVE DATE NOTE: By T.D. 8873, 65 FR 6007, Feb. 8, 2000, § 35.3405–1 was redesignated as § 35.3405–1T and new § 35.3405–1 was added, effective Jan. 1, 2001.

§ 35.3405–1T Questions and answers relating to withholding on pensions, annuities, and certain other deferred income (temporary regulations).

The following questions and answers relate to withholding on pensions, annuities, and other deferred income under section 3405 of the Internal Revenue Code of 1954, as added by section 334 of the Tax Equity and Fiscal Responsibility Tax Act of 1982 (Pub. L. 97–248) (TEFRA):

a. In general.
b. Periodic payments.
c. Nonperiodic distributions.
d. Notice and election procedures.
e. Reporting and recordkeeping.

A. IN GENERAL

a–1. Q. How did TEFRA change the law on withholding requirements for pensions, annuities, and other deferred income?

A. TEFRA amended the Internal Revenue Code to impose withholding requirements on designated distributions paid after December 31, 1982. Further, although under prior law individuals could elect to have Federal income tax withheld from certain pension and annuity payments, TEFRA requires withholding on all designated distributions unless the payee elects not to have withholding apply.

a–2. Q. What type of payment is a designated distribution that is subject to the new withholding rules?

A. A designated distribution is 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. However, a designated distribution does not include any portion of a distribution which it is reasonable to believe is not includible in the gross income of the payee. For rules concerning when it is reasonable to believe that all or part of a distribution is not includible in the gross income of the recipient, see questions a–24 through a–33. In addition, a payment or distribution that is treated as wages under section 3401(a) is not a designated distribution subject to the new withholding rules. For examples of these payments, see questions a–18 through a–23.

a–3 Q. What is an employer deferred compensation plan for purposes of the new withholding rules?

A. An employer deferred compensation plan is any pension, annuity, profit-sharing, stock bonus, or other plan that defers the receipt of compensation.

a–4. Q. What is a commercial annuity for purposes of the new withholding rules?

A. A commercial annuity is an annuity, endowment, or life insurance contract issued by an insurance company licensed to do business under the laws of any State. See, also, question f–21.

a–5. Q. When does the new law take effect?

A. In general, withholding is required on any designated distribution made

after December 31, 1982. In the case of periodic payments beginning before January 1, 1983, the first payment after December 31, 1982 is treated as the first periodic payment for purposes of the withholding requirements. The Secretary has authority to delay (but not beyond June 30, 1983) the application of these withholding provisions to any payor if the payor can establish that it is impossible to comply with these provisions without undue hardship. Additionally, no penalty will be imposed for failure to withhold on periodic payments if the failure occurs before July 1, 1983, and if a good faith attempt is made to comply.

Procedures for requesting a delay in implementation of the withholding provisions are under consideration.

a–6. Q. What effect does the new law have on the old law provisions relating to withholding of tax from annuity payments by request?

A. If payment is part of a designated distribution, the rules of section 3402(o) (relating to voluntary withholding on certain payments) do not apply. Therefore, a payee receiving amounts that are subject to withholding under the new provisions described in this regulation may not choose to use the voluntary withholding system of section 3402(o) with respect to those amounts. Also, if a payee had a fixed amount withheld by request, a different amount will probably be withheld when the new provisions take effect unless the rule provided in question a–7 applies. However, section 3402(o) will continue to apply to annuity payments that are not designated distributions, to sick pay, and to supplemental unemployment benefits.

a–7. Q. If a recipient of a pension or annuity has previously elected voluntary withholding under section 3402(o), is the Form W–4P effective for withholding on payments after December 31, 1982?

A. Yes, if the plan administrator or payor wishes to honor it; the Form W–4P can be treated by the plan administrator or payor as an election to withhold the flat dollar amount specified on the form if the payee, is notified of his right to elect out of withholding and if he is notified that his previously filed W–4P will remain effective unless he elects out of withholding or files a new withholding certificate. If these requirements are met the plan administrator or payor may treat the Form W–4P as a voluntary withholding agreement under section 3402(p). See, also, section 3402(i). These amounts withheld should be reported in the same manner as amounts withheld under section 3405.

a–8. Q. What amount of Federal income tax will be withheld from designated distributions?

A. The amount to be withheld by any payor (or, in certain cases, a plan administrator) depends upon whether the payment is a periodic payment, a nonperiodic distribution other than a qualified total distribution, or a qualified total distribution. However, the maximum amount to be withheld cannot exceed the sum of the amount of money and the fair market value of property (other than employer securities as defined in section 402(a)(3)) received in the distribution.

a–9. Q. What is a periodic payment?

A. A periodic payment is an annuity or similar periodic payment whether paid by a licensed life insurance company, a financial institution, or a plan. The term ''annuity'' means 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.

a–10. Q. How will federal income tax be withheld from a periodic payment?

A. In the case of a periodic payment, 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 filed a withholding certificate, the amount to be withheld is calculated by treating the payee as a married individual claiming three withholding allowances.

For additional questions and answers concerning periodic payments, see part b.

a–11. Q. How will Federal income tax be withheld from a ''qualified total distribution?''

A. A ''qualified total distribution'' means any designated distribution which it is reasonable to believe is made within one taxable year of the

payee, is made from or under a qualified plan described in section 401(a) or section 403(a), and consists of the balance to the credit of the employee under the plans. For additional questions and answers concerning qualified total distributions, see part c. The amount to be withheld on qualified total distributions will be determined under tables prescribed by the Secretary that approximate the tax that would be imposed under section 402(e) if the payee elected to treat the distribution as a lump sum distribution within the meaning of section 402(e)(4)(A). See, in this respect, question c–8.

a–12. Q. What amount of Federal income tax will be withheld from a designated distribution that is not a periodic payment or a qualified total distribution?

A. If a designated distribution is not a periodic payment or a qualified total distribution, the amount to be withheld is computed by multiplying the amount of the designated distribution by 10 percent.

a–13. Q. Who must withhold?

A. Generally, the payor of a designated distribution must withhold, and is liable for payment of, the tax required to be withheld. However, in the case of a distribution from a plan described in section 401(a) (relating to pension, profit-sharing, and stock bonus plans), section 403(a) (relating to certain annuity plans), or section 301(d) of the Tax Reduction Act of 1975 (relating to certain employee stock ownership plans, sometimes called ''TRASOP's''), the plan administrator must withhold, and is liable for payment of, the withheld tax unless he directs the payor to withhold the tax and furnishes the payor with any information that may be required by the Secretary in forms or regulations. This provision applies to qualified plans as well as once qualified plans that are no longer qualified. For a description of the material that the plan administrator must furnish to the payor, see question e–3.

a–14. Q. Who is a plan administrator?

A. Under section 414(g), the plan administrator is the person specifically designated as the plan administrator by the terms of the plan or trust. If the plan or trust does not specifically designate the plan administrator (as provided in §1.414(g)–1(a) of the Income Tax Regulations), then the plan administrator is generally determined as follows:

(1) In the case of a plan maintained by a single employer, the employer is the plan administrator.

(2) In the case of a plan maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives who maintain the plan is the plan administrator.

(3) In the case in which (1) or (2) does not apply, the person actually responsible for the control, disposition, or management of the assets is the plan administrator.

a–15. Q. If a bank trustee, regulated investment company, or insurance company makes a periodic payment to a payee solely at the direction of an employer sponsored individual retirement account (IRA), is the bank trustee, regulated investment company or insurance company a payor subject to the pension withholding provisions?

A. Yes. the term ''payor'' generally means the person actually paying the annuity or other payment (even if the person is acting as an agent). Because this is not a payment from a plan described in section 401(a) or 403(a), responsibility for withholding is on the bank trustee, regulated investment company, or insurance company and not on the employer who sponsors the account.

a–16. Q. If a bank trustee transfers plan funds to the employer who sponsors a plan described in section 401(a) and the employer makes the designated distributions, is the employer a payor?

A. Yes. The employer is a payor because it acts as an agent for the bank trustee. Even though the plan administrator has transferred liability to the bank trustee under section 3405(c)(2), the transfer of funds to the employer does not relieve the bank trustee of its liability for withholding because the rule on transfer of liability only applies to plan administrators. Therefore, if the employer fails to withhold on designated distributions, either the employer or the bank trustee may be

liable for failure to withhold. Note, however, that the plan administrator could transfer liability for withholding to the employer as payor under section 3405(c)(2). See, in this respect, questions e–2 and e–3.

a–17. Q. Do the withholding provisions apply to annuities paid from an employer deferred compensation plan, an individual retirement plan, or a commercial annuity to the surviving spouse or other beneficiary of a deceased payee?

A. Yes.

a–18. Q. Do these withholding provisions apply to designated distributions under all nonqualified employer deferred compensation plans?

A. No. The withholding provisions relating to pensions and annuities do not apply to any amounts that are wages without regard to these provisions. Wages to which the general wage withholding rules apply mean any remuneration paid by an employer for services performed by an employee unless the amount paid falls within one of the exceptions of section 3401(a). For example, wages do not include remuneration paid to, or on behalf of, an employee or beneficiary from or to a trust qualified under section 401(a) and tax-exempt under section 501(a). There is no exception for contributions to, or benefits paid from, some nonqualified plans. In general, any contributions to, or benefits from, a nonqualified plan that are taxable under section 83 are subject to wage withholding at the time that they are includible in the recipient's gross income.

a–19. Q. Do these withholding provisions apply to designated distributions from a bond purchase plan described in section 405(a)?

A. Yes. Although a bond purchase plan is not a qualified plan, section 3402(a) does not apply to contributions to, or distributions from, such a plan. Therefore, designated distributions from a bond purchase plan are subject to the new withholding rules of section 3405. Similarly, the new withholding rules apply to designated distributions of an individual retirement bond described in section 409 or from an annuity plan described in section 403(a). For purposes of the withholding provisions of section 3405, a designated distribution from a bond purchase plan described in section 405(a) or an individual retirement bond described in section 409 occurs when an individual redeems a bond.

a–20. Q. Do these withholding provisions apply to designated distributions from a tax-sheltered annuity described in section 403(b)?

A. Yes. Section 31.3401(a)–1(b)(1)(i) of the Employment Tax Regulations provides that there is no withholding required under the wage withholding provisions to the extent that any amounts are taxable under the rules of section 72 or 403. Because designated distributions are not subject to the general wage withholding provisions, the new provisions of section 3405 apply to these designated distributions.

a–21. Q. An employer maintains a nonqualified deferred compensation plan such as a supplemental executive retirement (''top hat'') plan. Payments under the plan are made in the form of a single sum payment at retirement. Amounts paid at retirement are includible in income as compensation in the year received. Must the payor withhold on these amounts according to the rules in section 3405?

