

Final Regulation Addresses Income Tax Withholding on Non- Eligible Rollover Distributions From Retirement Plans

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Final Regulation: Withholding on Certain Distributions Under Section 3405(a) and (b), 26 CFR Part 31, 89 Fed. Reg. 84079 (Oct. 21, 2024)

Available at <https://www.govinfo.gov/content/pkg/FR-2024-10-21/pdf/2024-24224.pdf>

The IRS has released a final regulation that outlines a payor's obligation to withhold income taxes on certain periodic payments and nonperiodic distributions from employer deferred compensation plans such as 401(k) plans, individual retirement plans, and commercial annuities that are not eligible rollover distributions. The regulation specifically addresses withholding obligations for payments to (1) payees with a military or diplomatic post office address; (2) payees with a residence address located within the U.S.; (3) payees with a residence address located outside of the U.S. or who have not provided a residence address; and (4) foreign persons. Highlights are as follows:

- **Military or Diplomatic Post Office Address.** An Army Post Office (APO), Fleet Post Office (FPO), or Diplomatic Post Office (DPO) address is treated as an address located within the U.S. for tax withholding purposes. APO is associated with Army or Air Force installations, FPO pertains to Navy installations and ships, and both APO/FPO addresses are used by Department of Defense personnel, their family members, and other authorized users. DPO provides global mail service to authorized personnel assigned to designated posts abroad. [EBIA Comment: This means that individuals with any of these addresses can elect out of withholding for any plan distribution.]
- **Residence Address Located Within the U.S.** Generally, if a payee's residence address is located within the U.S., payors must withhold income tax from any plan distribution unless the payee makes a valid election to opt out of withholding. No opt-out election is permitted where the payee instructs the payor to send the distribution (1) to a financial institution or other person located outside of the U.S. (either as a first or subsequent step transaction), or (2) in accordance with payment instructions that include certain international identifiers (such as IAT, IBAN, or other similar codes associated with financial institutions or individuals outside the U.S.).
- **Residence Address Located Outside of the U.S.** Unless the nonresident alien exception applies (i.e., certification by recipient that they are neither a U.S. citizen nor a resident alien of the U.S., and are not an individual who expatriated before June 17, 2008), payors must withhold income tax from any designated distribution if the payee's provided residence address is located outside of the U.S., even if the payee has requested the distribution be deposited with a financial institution located in the U.S., or attempted to elect out of withholding.
- **No Residence Address.** Payors must withhold income tax if a payee has not provided a residence address to the payor. A payee who provides a payor with an address for the payee's nominee,

trustee, or agent without also providing the payee's residence address is considered to have not provided a residence address under the regulation.

- *Foreign Persons.* The withholding rules under the regulation do not apply to payments of U.S.-source nonbusiness income to foreign persons (i.e., nonresident alien individuals and foreign corporations) that are subject to withholding under Code §§ 1441 through 1446 (including any payments that would be subject to these rules but for a tax treaty). For example, Code § 3405(a) or (b) withholding would not apply to a U.S.-source distribution from a 401(k) plan to a nonresident alien individual.

The regulation applies with respect to payments and distributions made on or after January 1, 2026, but taxpayers may apply the regulation to earlier payments and distributions.

EBIA Comment: The IRS stresses that the final regulation provides administrable standards that have been relied upon for many years, is consistent with legislative history, and appropriately addresses tax avoidance concerns. Given that proposed regulations on this topic were issued on May 31, 2019, and the IRS received no comments from interested taxpayers, it is likely that many plans are already substantially compliant with the final rules. Nevertheless, plans should review their procedures for withholding on distributions to ensure that all requirements are met, especially in cases where the payee provides no residence address. For more information, see EBIA's 401(k) Plans manual at Sections XIV.B ("Defining an Eligible Rollover Distribution") and XIV.J.2 ("Income Tax and Withholding Rules for Plan Distributions Other Than Eligible Rollover Distributions").

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