A. No. Section 3405(d)(1)(B)(i) provides that a designated distribution on which withholding is required does not include amounts that are wages without regard to the rules of section 3405. Therefore, withholding on payments that are includible in income as compensation are based on the rules for withholding on wages contained in section 3402.

a–22. Q. Do the withholding provisions of section 3405 apply to a retirement plan maintained by a State or local government on behalf of its employees?

A. Yes. A retirement plan maintained by a State or local government on behalf of its employees is a plan that defers the receipt of compensation. The fact that a plan deferring the receipt of compensation is maintained by a governmental unit does not make the withholding provisions inapplicable. Thus, annuity payments and other distributions under the Federal Civil Service Retirement System or under the plan of any State or municipality are subject to withholding.

a–23. Q. Are payments from a state or local plan of deferred compensation described in section 457 subject to the withholding requirements of section 3405?

A. No. Amounts paid from a plan described in section 457 are paid from a plan that defers the receipt of compensation. However, amounts paid from a deferred compensation plan described in section 457 are wages under section 3401(a). Therefore, the general wage withholding rules, not the special rules of section 3405, apply to these payments.

a–24. Q. An individual retires and begins receiving periodic payments under a commercial annuity contract that was distributed to him from a contributory qualified plan. The insurance company is the payor and is liable for withholding because the plan administrator has transferred liability under the rules of section 3405(c)(2). Must the payor determine whether the employee's investment in the contract is recoverable within three years?

A. Yes. Under section 72(d), if the annuity payments during the first three years equal or exceed the amount contributed by the employee to the plan, no amounts are includible in income until the employee's contributions are recovered. Because the application of section 72(d) may affect the extent to which it is reasonable to believe that amounts are not includible in income and, therefore, not subject to withholding, the payor must determine whether section 72(d) applies to the annuity payments. As a general rule, the information necessary to determine the employee's investment in the contract must be provided to the payor by the plan administrator. See, however, questions a–27 and a–33.

a–25. Q. If the payor in question a–24 determines that the employee's investment in the contract is not recoverable within 3 years, must the payor compute the exclusion ratio under section 72(b) to calculate the amount of each payment that is not includible in gross income?

A. Yes. The operation of section 72(b) affects the extent to which it is reasonable to believe that amounts are not includible in gross income. Therefore, the payor must compute the exclusion ratio to determine what portion of each payment is subject to withholding under section 3405. As a general rule, the information necessary to determine the employee's exclusion ratio must be provided to the payor by the plan administrator. See, however, questions a–27 and a–33.

a–26. Q. In questions a–24 and a–25, may the payor (i.e., the insurance company) rely on the information furnished by the plan administrator to determine the amounts that are includible in gross income?

A. In the absence of information to the contrary supplied by the payee, the payor may rely on the information furnished by the plan administrator. See, with respect to the plan administrator's duty to report to the payor, questions e–2 and e–3.

a–27. Q. What is the result in questions a–24 and a–25 if the plan administrator fails to provide the payor with any information concerning the amount of employee contributions?

A. Until the earlier of December 31, 1983, or the date on which the plan administrator provides the payor with information concerning the amount of employee contributions, it is reasonable for the payor to assume that the employee's investment in the annuity contract is zero unless the payor has independent specific knowledge of the amount of employee contributions. Additionally, if the payee notifies the payor of the amount of employee contributions, the payor must compute the taxable portion of the payment based on the information supplied by the payee. If the plan administrator fails to provide the payor with this information on or before December 31, 1983, the plan administrator will be liable for failure to withhold and pay the tax due. See questions e–2 through e–5 for rules on the plan administrator's ability to transfer liability for withholding to the payor. See also question a–33 with respect to the plan administrator's failure to provide the necessary information prior to December 31, 1983.

a–28. Q. If a beneficiary receives the balance to the credit of an employee from an annuity described in section 403(b) on account of the employee's death, is it reasonable to believe that the $5,000 death benefit exclusion of section 101(b) is not includible in gross income?

A. Yes. Although the amount of the death benefit exclusion allowable may be limited by section 101(b)(2)(B)(iii), the payor, for withholding purposes, may use the maximum death benefit exclusion ($5,000) in computing the amount of the distribution that is subject to withholding. See also, in this respect, question c–3.

a–29. Q. What is the appropriate treatment of a distribution (whether periodic or nonperiodic) that includes employer securities?

A. Employer securities are significant in the calculation of amounts subject to withholding in two respects. First, the maximum amount to be withheld cannot exceed the sum of the amount of money plus the fair market value of property received, *except* employer securities. In other words, a payor will not be forced to dispose of employer securities in order to meet withholding tax liability. Thus, for example, if an individual receives a distribution from a stock bonus plan that includes $1,000 worth of employer stock and $5 in cash for payment of fractional shares of stock, all of the cash, but none of the stock, may be retained by the payor to satisfy the withholding obligation. Second, under certain circumstances, the net unrealized appreciation in employer securities is not includible in gross income. See, in this respect, the rules of sections 402(a)(1) and 402(e)(4)(J).

a–30. Q. Is it reasonable to believe that all net unrealized appreciation from employer securities is not includible in gross income in the case of a qualified total distribution?

A. Yes. Although a qualified total distribution may include a distribution that is not a lump sum distribution, it is reasonable to believe that all net unrealized appreciation from employer securities is not includible in gross income.

a–31. Q. Is it reasonable to believe that a distribution is not includible in gross income if the distribution consists of employee contributions from a plan described in section 401(a) and the amount distributed is not specifically designated as accumulated deductible employee contributions?

A. Yes. Employee contributions to a plan described in section 401(a) are not deductible from gross income when contributed unless they are deductible employee contributions under section 72(o)(5). Unless the payor has specific knowledge that employee contributions distributed from a plan described in section 401(a) are accumulated deductible employee contributions, it is reasonable to assume that the amounts are excludible from gross income in the year when received.

a–32. Q. In the case of disability payments paid under a noncontributory plan to a disability retiree who has not attained age 65, is it reasonable to believe that all amounts paid to the payee are includible in gross income?

A. Yes. Whether or not all or part of the disability payments paid under a noncontributory plan to a permanently disabled retiree who has not attained age 65 are includible in gross income depends on the adjusted gross income of the taxpayer and on whether the taxpayer is permanently and totally disabled. In this situation, it is reasonable for the payor to assume that all amounts paid to the payee are includible in gross income unless the payor has specific independent knowledge that all or part of the periodic payments are not includible in gross income. Additionally, if the payee notifies the payor of the amount excludible from gross income, the payor must compute the taxable portion of the payment based on information provided by the payee.

a–33. Q. In the case of a periodic payment, is it reasonable to believe that all amounts paid to the payee are includible in gross income?

A. Yes. As an alternative to the general rule that a designated distribution does not include amounts which it is reasonable to believe are not includible in gross income, the payor of any periodic payment may assume that the entire amount of the payment is includible in gross income. The wage withholding tables must be used without adjustment for the fact that Federal income tax is being withheld on the gross amount. If the payor uses this alternative method of calculating the amount of the designated distribution, he must include with the notice of the election not to have withholding apply the following additional statements:

(1) Tax will be withheld on the gross amount of the payment even though the payee may be receiving amounts that are not subject to withholding because they are excludible from gross income;

(2) This withholding procedure may result in excess withholding on the payment; and

(3) The payee may adjust the allowances claimed on the withholding certificate if he wants a lesser amount withheld from each payment or he may provide the payor with the information necessary to calculate the taxable portion of each payment.

This alternative will not apply to periodic payments made after the earlier of December 31, 1983, or the date on which the plan administrator supplies the payor with the information necessary to calculate the taxable portion of the distribution.

See, also, questions e–3, e–4, and e–5.

a–34. Q. May the payor rely on a plan administrator's computation of the amount to be withheld?

A. Yes. Although the plan administrator is not required to compute the amount to be withheld in order to transfer liability for withholding to the payor, the plan administrator may provide such information to the payor, and the payor may rely on such computations unless the payor knows or has reason to know that the computations are incorrect.

a–35. Q. Under the plans of certain States, individuals may receive payments from more than one retirement system, such as payments from the state's teacher's retirement plan and from the state's regular retirement plan. Must these payments be aggregated for purposes of providing a single notice and election to a payee or for purposes of determining whether the floor on withholding tax (i.e., $5,400 for a married individual claiming three allowances) has been reached?

A. No. However, if it is feasible to aggregate payments under more than one retirement system, the payor is permitted to do so for these purposes.

a–36. Q. If a payment is made by one check to more than one beneficiary, such as a surviving spouse and a minor child, how is the amount to be withheld computed?

A. The payor may compute the withholding on a payment made by one check to more than one beneficiary as if the payment were made to only one beneficiary. In this case, the payor must base withholding for the total amount of the designated distribution on the withholding certificate of the payee to whom the election was sent.

Alternatively, if each payee files a withholding certificate and the payor knows the amount of the payment of which each payee is entitled, the payor may determine the amount to be withheld with respect to each payee. If the payor does not know the amount of the payment to which each payee is entitled, he may treat the payment as being made pro-rata to each payee. If only one withholding certificate is received, the payor must base withholding for the total amount of the designated distribution on the withholding certificate of one of the payees, such as the surviving spouse's certificate. Thus, if notice of the election not to have withholding apply is supplied to each payee at the times required in section 3405(c) (10) and only one payee makes the election or files a certificate, the payor must assume that the election or filing was made by the payee on behalf of the other payees.

a–37. Q. If a payor makes an error in computing the amount of a designated distribution that is subject to withholding, must the payor make a retroactive correction of the error?

A. No, provided the error was a reasonable one. Thus, if a payor either underwithholds or overwithholds because the amount of the designated distribution (*i.e.*, the taxable portion of the payment) was incorrectly calculated, no retroactive make-up is required if one of the following applies: (1) The payor reasonably relied on information furnished by the plan administrator (including the computation of the amount to be withheld), (2) the payor relied on a payee's representations on the withholding certificate, (3) the payor reasonably relied on the rules of this regulation, or (4) the payor made a mathematical error in computations. However, if the amount of the designated distribution is correctly computed, but the payor makes an error in applying the withholding

tables, the normal rules concerning failure to withhold and pay the tax will apply.

B. WITHHOLDING ON PERIODIC PAYMENTS

b–1. Q. Is the payor of periodic payments required to aggregate such payments with a payee's compensation to determine the amount of tax to be withheld under section 3405(a)(1)?

A. No. Although the payor must withhold from any periodic payment the amount that has to be withheld if the payment were a payment of wages by an employer to an employee for a payroll period, the amount to be withheld under section 3405(a)(1) is calculated separately of any amounts that actually are wages to the payee for the same period.

b–2. Q. Can either the percentage method (section 3402(b)) or the wage bracket method (section 3402(c)) be used to determine the withholding liability on a periodic payment?

A. Yes. Withholding on a periodic payment is accomplished by treating the payment as if it were wages. Therefore, unless the employee has elected not to have withholding apply, any method of withholding that is an appropriate method for withholding on wages is also an appropriate method for withholding on periodic payments. Refer to the Employer's Tax Guide (Circular E) and Publication 493, Alternative Tax Withholding Methods and Tables for the general procedures on withholding, deposit, payment, and reporting of Federal income tax withheld. Note, however, that any specific procedures contained in this regulation take precedence over any contrary rules in Circular E and Publication 493.

b–3. Q. Do rules similar to those for wage withholding applly to the filing of a withholding certificate for periodic payments?

A. Yes. Unless the rules of section 3405 specifically conflict with the rules of section 3402, the rules for withholding on periodic payments will parallel the rules for wage withholding. Thus, if a withholding certificate is filed by a payee, it will generally take effect as provided in section 3402(f)(3) for certificates filed to replace existing certificates. If a withholding certificate is furnished by a payee on or before the date on which payments commence, it takes effect with respect to payments made more than 30 days after the certificate is furnished, unless the payor elects to make it effective at an earlier date. If a withholding certificate is furnished by a payee after the date on which payments commence, it takes effect with respect to payments made on or after the status determination date (January 1, May 1, July 1, or October 1) that is at least 30 days after the date the certificate is filed, unless the payor elects to make it effective at an earlier date. If no withholding certificate is filed, the amount withheld is determined as if the payee were a married person claiming three withholding allowances.

b–4. Q. If no withholding certificate has been filed and the payor is aware that the payee is single, is it still appropriate to base withholding on a married individual claiming three allowances?

A. Yes. If no withholding certificate is filed, the payor is not required or permitted to base withholding on the amount of allowances the payee actually is entitled to claim. Thus, the payor must base withholding on the rates for a married person with three withholding allowances.

b–5. Q. May a payor determine whether payments to an individual are subject to withholding based on the amount of the first periodic payment for the year?

A. No. Periodic payments can vary during a calendar year because of make-up of past due payments, variable rates of payments, or cost-of-living adjustments, so that withholding based on the first payment within a year may be an inaccurate measure of withholding on total payments for the year. Therefore, the amount to be withheld is determined each payment period in the same manner as applies to withholding on wages. See, in this respect, Circular E and the regulations under section 3402.

b–6. Q. If a payment period is specified as by the terms of a commercial annuity contract, must this period be used as the appropriate period for determining the amount to be withheld?

A. Yes. Similarly, if the payment period is designated in a plan administrator's report or on an individual retirement account payout schedule agreed

to by payor and payee, this period must be used as the appropriate payment period.

b–7. Q. If the payor received no report from the plan administrator or beneficiary concerning the payment period, but knows the frequency of payments, can the known frequency be used as the appropriate payment period?

A. Yes. However, if no report is received and the payor has no knowledge of the frequency of payments, then he must treat the distribution as a nonperiodic distribution. Therefore, a distribution cannot be a periodic payment unless the frequency of payments is known. See, in this respect, questions b–8 and c–2. For rules concerning the plan administrator's failure to provide this information, see questions e–2 and e–3.

b–8. Q. If a payee receives a one-time payment that is a make-up payment resulting from an insurance company's incorrect calculation of a monthly annuity amount, is the one-time payment part of a series of periodic payments?

A. Yes. Because the one-time payment is a catch-up of prior amounts due as periodic payments, it is treated as part of a series of periodic payments. These payments are treated for withholding purposes in a manner similar to the treatment of supplemental wage payments in §31.3402(g)–1 of the Employment Tax Regulations.

C. WITHHOLDING ON NONPERIODIC DISTRIBUTIONS

c–1. Q. Must an individual receive a lump-sum distribution within the meaning of section 402(e)(4) to have a qualified total distribution?

A. No. A ''qualified total distribution'' is any distribution that (i) is a designated distribution, (ii) is reasonable to believe is made within one taxable year of the recipient, (iii) is made under a plan described in section 401(a) or 403(a), and (iv) consists of the balance to the credit of the employee under such plan. Thus, a distribution from a plan described in section 401(a) that does not meet the requirements (such as the minimum 5-year period of participation in section 402(e)(4)(H)) for a lump sum distribution within the meaning of section 402(e)(4) may still be a qualified total distribution for purposes of withholding.

c–2. Q. If a class year plan permits annual withdrawal of participants' vested amounts, are these withdrawals considered periodic payments?

A. No. A class year plan is a plan under which amounts contributed by an employer for a year become vested a number of years (*e.g.*, five years) after the year in which the amounts are contributed. Generally, class year plans permit withdrawals each year of amounts that have vested during the year. However, these distributions are not made with respect to an established frequency of payments, so the withdrawals must be treated as nonperiodic distributions, subject to withholding at the 10 percent rate.

c–3. Q. If a beneficiary receives the balance to the credit of a payee from an annuity contract on account of the payee's death, is this final payment a nonperiodic distribution?

A. Yes. The lump sum death benefit in this situation is a one-time payment that cannot be characterized as a periodic payment. The payment may be a qualified total distribution if the requirements of section 3405(c)(4) are satisfied, but otherwise it will be treated as a nonperiodic distribution other than a qualified total distribution.

c–4. Q. Is it permissible to assume that an individual is a calendar year taxpayer for purposes of determining whether a distribution is a ''qualified total distribution?''

A. Yes, unless the payor or plan administrator has reason to believe that the payee is not a calendar year taxpayer. The payor or plan administrator has reason to believe that the payee is not a calendar year taxpayer if the payee tells the payor or plan administrator that he is not a calendar year taxpayer.

c–5. Q. Is a distribution of accumulated deductible employee contributions with earnings that is paid on account of an employee's separation from service treated as a qualified total distribution?

A. Yes. As long as the other requirements for a qualified total distribution are met, a distribution of accumulated deductible employee contributions

with earnings is eligible for withholding at the rate applicable to qualified total distributions even though the distribution could never be a lump sum distribution. Because accumulated deductible employee contributions are treated separately in determining whether a distribution is a qualified total distribution, the answer would be the same even if the recipient received none (or a portion) of the vested employer contributions in his account.

c–6. Q. What is meant by the ''balance to the credit'' of an employee under a plan described in section 401(a) or 403(a)?

A. In general, the balance to the credit of an employee includes any amount credited to the employee under the plan on the date the distribution commences. The balance to the credit of an employee includes an amount credited after the date the distribution commences if it is attributable to services performed before that date or is attributable to earnings on an amount credited to the employee before that date. Additionally, the balance to the credit of an employee includes any amount payable as an annuity with respect to the employee under the plan. Amounts that have been placed in a separate account for the funding of medical benefits under section 401(h) or amounts that are forfeitable under the plan are not included in the balance to the credit of an employee. Finally, accumulated deductible employee contributions (within the meaning of section 72(o)(5)(B)) are not included in the balance to the credit of an employee for the purposes of determining whether a distribution is a ''qualified total distribution.''

c–7. Q. Can a payor rely on a plan administrator's report in determining whether a distribution consists of the balance to the credit of an employee under a plan?

A. Yes. If the plan administrator does not inform the payor that the distribution consists of the balance to the credit of the employee, the payor may not assume that the distribution is a qualified total distribution and must treat the distribution as a nonperiodic distribution that is not a qualified total distribution. However, the payor may rely on the payee's representations that a distribution does consist of the balance to the credit of the employee under the plan.

c–8. Q. What table must be used to calculate the amount to be withheld from a ''qualified total distribution?''

A. The table to be used for withholding on ''qualified total distributions'' will be published by the Secretary in the near future.

D. NOTICE AND ELECTION PROCEDURES

d–1. Q. May a payee elect not to have Federal income tax withheld from a designated distribution?

A. Yes. Withholding is not required on any periodic payment or nonperiodic distribution if the payee elects not to have withholding apply. If the payee makes this election, it is effective until revoked. The payor is required to provide each payee with notice of the right to elect not to have withholding apply and of the right to revoke the election.

d–2. Q. In the case of a designated distribution made on account of the death of an employee, who makes the election not to have withholding apply?

A. The election may be made by the beneficiary of plan benefits specified by the decedent in accordance with plan procedures or, if there is no designated beneficiary, by the beneficiary specified under the terms of the plan. If there is not a designated beneficiary and the terms of the plan do not specify a beneficiary, then the election may be made by the executor or the personal representative of the decedent.

d–3. Q. Who is required to provide notice to the payee of the payee's right not to have withholding apply?

A. Section 3405(d)(10)(B) requires the payor to provide notice to the payee of the payee's right to elect not to have withholding apply. Thus, even if the plan administrator has failed to transfer liability for withholding to the payor, the payor must provide notice to the payees.

d–4. Q. When must notice of the right to elect not to have withholding apply be given for periodic payments?

A. In the case of periodic payments, notice of the election must be provided not earlier than six months before the first payment and not later than when making the first payment. However,

even if notice is provided at a date before the first payment,notice must also be given when making the first payment. Thereafter, notice must be provided at least once each calendar year of the right to make the election and to revoke the election.

d–5. Q. Must notice of the right to elect not to have withholding apply be provided to those payees whose annual payments are less than $5,400?

A. Yes. However, under the statute, notice is only required to be provided when making the first payment. Therefore, a payor may provide notice to a payee with annual payments less than $5,400 by indicating to the payee when making the first payment that no Federal income tax will be withheld unless the payee chooses to have withholding apply by filing a withholding certificate, if the payor also provides information concerning where a withholding certificate may be obtained.

d–6. Q. Must notice of the right to elect not to have withholding apply be provided in the same manner to all payees?

A. No. If the payor provides notice to all payees when making the first payment, the payor may, in addition, provide earlier notice as provided in section 3405(d)(10)(B)(i)(I) to selected groups of payees, such as those payees whose annual payments are over $5,400.

d–7. Q. Must notice be attached to the first payment to satisfy the requirement that notice be provided ''when making'' the first payment?

A. No. Because many payees utilize electronic funds transfer to deposit their pension or annuity checks, notice does not have to be attached physically to the check.

d–8. Q. If a payee utilizes electronic funds transfer and notice is mailed directly to the payee at the same time the check is issued, is the notice requirement satisfied even though the payee receives the notice fifteen days after the check is deposited?

A. Yes. Although it is desirable that the notice reach the payee immediately prior to or concurrent with receipt of the check, the notice requirement is deemed to be satisfied if the payee receives the notice within 15 days before or after receipt of the first payment.

d–9. Q. When is the payor required to notify the payee of his right to elect not to have withholding apply to a nonperiodic distribution?

A. Section 3405(d)(10)(B)(ii) requires that notice must be provided to the payee at the time of a nonperiodic distribution. Since notice provided at the time of the distribution could result in delay of receipt of the benefit check if the payee elects out of withholding, notice for nonperiodic distributions should be given not earlier than six months prior to the distribution and not later than the time that will give the payee reasonable time to elect not to have withholding apply and to reply to the payor with the election information. What is reasonable time depends upon the facts and circumstances of each case.

d–10. Q. What is a ''reasonable time'' for notice with respect to a nonperiodic distribution from a qualified plan?

A. The ''reasonable time'' requirement is satisfied with respect to a nonperiodic distribution if the notice is included in the basic claim for benefits application that is provided to the participant by the plan administrator.

d–11. Q. If the payor of a periodic payment provides notice of the election not to have withholding apply within the time specified by section 3405(d)(10)(B)(i)(I), may the payor specify a time prior to distribution by which the election must be made?

A. Yes. The election not to have withholding apply is generally given effect as provided in section 3402(f)(3) for a certificate filed to replace an existing certificate. However, the payor may require that the election is made up to 30 days before the first payment to be effective for the first payment. See question b–3.

d–12. Q. If the payor of a nonperiodic distribution provides notice of the election not to have withholding apply within a reasonable time prior to the distribution, may the payor specify a time prior to distribution by which the election must be made?

A. No. The payee has the right to make or revoke an election at any time prior to the distribution. Therefore, the payor may place a deadline on the

time to elect without delaying payment of the distribution, but must accept any election or revocation made up to the time of distribution.

d–13. Q. What is a ''reasonable time'' for notice with respect to a distribution from an individual retirement account?

A. A payor may provide notice of the election not to have withholding apply at the time the beneficiary requests a withdrawal from his individual retirement account. This rule also applies to distributions from bank sponsored prototype plans and other plans that permit withdrawals on request.

d–14. Q. If notice is provided to a payee prior to the first payment of a periodic payment, why must it also be provided at the time of the first payment or distribution?

A. Section 3405(d)(10)(B)(i)(II) of the Internal Revenue Code requires such notice. In addition, because the payee has the right to make an election or to revoke a prior election at any time prior to the beginning of the payment period, notice must be provided when making the first payment in order to offer the payee ample opportunity to make or revoke an election not to have withholding apply even if the election will not be effective until later payments.

d–15. Q. If a payee who has been receiving periodic payments is rehired by the same employer, has his benefits suspended, and then recommences receiving periodic payments, must notice again be provided to the payee?

A. Yes. Upon recommencement of benefits, the first payment thereafter is treated as the first payment for purposes of the notice requirements.

d–16. Q. Must a payor provide notice if it is reasonable to believe that the entire amount payable is excludible from the payee's gross income?

A. No. Amounts which it is reasonable to believe are not includible in gross income are not designated distributions. Therefore, no notice is required of the ability to elect not to have withholding apply.

d–17. Q. If the payor of a periodic payment under a qualified plan knows that an employee's investment in an annuity contract will be recovered within three years, must he provide notice of the right to elect out of withholding at the time the first payment is made?

A. No. The first payment is not a designated distribution, and, therefore, is not a periodic payment subject to the notice requirements of section 3405(d)(10)(B)(i). There is no withholding obligation until the employee's investment in the contract is recovered because those amounts that equal the investment in the contract are not includible in gross income and, therefore, are not designated distributions. Therefore, the first payment after the employee's investment in the contract is recouped is the first payment for purposes of the notice requirements.

d–18. Q. What information concerning the election not to have withholding apply must be provided by the payor to the payee?

A. Notice to a payee must contain the following information:

(1) Notice of the payee's right to elect not to have withholding apply to any payment or distribution and how to make that election,

(2) Notice of the payee's right to revoke such an election at any time and a statement that the election remains effective until revoked,

(3) A statement to advise payees that penalties may be incurred under the estimated tax payment rules if the payments of estimated tax are not adequate and sufficient tax is not withheld from the payment or distribution.

In the event that the payor does not know what part of a distribution is includible in gross income and treats these payments as provided in question a–33, the following additional statements must be included with the notice:

(1) Tax will be withheld on the gross amount of the payment even though the payee may be receiving amounts that are not subject to withholding because they are excludible from gross income,

(2) This withholding procedure may result in excess withholding on the payment, and

(3) The payee may adjust his allowances claimed on the withholding certificate if he wants a lesser amount withheld from each payment or he may provide the payor with the information

necessary to calculate the taxable portion of each payment.

d–19. Q. Is there any information that, although not required, it is desirable to include in the notice to payees?

A. It is desirable to include a statement in the notice to payees that the election not to have withholding apply is prospective only and that any election made after a payment or distribution to the payee is not an election with respect to that payment or distribution.

d–20. Q. May the plan administrator provide the notice to payees on behalf of the payor?

A. The plan administrator may provide notice on behalf of the payor. However, the payor has sole responsibility for providing this notice whether or not the plan administrator has shifted liability for withholding to the payor, and if the plan administrator fails to provide adequate notice, the payor is responsible.

d-21. Q. Is there a sample notice that can be used to satisfy the notice requirement for periodic payments?

A. Yes. Any payor who uses the following sample notice is deemed to satisfy the notice requirement if notice is timely provided:

Notice of Withholding on Periodic Payments

Beginning on January 1, 1983, the [pension] OR [annuity] payments you receive from the [insert name of plan or company] will be subject to Federal income tax withholding unless you elect not to have withholding apply. Withholding will only apply to the portion of your [pension] OR [annuity] payment that is already included in your income subject to Federal income tax and will be like wage withholding. Thus, there will be no withholding on the return of your own nondeductible contributions to the [plan] OR [contract].

You may elect not to have withholding apply to your [pension] OR [annuity] payments by returning the signed and dated election [manner may be specified] to [insert name and address]. Your election will remain in effect until you revoke it. You may revoke your election at any time by returning the signed and dated revocation to [insert appropriate name or address]. Any election or revocation will be effective no later than the January 1, May 1, July 1, or October 1 after it is received, so long as it is received at least 30 days before that date. You may make and revoke elections not to have withholding apply as often as you wish. Additional elections may be obtained from [insert name and address].

If you do not return the election by [insert date], Federal income tax will be withheld from the taxable portion of your [pension] OR [annuity] payments as if you were a married individual claiming three withholding allowances. As a result, no Federal income tax will be withheld if the taxable portion of your annual [pension] OR [annuity] payments are less than $5,400.

If you elect not to have withholding apply to your [pension] OR [annuity] payments, or if you do not have enough Federal income tax withheld from your [pension] OR [annuity] payments, you may be responsible for payment of estimated tax. You may incur penalties under the estimated tax rules if your withholding and estimated tax payments are not sufficient.

d–22. Q. Is there sample language that may be used to elect not to have withholding apply or to revoke a prior election not to have withholding apply?

A. Yes. A payee may elect not to have withholding apply or revoke a prior election in any manner that clearly shows the payee's intent. The following language would suffice:

Election for Recipients of Periodic Payments

Instructions: Check Box A if you do not want any Federal income tax withheld from your [pension] OR [annuity]. Check Box B to revoke an election not to have withholding apply. Return the signed and dated election to [insert name and address].

Even if you elect not to have Federal income tax withheld, you are liable for payment of Federal income tax on the taxable portion of your [pension] OR [annuity]. You also may be subject to tax penalties under the estimated tax payment rules if your payments of estimated tax and withholding, if any, are not adequate.

A ☐ I do not want to have Federal income tax withheld from my [pension] OR [annuity].

B ☐ I want to have Federal income tax withheld from my [pension] OR [annuity].

Signed: _____
(Name)

Date: _____

Return your completed election to: [insert name and address]

d–23. Q. May the payee's election be combined with a withholding certificate?

A. Yes. The payor may provide a single statement for the payee to fill out and return that would enable the payee to elect not to have withholding apply

or to revoke a previous election and, at the same time, would enable the payee to claim the number of withholding allowances and, also, the dollar amount the payee wants withheld.

d–24. Q. Will a notice mailed to the last known address of the payee fulfill the notice requirement of section 3405(d)(10)(B)?

A. Yes.

d–25. Q. Is there a sample notice that can be used to satisfy the notice requirement for nonperiodic distribution?

A. Yes. Any payor who uses the following sample notice is deemed to satisfy the notice requirement if notice is timely provided:

Notice of Withholding on Distributions or Withdrawals From Annuities, IRA's, Pension, Profit Sharing, Stock Bonus, and Other Deferred Compensation Plans

The [distributions] OR [withdrawals] you receive from the [insert name of plan or company] are subject to Federal income tax withholding unless you elect not to have withholding apply. Withholding will only apply to the portion of your [distribution] OR [withdrawal] that is included in your income subject to Federal income tax. Thus, for example, there will be no withholding on the return of your own nondeductible contributions to the [plan] OR [contract].

You may elect not to have withholding apply to your [distribution] OR [withdrawal] payments by signing and dating the attached election and returning it [manner may be specified] to [insert name and address].

If you do not return the election by [insert date] receipt of your payments may be delayed. If you do not respond by the date your [distribution] OR [withdrawal] is scheduled to begin, Federal income tax will be withheld from the taxable portion of your [distribution] OR [withdrawal]. [Insert information on rates if desired].

If you elect not to have withholding apply to your [distribution] OR [withdrawal] payments, or if you do not have enough Federal income tax withheld from your [distribution] OR [withdrawal], you may be responsible for payment of estimated tax. You may incur penalties under the estimated tax rules if your withholding and estimated tax payments are not sufficient.

d–26. Q. Is there sample language that may be used for payees of nonperiodic distributions to elect not to have withholding apply?

A. Yes. A payee of a nonperiodic distribution may elect not to have withholding apply in any manner that clearly shows the payee's intent. The following language would suffice:

Election For Payees of Nonperiodic Payments

Instructions: If you do not want any Federal income tax withheld from your [distribution] OR [withdrawal], sign and date this election and return it to [insert name and address].

Even if you elect not to have Federal income tax withheld, you are liable for payment of Federal income tax on the taxable portion of your [distribution] OR [withdrawal]. You also may be subject to tax penalties under the estimated tax payment rules if your payments of estimated tax and withholding, if any, are not adequate.

I do not want to have Federal income tax withheld from my [distribution] OR [withdrawal].

Signed: _____
(Name)

Date: _____

Return your completed election to: [insert name and address]

d–27. Q. If the payor provides notice prior to making the first payment, can an abbreviated notice be used to satisfy the notice requirement of section 3405(d)(10)(B)(i)(II)?

A. Yes. It is permissible to provide with the payment a statement that the payee has the right to elect out of withholding. For example, the following sample notice could be used to satisfy the notice requirement if the payor has provided notice previously:

If Federal income taxes have been withheld from the [pension] OR [annuity] payments you are receiving and if you do not wish to have taxes withheld, you should notify [insert name and address]. However, if you elect not to have withholding apply to your [pension] OR [annuity] payments, or if you do not have enough Federal income tax withheld from your [pension] OR [annuity] payment, you may be responsible for payment of estimated tax. You may incur penalties under the estimated tax rules if your withholding and estimated tax payments are not sufficient.

If Federal income taxes are not being withheld from your [pension] OR [annuity] payment because you have elected not to have withholding apply and if you wish to revoke that election and have Federal income taxes withheld from your [pension] OR [annuity]

payments, you should notify [insert name and address].

d–28. Q. Must an employee who receives a distribution from a plan described in section 401(a) that includes amounts attributable to employer contributions and to accumulated deductible employee contributions make two elections not to have withholding apply?

A. No. Although accumulated deductible employee contributions are treated separately in determining whether a distribution is a qualified total distribution, an employee needs to make only one election not to have withholding apply to any distributions occurring at the same time from or under the same plan. However, the plan administrator could require the employee to make separate elections with respect to the distributions.

d–29. Q. If the administrator of a plan described in section 401(a) makes a qualified total distribution to an employee out of funds contained in two or more trusts, must the employee make a separate election not to have withholding apply with respect to the distribution from each trust?

A. No. The fact that a plan may use several trusts does not eliminate treatment of the distribution as a single qualified total distribution for which only one election is necessary.

d–30. Q. Is it permissible to provide notice to persons already in pay status on January 1, 1983, in a newsletter of the plan administrator?

a. Yes, provided that this notice is received by the payee within 15 days of the payee's receipt of the first periodic payment after December 31, 1982, and such notice provides the means to make an election and instructions for electing not to have withholding apply. It is desirable that payees be afforded the maximum opportunity to make the election provided by section 3405(a)(2). Payors are encouraged to give payees notice of their election opportunities at least 30 days before the first periodic payment after December 31, 1982.

d–31. Q. Is it permissible to provide the annual notice required by section 3405(d)(10)(B)(i)(III) on January 1, 1984, December 31, 1985, and January 1, 1986?

A. No. The annual notice required by section 3405(d)(10)(B)(i)(III) should be provided at approximately the same time each calendar year.

d–32. Q. Under what circumstances may an election made with respect to a nonperiodic distribution apply to subsequent distributions?

A. Generally, any election not to have withholding apply to a nonperiodic distribution may apply to any subsequent payment or distribution from or under the same plan or arrangement. However, the payor must still provide notice of the election and revocation procedures upon each subsequent distribution and must include the statement concerning liability for payment of estimated tax if the payee does not have withholding applied.

d–33. Q. How may a payee who intends to make a qualifying rollover (as defined in section 402(a)(5) or section 408(d)(3)) of a distribution elect not to have Federal income tax withheld from the distribution?

A. The payee may elect not to have withholding apply by making the election on the form provided by the payor. Alternatively, if the payee directs the payor to pay over the distribution to a qualified plan or an individual retirement account, the payor may treat this direction as an election not to have withholding apply.

d–34. Q. If a payee claims more than 14 withholding allowances on a withholding certificate, must the payor remit a copy of the withholding certificate to the Internal Revenue Service?

A. No. Because a payee may, at any time, elect out of withholding, the rules of § 31.3402(f)(2)–1(g) of the Employment Tax Regulations do not apply. Therefore, a payee may claim more than 14 allowances and the payor need not remit the withholding certificate to the Internal Revenue Service.

E. REPORTING AND RECORDKEEPING

e–1. Q. If designated distributions are made from or under a plan described in section 401(a), who has responsibility for making the returns and reports required by section 6047(e)?

A. Generally, the plan administrator, as defined in section 414(g), is responsible for maintaining the records and making the reports required by section 6047(e). However, if the plan administrator fails to keep the required records and make the required reports, the employer maintaining the plan is responsible for the reports and returns.

e–2. Q. How may a plan administrator of a plan described in section 401(a) or 403(a) transfer his duty to withhold to a payor?

A. A plan administrator of a plan described in section 401(a) or 403(a) may transfer the liability for withholding by (1) directing the payor in writing to withhold the tax and (2) providing the payor with any required information. This direction is presumed to remain in effect until the plan administrator revokes it in writing.

e–3. Q. What information must the plan administrator provide to the payor in order to transfer his liability for withholding?

A. The general rule is that the plan administrator must provide the payor with all information necessary to compute correctly the withholding tax liability. To satisfy this requirement, the plan administrator must explicitly inform the payor of the information that would be reportable on the Form W-2P or 1099R or that such information is not applicable to a particular payee or to any payments under the plan. For example, if the plan administrator is silent with respect to any employee contributions, he has not satisfied his reporting obligation even if there are no employee contributions to the plan. Thus, the plan administrator is expected to provide the payor with the following minimum information:

(1) The name, address, and social security number of the payee and the payee's spouse or other beneficiary if applicable,

(2) The existence and amount of any employee contributions,

(3) The amount of accumulated deductible employee contributions, if any,

(4) The payee's cost basis in any employer securities and the current fair market value of the securities,

(5) The existence and amount of any premiums paid for the current cost of life insurance that were previously includible in income,

(6) A statement of the reason (*e.g.*, death, disability, retirement) for the payment or distribution,

(7) The date on which payments commence and the amount and frequency of payments,

(8) The age of the payee and of the payee's spouse or designated beneficiary if applicable, and

(9) Any other information required by Form W–2P or 1099R.

If, prior to December 31, 1983, the plan administrator fails to provide the payor with the information required in items (2) through (5) the payor is liable for withholding. However, the payor may withhold on the payment as if all amounts are includible in gross income. See question a–33.

e–4. Q. If, after December 31, 1983, the plan administrator does not notify the payor of the amount of employee contributions with respect to one payee, has withholding liability shifted to the payor?

A. Yes. The plan administrator satisfies the requirements of question e–3 as to the information that must be supplied to the payor so long as the failure to provide the required information occurs on an infrequent basis or the plan administrator informs the payor in writing that he has made a good faith effort to supply all the required information but the amount of employee contributions as to a particular payee is unavailable.

e–5. Q. If, after December 31, 1983, the plan administrator fails to supply the payor with any information concerning the existence or amount of any employee contributions, has withholding liability shifted to the payor?

A. No. The plan administrator has not satisfied his reporting obligation as required in question e–3 as to employee contributions even if there are no employee contributions unless he affirmatively states that there are no employee contributions or states that the reporting of this item is not applicable in determining the payee's tax liability.

e–6. Q. Is it permissible to satisfy the requirements of section 6047(e) by maintaining records necessary to provide the information contained on Form W–2P and 1099R?

A. Section 6047(e) will be satisfied if, in addition to the information necessary to complete Forms W–2P and 1099R, the following information is maintained:

(1) Payee's date of birth (if known), and date of spouse's or designated

beneficiary's birth (if applicable and known);

(2) Plan administrator's name, address, and employer identification number (EIN);

(3) Plan's name and identification number and sponsor's name, address, and EIN; and

(4) Date on which payments commence and amount and frequency of payments.

e–7. Q. If the interim method of withholding on periodic payments (i.e., withholding on the gross amount) is used, must the employer, plan administrator, or issuer of any contract still maintain the information required by Form W–2P?

A. Yes. Even if this interim method is used, the recipient must be provided with the information that will enable him to determine his tax liability and adjust his claimed exemptions or claim a credit or refund.

e–8. What events trigger the reporting requirements of section 6047(e)?

A. Reporting is required any time there is a designated distribution to which section 3405 applies. Therefore, the old law rule that distributions of less than $600 per year do not require reporting no longer applies. Additionally, an exchange of insurance contracts under which any designated distribution (including a tax-free exchange under section 1035) may be made is a reportable event even though a designated distribution does not occur. To insure proper reporting when a designated distribution is made under the new contract, it is anticipated that the issuer of the contract to be exchanged will provide the information necessary to compute the amount to be withheld to the policyholder and to the issuer of the new contract.

e–9. Q. Will the reporting requirement be satisfied if Form W–2P or Form 1099R is filed?

A. Yes. In the absence of other forms or regulations, the reporting requirement is satisfied if Form W–2P or Form 1099R is filed with respect to each payee.

e–10. Q. How should the payor or plan administrator remit payments of amounts withheld under section 3405?

A. The payor or plan administrator must deposit the amount withheld under section 3405 with a Federal Reserve Bank or an authorized financial institution in accordance with the provisions of §31.6302(c)–1(a)(1)(i) of the Procedure and Administration Regulations, which provides the procedures for depositing employment taxes. For purposes of applying these procedures to amounts withheld under section 3405, the term ''taxes'' as defined in §31.6302(c)–1(a)(1)(iii) includes the income tax withheld under section 3405 with respect to designated distributions. A payor or plan administrator who remits these amounts in accordance with those rules must report the amounts deposited on the same Form 941 or 941E, whichever is appropriate, that he uses to report the employment taxes he had deposited under §31.6302(c)–1(a)(1)(i).

F. OTHER

f–1. Q. If a plan administrator or other payor distributes property other than cash to payees, is it permissible to use the value of the property as of the last preceding valuation date to determine the amount of Federal income tax that must be withheld from each distribution?

A. Yes. In many situations, the plan administrator or payor will not be able to determine the value of property to be distributed as of the date of distribution without delaying payment to the payee. In these cases, the plan administrator or payor may determine the value of the property to be distributed as of the last preceding valuation date prior to the date of distribution, as long as the valuation is made at least once each year. If the most recent valuation date occurred within the 90 days immediately preceding the date of distribution, the next most recent valuation date may be used.

f–2. Q. How is withholding accomplished if a payee receives only property other than employer securities?

A. A payor or plan administrator must satisfy the obligation to withhold on distributions of property other than employer securities even if this requires selling all or part of the property and distributing the cash remaining after Federal income tax is withheld. However, the payor or plan administrator may instead permit the payee to remit to the payor or plan administrator sufficient cash to satisfy

the withholding obligation. Additionally, if a distribution of property other than cash includes property that is not includible in a designated distribution, such as the distribution of U.S. Savings Bonds or an annuity contract, such property need not be sold or redeemed to meet any withholding obligation.

f–3. Q. If a designated distribution includes cash and property other than employer securities, is it permissible to satisfy the withholding obligation with respect to the entire distribution by using the cash distributed, provided the cash distributed is sufficient to satisfy the withholding obligation?

A. Yes, as long as there is sufficient cash to satisfy the withholding obligation for the entire distribution. There is no requirement that tax be withheld from each type of property in portion to its value.

f–4. Q. If a loan from a qualified plan is treated as a distribution under section 72(p), is the amount of the loan subject to withholding under section 3405?

A. Yes. If, and to the extent that, the loan is treated as a distribution when made, withholding is accomplished by withholding tax from the amount of the loan that is treated as a distribution. Thus, for example, if a loan of $12,000 that must be repaid within 5 years is made to a common law employee with a vested account balance of $5,000, $2,000 is treated as a distribution under section 72(p), and the payor or plan administrator must withhold tax from the $2,000.

f–5. Q. Is a loan that is treated as a distribution under section 72(p) a nonperiodic distribution other than a qualified total distribution?

A. Yes.

f–6. Q. Must a payor or plan administrator withhold tax on a nonperiodic distribution (including a qualified total distribution) if the amount of the distribution is less than $200?

A. No. However, all amounts received within one taxable year of the payee from the payor or plan administrator under the same plan or arrangement must be aggregated for purposes of determining whether the $200 floor is reached. If the payor or plan administrator does not know at the time a first payment of $200 or less is made whether there will be additional payments during the year for which aggregation is required, the payor or plan administrator need not withhold from the first payment. If distributions are made within one taxable year under more than one plan of an employer, the plan administrator or payor may, but need not, aggregate the distributions for purposes of determining whether the $200 floor is reached.

f–7. Q. If a nonperiodic distribution (including a qualified total distribution) to a payee will be less than $200, must the payor provide notice to the payee of the right to elect not to have withholding apply?

A. No.

f–8. Q. How is withholding accomplished if a qualified total distribution is paid in installments during one taxable year of the payee?

A. Withholding can be accomplished on a qualified total distribution that is paid in installments within one taxable year by either one of the following methods:

Under Option 1, the tax on the first installment is calculated under the qualified total distribution table. The tax on each subsequent installment is calculated by finding the tax under the table on the cumulative amount of the installments for the year and subtracting the amount of tax already withheld from the tax due with respect to the cumulative amount of the installments.

Under Option 2, the payor or plan administrator can withhold the tax on all installments except the final installment at a 10 percent rate. The tax on the final installment may be calculated by finding the tax under the qualified total distribution table on the cumulative amount of the installments for the year and subtracting the amount of tax already withheld from the installments. Option 2 may be used even if the amount of the tax that should be withheld from the final installment under the qualified total distribution tables exceeds the amount of the final installment. The plan administrator or payor will not be subject to penalties under section 6651 with respect to the difference between the tax that should have been withheld from

the final installment under the qualified total distribution tables and the amount of the final installment.

The effect of these alternatives is illustrated by the following example:

An individual receives within one taxable year the balance to his credit under a plan described in section 401(a) or 403(a). The balance to his credit is paid in three installments of $1,000, $10,000, and $60,000. The amount of tax to be withheld from the installments may be calculated under Option 1 or Option 2.

Option 1—Withholding on each installment computed by finding tax under qualified total distribution tables on the cumulative amount of the distribution and subtracting the tax already withheld.

I.:	
1. Amount of installment 1	$1,000
2. Withholding obligation on installment 1	50
II.:	
1. Amount of installments 1 and 2	11,000
2. Withholding obligation on installments 1 and 2	550
3. Withholding paid on installment 1	50
4. Withholding obligation on installment 2 (2 minus 3)	500
III.:	
1. Amount of installments 1, 2, and 3	71,000
2. Withholding obligation on installments 1, 2, and 3	9,580
3. Withholding paid on installments 1 and 2	550
4. Withholding obligation on installment 3 (2 minus 3)	9,030
Total withholding obligation	9,580

Option 2—Withholding computed by withholding at 10 percent rate for all but the final installment. Withholding on the final installment computed by finding tax under qualified total distribution table for the cumulative amount of the distribution and subtracting the amount of tax already withheld:

I.:	
1. Amount of installment 1	$1,000
2. Withholding obligation on installment 1	100
II.:	
1. Amount of installment 2	10,000
2. Withholding obligation on installment 2	1,000
III.:	
1. Amount of installments 1, 2, and 3	71,000
2. Withholding obligation on installments 1, 2, and 3	9,580
3. Withholding paid on installments 1 and 2	1,100
4. Withholding obligation on installment 3 (2 minus 3)	8,480
Total withholding obligation	9,580

f–9. Q. A plan described in section 401 (a) invests in life insurance contracts for its participants. Each year the current cost of the life insurance element (PS 58 cost) is taxable to the participants under section 72. Is withholding required on this amount even though there is no amount actually distributed to the participant?

A. No. Because the PS 58 costs are not distributed or deemed to be distributed, they are not designated distributions for which withholding is required.

f–10. Q. The plan administrator or payor of a plan described in section 401 (a) has been properly reporting distributions on a multiple contract basis for purposes of section 72. How should the plan administrator or payor determine the amount of each payment that is includible in gross income for withholding purposes?

A. In the absence of revenue rulings or regulations to the contrary, the plan administrator or payor of a plan that properly reports distributions on a multiple contract basis should use that method to determine the taxable portion of a payment for withholding purposes.

f–11. Q. The plan administrator or payor of a plan described in section 401 (a) has been reporting distributions on a multiple contract basis for purposes of section 72 and has properly switched to the single contract method for reporting distributions. How should the plan administrator or payor determine the amount of each payment that is includible in gross income for withholding purposes?

A. If a plan has properly switched from the multiple contract basis to the single contract basis for reporting distributions, the plan administrator or payor may assume that all amounts prior to the year of switch were reported by the payees on a multiple contract basis. Therefore, for example, in the case of an individual whose annuity payments have not commenced prior to the date of the switch to a single contract basis, the payee's investment in the contract can be assumed to have been recovered on a multiple contract basis prior to the year of the switch and on a single contract basis thereafter for purposes of determining the amount of each payment that is includible in gross income for withholding purposes. This rule applies even though payees may have amended their income tax returns for prior years to report all payments on a single contract basis.

f–12. Q. If a plan that makes payments subject to the withholding and notice requirements of section 3405 makes separate payments to the same individual as a retired participant and as a surviving spouse of a retired participant, must the two payments be aggregated for withholding purposes?

A. No, unless the payor wishes to aggregate them.

f–13. Q. An insurance company makes payments under certain variable annuity contracts. The Investment Company Act of 1940 (section 22(e)) applies to these variable annuity contracts and requires that the insurance company make a payout within 7 days after a payee requests a withdrawal from his contract. Under these circumstances, how may notice be provided to a payee of his right to elect out of withholding for a nonperiodic distribution?

A. In this situation, the insurance company has only seven days in which to notify a payee of his right to elect out of withholding. It is not feasible for the insurance company to secure an election in writing unless the payee supplies the written election at the time he requests a withdrawal. Therefore, the notice and election can be provided in the following manner: (1) The insurance company may mail a notice to a payee on the day the request for withdrawal is received and (2) the notice may specify that unless the payee calls the company at a toll-free telephone number supplied on the notice within seven days of the date the request was received, the company will withhold from the distribution. Notice provided in this manner is deemed to satisfy the ''reasonable time'' requirement of question d–9. Insurance companies that encounter this problem are encouraged to supply an election form to a payee at the time an annuity contract is purchased. If a payee supplies an election with the request for withdrawal, notice still must be given but the insurance company may honor the election received if no other communication is received after notice is provided to the payee.

f–14. Q. If an individual receives periodic payments from two or more plans of one member of a controlled group of corporations, separate periodic payments from two members of a controlled group of corporations out of one plan, or periodic payments from separate plans of two members of a controlled group, must the periodic payments be aggregated for withholding purposes?

A. No, unless the plan administrator or payor wishes to aggregate the payments. Section 414(b) does not require that plans of a controlled group of corporations be aggregated for withholding purposes. The same rule applies to a group of trades or businesses under common control or an affiliated service group described in section 414 (c) or (m).

f–15. Q. How is withholding appplied to a designated distribution from an individual retirement account (IRA) described in section 408(a) that is payable upon demand even though payments are scheduled to be made over a period certain greater than one year?

A. Distributions from IRAs that are payable upon demand are not periodic payments taxable under section 72 because they do not constitute annuity contracts within the meaning of section 408(d)(2). Therefore, designated distributions from an IRA that are payable upon demand are treated as nonperiodic distributions subject to withholding at the 10% rate even if the distributions are paid over a period certain.

f–16. Q. Under the rules of section 72, a portion of certain payments that may vary because of investment experience, cost of living indices, or similar criteria is treated as not received as an annuity. For withholding purposes, must these amounts be treated as nonperiodic distributions even though part of each payment is a periodic payment?

A. No. For withholding purposes, amounts will be considered periodic payments even though a portion of each payment is treated as an amount not received as an annuity under §1.72–2(b)(3) of the Income Tax Regulations.

f–17. Q. Is the payor of distributions under a funded nonqualified deferred compensation plan that are payable as an annuity and taxable under section 72 required to withhold under section 3405?

A. Yes. Section 31.3401(a)–1(b)(1)(i) of the Employment Tax Regulations provides that any amounts received as an annuity and taxable under section 72

are excepted from the general definition of wages. Therefore, to the extent that section 402(b) requires that distributions from nonqualified plans which are received as an annuity are taxable under the rules of section 72, section 3405 will apply. See, however, question a–18 for the rules relating to distributions from a nonqualified deferred compensation plan that are taxable under section 83. Therefore, whether the payor or plan administrator of a nonqualified plan is required to withhold under section 3402 or section 3405 depends upon what section of the Code governs the taxation of amounts contributed or distributed.

f–18. Q. Are amounts paid in connection with a partial or complete surrender or upon the maturity or endowment of a commercial annuity subject to the new withholding rules?

A. Yes. Amounts paid in connection with a partial or complete surrender or upon the maturity or endowment of a commercial annuity are subject to the new withholding rules to the extent that they are designated distributions. Thus, withholding is required on the complete or partial surrender of an annuity, life insurance or endowment contract to the extent they are designated distributions.

f–19. Q. Are amounts paid in connection with a partial surrender of a commercial annuity periodic payments?

A. Generally, no. Unless the amount paid in connection with the partial surrender is one of a series of payments payable over a period of greater than one year and taxable under section 72 as an amount received as an annuity, the amount paid is not a periodic payment.

f–20. Q. Are amounts paid in connection with a partial or complete surrender of an annuity contract subject to the new withholding rules?

A. Yes. Amounts paid in connection with a partial or complete surrender of an annuity contract are subject to the new withholding rules to the extent that they are designated distributions.

f–21. Q. Is it reasonable to believe that amounts distributed in connection with a commercial annuity that was acquired on or before August 13, 1982, or are otherwise described in section 72(e)(5), which are not treated as amounts received as an annuity under section 72, will not be includible in the gross income of the recipient?

A. Generally, yes. Under the rules of section 72(e) prior to the passage of TEFRA, amounts not received as an annuity were not taxable until the investment in the contract was recovered. Thus, for distributions that are not received as an annuity under a commercial annuity contract acquired on or before August 13, 1982, it is reasonable to believe that amounts distributed are not includible in the payee's gross income to the extent they represent unrecovered investment in the contract. The special transitional rule of question a–33, available for plan administrators, may be used until December 31, 1983, by payors of commercial annuities who lack records with regard to the payee's unrecovered investment in the contract.

f–22. Q. For commercial annuity contracts entered into after August 13, 1982, which are not described in section 72(e)(5), is it reasonable to believe that amounts distributed, which are not amounts received as an annuity under section 72, are not includible in gross income?

A. Generally, no. TEFRA amended section 72(e) to provide that amounts not received as an annuity will be includible in gross income until all earnings or other amounts that are not part of the investment in the contract have been distributed. Thus, it is not reasonable to believe that amounts distributed in connection with a commercial annuity contract entered into after August 13, 1982, are excludible from gross income until all earnings or other amounts that are not part of the investment in the contract have been distributed. This new rule does not apply to distributions from commercial annuities described in section 72(e)(5). Question f–21 provides the proper rule with respect to distributions from commercial annuities described in section 72(e)(5).

f–23. Q. Is it reasonable to believe that amounts involved solely in connection with an exchange of commercial annuities under section 1035 of the Code will not be includible in the gross income of the recipient?

A. Yes. Designated distributions include only amounts that it is reasonable to believe are includible in the gross income of the recipient. In the case of a commercial annuity exchange under section 1035 in which no cash or other property is exchanged, it is reasonable to believe that no portion is includible in the gross income of a recipient. An annuity exchange includes an exchange of annuity, endowment, or life insurance contracts issued by a life insurance company licensed to do business under the laws of any State. Thus, such exchanges are not subject to the withholding rules of section 3405. However, see question e–8 concerning recordkeeping requirements with respect to the nontaxable exchange of commercial annuity contracts under section 1035.

f–24. Q. Is it reasonable to believe that amounts distributed in connection with a surrender of a life insurance or endowment contract, or in connection with an exchange of life insurance or endowment contracts in which cash or other property is distributed, will not be includible in gross income?

A. Generally, no. Amounts distributed in connection with the surrender of a life insurance or endowment contract, or in connection with an exchange of life insurance or endowment contracts in which cash or other property is distributed are includible in income to the extent that the amount received exceeds the policyholder's investment in the contract. However, if a life insurance or endowment contract issued before August 13, 1982, is surrendered within ten years of the date of its issuance, or is exchanged within ten years of the date of its issuance, the payor may assume that no amounts are includible in the gross income of the policyholder if the cash or other property received by the policyholder in connection with the surrender or exchange of the life insurance or endowment contract does not exceed $10,000. If a life insurance or endowment contract issued before August 13, 1982, is surrendered or exchanged ten years or more after the date of its issuance, the payor may assume that no amounts are includible in the gross income of the policyholder if the cash or other property received by the policyholder in connection with the surrender or exchange of the life insurance or endowment contract does not exceed $5,000. If the payor utilizes the special rule in the two preceding sentences, the payor must notify the policyholder, at the time described in question d–4, that all or part of the amount distributed may be includible in the policyholder's gross income. See question f–23 for additional rules concerning certain exchanges of annuity contracts.

f–25. Q. Do the requirements of section 3405(d)(10), relating to the time at which notice must be provided, also apply to the time at which an election out of withholding may be made?

A. Generally, yes. For example, an individual may not at commencement of employment execute an election out of withholding to be honored by a plan administrator or payor when the individual terminates employment and receives a distribution from a deferred compensation plan. See, however, question f–13 for a special rule applicable to certain annuity contracts.

f–26. Q. If a payor provided notice prior to January 1, 1983, but failed to include all of the information required by question d–18, may the abbreviated notice of question d–27 be supplied when making the first payment?

A. Yes, as long as the abbreviated notice contains all of the information required by question d–18 that was not supplied with the earlier notice.

f–27. Q. When must notice of the right to elect not to have withholding apply be given as to designated distributions from an individual retirement account (IRA) described in section 408(a) that is payable on demand even though payments are scheduled to be made over a period greater than one year?

A. Under question f–15, designated distributions from an IRA that are payable upon demand are treated as nonperiodic distributions subject to withholding at the 10 percent rate even if the distributions are paid over a certain period. Section 3405(d)(10)(B)(i) requires the payor of a nonperiodic distribution to transmit to the payee notice, at the time of the distribution or at such earlier time as may be provided in regulations, of the right to elect not to have withholding apply. If distributions from an IRA have begun and are

scheduled to be made at quarterly or more frequent intervals, then, in lieu of providing a notice at the time of each distribution, the payor may furnish a blanket notice applicable to all such distributions that are expected to be made to the payee from the account during a calendar year. Such a blanket notice must be furnished at a reasonable time before the first payment made in the calendar year to which the notice relates, except that a blanket notice relating to distributions from an IRA during 1983 may be made by the later of October 1, 1983, or the date of the first designated distribution from the IRA.

G. DELAY PROCEDURES

g–1. Q. When does the new law take effect?

A. In general, withholding is required on any designated distributions made after December 31, 1982.

g–2. Q. Is there a penalty for failure to withhold under section 3405 on designated distributions made after December 31, 1982?

A. Yes. In general, section 6651 governs the failure to file a return and to withhold tax under section 3405.

g–3. Q. Are there any circumstances under which the withholding and notice requirements of section 3405 may be delayed to a date later than January 1, 1983?

A. Yes. The Secretary has authority to delay, but not beyond June 30, 1983, the application of these withholding provisions to any payor or plan administrator if the payor or plan administrator can establish that he is unable to comply with these provisions without undue hardship.

g–4. Q. Under what circumstances may a payor or plan administrator who is experiencing undue hardship in complying with section 3405 delay implementation of the notice and withholding requirements?

A. For those payors and plan administrators who experience undue hardship in complying with the provisions of section 3405, the withholding and notice requirements of section 3405 may be delayed so long as undue hardship exists up to July 1, 1983.

g–5. Q. Must approval be obtained from the Internal Revenue Service to be entitled to the delay referred to in question g–4 if the delay will be no later than April 1, 1983?

A. No. If a payor or plan administrator can establish that undue hardship would result if required to comply with the provisions of this section before April 1, 1983, prior approval from the Internal Revenue Service is not required and should not be requested. For purposes of this delay up to April 1, 1983, undue hardship will be presumed to exist, in the absence of bad faith, as long as the payor or plan administrator can establish that at least one of the conditions listed in question g–6 is present. The payor or plan administrator should prepare and retain a statement of undue hardship as described in question g–9 and should maintain any documents necessary to support the representations made in that statement.

g–6. Q. What constitutes undue hardship?

A. For purposes of these delay procedures, the term ''undue hardship'' generally means more than an inconvenience or increased costs to the payor or plan administrator. In the case of a payor or plan administrator who complies with the notice and withholding requirements of section 3405 on or before April 1, 1983, undue hardship will be presumed to exist if one or more of the following conditions is present:

(1) The payor or plan administrator encounters significant delay or other substantial difficulty in obtaining authorization for funds to develop forms, to mail notices, to process responses, to develop new computer programs, or to obtain and train personnel to implement withholding.

(2) The payor or plan administrator incurs substantial increases in unbudgeted costs to develop forms, to mail notices, to process responses, to develop new computer programs, or to obtain and train personnel.

(3) There is difficulty in obtaining trained personnel, including professional or semi-professional individuals, whose skills are necessary to implement withholding.

(4) Training new or present employees or hiring new employees to implement withholding would cause substantially increased costs or would disrupt

the payor's or plan administrator's operations, and such disruption or increased costs would not occur if withholding were implemented at a later date.

(5) Plan benefits change due to a collective bargaining agreement concluded between October 1, 1982, and April 1, 1983.

(6) A payor who provided notice prior to January 1, 1983, receives a substantial number of inquiries from payees. These inquiries indicate the payees' lack of understanding of the new withholding provisions and the payor cannot answer all questions and receive responses by January 1, 1983.

(7) The payor or plan administrator is unable to implement withholding on account of the occurrence of an event, such as fire, flood, earthquake, explosion, or strike, beyond the control of the payor or plan administrator.

(8) The payor or plan administrator is scheduled to install a new data processing hardware package or system between December 1, 1982, and July 1, 1983, that will be used for the process of pension withholding.

An examble of a circumstance not considered as resulting in undue hardship would be changes in the withholding tables effective July 1, 1983.

The following examples illustrate situations in which an undue hardship that will permit delay in implementation of the notice and withholding provisions exists:

Example 1. A is the payor and plan administrator of a deferred compensation plan that is the subject of a collective bargaining agreement. The collectively bargained plan has fewer than 100 participants receiving annuity payments. All of A's available budget is scheduled to be used to pay plan benefits and administrative costs, and no funds are available to implement the new withholding requirements. A must obtain authorization to expend funds to implement withholding. Meetings at which A can obtain such authorization are held August 1 and February 1 of each year. After obtaining authorization on February 1, 1983, A will need to develop and mail withholding notices and elections, process responses and determine the amount to be withheld from each payee's annuity payment. A can implement withholding on April 1, 1983, without substantially disrupting its operations, but earlier implementation would disrupt its normal operations. Under these facts, A experiences undue hardship until at least April 1, 1983, as a result of the circumstances described in items (1) and (4) of question g–6.

Example 2. B, a bank, is a payor of pensions and annuities under plans described in section 401(a). The plan administrators of all these plans have transferred liability to B for withholding under section 3405. After T.D. 7839, relating to withholding from pensions, annuities and other deferred income, was published in the Federal Register on October 14, 1982, B determines that the withholding provisions can be implemented before April 1, 1983, on a reasonaable schedule, without substantial increases in costs or disruption of daily bank operations, according to the following schedule:

(a) B's counsel analyzes regulations and reports requirements to operations personnel; operations personnel develop new Forms, which are reviewed and revised by management and legal personnel; new forms are printed; personnel begin reprogramming computers, 8 weeks (Dec 9, 1982).

(b) Forms distributed to branch offices, 1 week (Dec 16, 1982).

(c) Forms mailed to payees, 1 week (Dec 23, 1982).

(d) Time allowed for response to mailing of notices, answering questions, mailing follow-up notices to payees, 6 weeks (Feb 3, 1983).

(e) Withholding calculated and entered into payment system, 6 weeks (Mar 17, 1983).

Total: 22 weeks.

Implementation is scheduled to begin March 17, 1983. Implementation prior to March 17, 1983, would substantially increase costs and would disrupt B's operations.

Under these facts, B experiences undue hardship under item (4) of question g–6, up to March 17, 1983, the scheduled date of implementation.

g–7. Q. If a payor or plan administrator qualifies for the delay described in question g–5, is there a procedure for requesting an additional delay up to July 1, 1983?

A. Yes. However, any request made for this additional delay will be considered on a case-by-case basis. It is anticipated these requests will be carefully scrutinized and generally will be granted only in circumstances where the payor or plan administrator can reasonably expect that more than one of the conditions described in question g–6 will exist on or after April 1, 1983, and up to July 1, 1983.

g–8. Q. How may a payor or plan administrator request this additional delay of up to 3 months for undue hardship?

A. The payor or plan administrator may request an additional delay of up to 3 months by filing in duplicate a

written statement of undue hardship signed under penalties of perjury with the director of the service center where the payor or plan administrator files Form 941 or Form 941E. This written request must state on the envelope and at the top of the letter ''PENSION WITHHOLDING: Undue Hardship'' and must include all the information required in a statement of undue hardship as described in question g–9.

g–9. Q. What information must the statement of undue hardship include?

A. The statement of undue hardship must include the following information:

(1) The name, address, and taxpayer indentification number of the payor or plan administrator.

(2) A complete statement of the facts upon which the payor is relying to show why a delay beyond April 1, 1983, is warranted. This statement must include as many of the conditions of undue hardship listed in question g–6 as pertain to the payor or plan administrator.

(3) A schedule or plan of implementation showing dates on which the payor will implement the provisions of this section, with no date later than July 1, 1983. This schedule should provide a complete timetable that includes such items as development of forms, mailing of notices, time for responses, programming computers, and calculation of withholding.

(4) An explanation of the steps taken which demonstrate the payor's or plan administrator's good faith attempt to comply with these notice and withholding requirements.

g–10. Q. When must the plan administrator or payor file this request for delay and statement of undue hardship?

A. Payors or plan administrators must file the statement of undue hardship on or before March 1, 1983. However, no request for delay may be filed with the Internal Revenue Service before January 1, 1983.

g–11. Q. Who must request the delay?

A. The delay should be requested by the payor or plan administrator who is actually liable for withholding. Therefore, generally the payor should request the delay. However, in the case of a distribution from a plan described in section 401(a), section 403(a), or section 301(d) of the Tax Reduction Act of 1975, the plan administrator is liable for withholding and should request the delay unless the plan administrator has transferred liability for withholding to the payor under section 3405(c).

g–12. Q. If a plan administrator has not yet transferred liability for withholding under section 3405(c) or has inadequately transferred liability, and the payor requests a delay, will the request for delay be treated as if the plan administrator had requested it?

A. Yes.

g–13. Q. If a plan administrator and a payor both file requests for delay and statements of undue hardship with respect to the same plan, will there be two separate three-month extensions?

A. No. A request for delay will delay the effective date only up to three months and in no case will it extend it past July 1, 1983.

g–14. Q. What are the consequences for failure to file the request for delay and statement of undue hardship in a timely manner?

A. If the request for delay and statement of undue hardship are not filed in a timely manner, the payor or plan administrator will not be entitled to any delay beyond the delay to which he may be entitled under question g–5. This rule will not apply in the case of an event such as strike, fire, flood, earthquake, or explosion that occurs after March 1, 1983, if compliance with the withholding provisions would have been possible absent the occurrence of the event.

g–15. Q. Will a payor or plan administrator receive a response from the Internal Revenue Service as to whether a delay after April 1, 1983, has been granted?

A. Yes. Since these requests for delay will be reviewed on a case-by-case basis, the payor or plan administrator will receive a response by April 1, 1983, as to whether or not a requested delay has been granted. If the request for delay is denied by the director of the service center, the payor or plan administrator is required to begin withholding by the later of April 1, 1983, or 10 days from the date on the response.

No penalties will be imposed under section 6651 for failure to withhold between April 1, 1983, and the day 10 days from the date on the response.

g–16. Q. If the director of the service center grants a delay up to July 1, 1983, must the payor or plan administrator retain a copy of the response from the Internal Revenue Service?

A. Yes. In addition, the payor or plan administrator must attach a copy of the response to the first Form 941 or 941E filed after the response is received.

g–17. Q. If a plan administrator or payor begins withholding before April 1, 1983, or July 1, 1983, can the payee request a refund from the plan administrator or payor of the amounts withheld?

A. No. Because plan administrators and payors are required to comply with the withholding and notice requirements as soon as they no longer experience undue hardship, they cannot refund any amounts withheld to a payee, except as provided in the regulations under section 6413 (in the case of a mistake by the payor or plan administrator).

g–18. Q. If a payor or plan administrator properly files the statement of undue hardship and receives a delay as provided in question g–7, will withholding from payments made after the delay period be required to make up for amounts that would have been withheld if there had been no delay granted?

A. No. No catch-up withholding is required for plan administrators or payors who are entitled to a delay up to April 1, 1983, as provided in question g–5 or granted a delay up to July 1, 1983, as provided in question g–7. However, if a payor or plan administrator who is entitled to a delay up to April 1, 1983, as provided in question g–5, is not granted a delay up to July 1, 1983, but is unable to implement withholding until July 1, 1983, despite a good faith effort to comply, no penalties will be imposed under section 6651 if the payor or plan administrator withholds between July 1, 1983, and December 31, 1983, both the amounts required to be withheld during that period and the amounts that should have been withheld between April 1, 1983, and June 30, 1983.

g–19. Q. If a payor or plan administrator does not receive and is not otherwise entitled to a delay under these regulations, will withholding from future payments be required to make up for amounts that would have been withheld if there had been no delay?

A. Yes, to the extent possible. An example of a situation in which a payor or plan administrator would not be able to withhold enough from subsequent payments to satisfy pre-July 1, 1983, withholding obligations is one where the recipient of a single life annuity died on July 1, 1983, before the payor or plan administrator began to withhold income tax from the annuity. In addition, a payor or plan administrator would not be able to satisfy the pre-July 1, 1983, withholding requirements if the payee elects out of withholding before all of the make-up withholding has been accomplished.

g–20. Q. What are the consequences if the payor or plan administrator cannot establish undue hardship and does not comply on January 1, 1983?

A. In general, if the payor or plan administrator cannot establish undue hardship and fails to withhold beginning January 1, 1983, the payor or plan administrator will be liable for the tax that should have been withheld and, in addition, the penalties provided in section 6651 will apply. However, the payor or plan administrator will not be liable for penalties for failure to file a return and for failure to pay the tax if a good faith effort is made to comply, and if, to the extent possible, withholding from post-implementation payments is sufficient to satisfy the pre-implementation withholding obligation. Whether the payor or plan administrator has made a good faith effort to comply depends on the facts and circumstances of each case. The facts and circumstances that will be considered include, but are not limited to, those conditions listed in question g–6.

g–21. Q. If a payor or plan administrator is required to make up amounts that should have been withheld, must he withhold from the first subsequent payment the entire amount that should have been previously withheld?

A. No. A payor or plan administrator may withhold a proportional amount

out of each subsequent payment made before January 1, 1984.

g–22. Q. Will the notice requirements of section 3405 apply before July 1, 1983, with respect to recipients of periodic payments that total less than $5400 per year?

A. No.

g–23. Q. Will the notice and withholding requirements of section 3405 apply before July 1, 1983, with respect to payments to nonresident alien individuals?

A. No.

g–24. Q. Does a payor or plan administrator who requested a delay prior to the publication of these procedures in the FEDERAL REGISTER *need to resubmit the request in light of these procedures?*

A. Yes. In order to be entitled to a delay, payors and plan adminstrators must follow the procedures required by these temporary regulations.

g–25. Q. Will the notice and withholding requirements of section 3405 apply before January 1, 1984, with respect to the exchange or complete or partial surrender of a commercial annuity under which the recipient had not irrevocably chosen, prior to January 1, 1984, to receive payments in the form of an annuity?

A. In the case of the exchange or complete or partial surrender of a commercial annuity under which the recipient had not irrevocably chosen, prior to January 1, 1984, to receive payments in the form of an annuity, the application of the notice and withholding provisions of this section may be delayed, so long as undue hardship exists, up to January 1, 1984. Prior approval from the Internal Revenue Service is not required for such delay, and should not be requested. For purposes of this delay, undue hardship will be presumed to exist, in the absence of bad faith, so long as the payor can establish that at least one of the conditions in question g–6 is present. The payor should prepare and retain a statement of undue hardship as described in question g–9 and should maintain any documents necessary to support the representations made in that statement.

[T.D. 7839, 47 FR 45868, Oct. 14, 1982; 47 FR 47241, Oct. 25, 1982; as amended by T.D. 7858, 47 FR 54066, Dec. 1, 1982; 47 FR 57021, Dec. 22, 1982; T.D. 7904, 48 FR 35091, Aug. 3, 1983; 48 FR 36449, Aug. 11, 1983. Redesignated by T.D. 8873, 65 FR 6007, Feb. 8, 2000]

EFFECTIVE DATE NOTE: By T.D. 8873, 65 FR 6007, Feb. 8, 2000, §35.3405–1T was redesignated from §35.3405–1, effective Jan. 1, 2001.

PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Sec.

35a.3406–2 Imposition of backup withholding for notified payee underreporting of reportable interest or dividend payments.
35a.9999–0 Effective date.
35a.9999–1 Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues.
35a.9999–2 Questions and answers concerning due diligence and issues in connection with backup withholding.
35a.9999–3 Questions and answers concerning backup withholding.
35a.9999–3A Question and answer relating to exemption from backup withholding for certain principal payments made outside the United States by brokers on certain obligations.
35a.9999–4T Questions and answers relating to the application of information reporting and backup withholding to payments by foreign offices of United States and foreign brokers and by United States offices of banks and brokers, and other related matters (temporary).
35a.9999–5 Questions and answers relating to repeal of 30 percent withholding by section 127 of the Tax Reform Act of 1984 and to the application of information reporting and backup withholding in light of such repeal.

AUTHORITY: 26 U.S.C. 7805; §35a.3406–2 also issued under 26 U.S.C. 3406(c)(3)(D) and 3406(i).

§35a.3406–2 Imposition of backup withholding for notified payee underreporting of reportable interest or dividend payments.

(a) *Requirement that a payor backup withhold due to a notified payee underreporting*—(1) *In general.* Except as otherwise provided in paragraph (a)(5) of this section, backup withholding under section 3406(a)(1)(C) applies to any reportable interest or dividend payment (as defined in section 3406(b)(2) and paragraph (a)(4) of this section) made to a payee, if the Internal Revenue Service or a broker (as defined in section 3406(h)(5) and paragraph (a)(7) of this section and pursuant to section 3406(d)(2)(B)(ii)(III)) notifies a payor (as defined in section 3406(h)(4) and in paragraph (a)(6) of this section) that