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Proposed Regulations on Retirement Plan Distribution Withholding for Recipients with Non-U.S. Addresses

On May 31, 2019, the IRS issued proposed regulations under Section 3405 of the Internal Revenue Code ("Code") relating to required tax withholding applicable to distributions made to recipients from retirement plans, IRAs, and commercial annuities ("retirement plan distributions") and circumstances when recipients may elect out of such withholding. The proposed regulations clarify the rules contained in prior IRS guidance (IRS Notice 87-7) regarding the inability by recipients of retirement plan distributions to elect out of withholding where they do not satisfy U.S. address requirements (discussed below).

The proposed regulations do not apply to retirement plan distributions that are considered to be "eligible rollover distributions" (generally lump sum distributions or distributions that are paid over a period of less than 10 years), which are subject to mandatory federal income tax withholding at a 20% rate unless the payee elects to directly roll over the distribution to another tax-qualified plan or IRA. Additionally, the proposed regulations do not apply to nonresident aliens, who generally remain subject to a tax withholding rate of 30%.

Where a recipient has provided a payor with a residence address in the U.S. or its possessions, the general retirement plan distribution withholding rules under Code Section 3405 apply, including: (i) retirement plan distributions that are made in periodic payments for life or for 10 years or more are subject to applicable wage withholding, and (ii) retirement plan distributions that are non-periodic payments and which are not eligible to be rolled over to a tax-qualified plan or IRA, are subject to tax withholding at a 10% rate. For both periodic and non-periodic payment wage withholding, recipients may generally elect to not have amounts withheld from their retirement plan distributions.

The following is a summary of the significant provisions of the proposed regulations that apply to retirement plan distributions when a recipient furnishes a payor with a foreign address:

- If a recipient provides the payor with a residence address outside of the U.S. (or its possessions), the recipient may not elect out of withholding.
- If the address provided by the recipient to the payor is a military or diplomatic post office address outside of the U.S. (*i.e.*, APO, FPO or DPO), it is treated like a U.S. address and the recipient may elect out of withholding.
- If the address provided by the recipient to the payor is outside of the U.S. (other than the address of a military of diplomatic post office outside the U.S.), then even if instructions indicate that the funds are to be delivered or forwarded to a bank or person

located inside the U.S., the recipient may not elect out of withholding.

- If the recipient does not provide the payor with any residence address, the recipient is treated as having provided the payor with a residence address that is outside of the U.S and may not elect out of withholding.

In addition to the above-mentioned rules that apply when a recipient furnishes a payor with a foreign address, the proposed regulations provide that if the address provided by the recipient to the payor is within the U.S. but instructions indicate that the funds are to be delivered or forwarded to a bank or person outside of the U.S., the recipient may not elect out of withholding.

The proposed regulations will become effective when final regulations are published in the Federal Register, and payors may continue to rely on prior IRS guidance until the proposed regulations are finalized. (Note: The rules relating to military and diplomatic post office addresses outside of the U.S. may be relied upon as of May 31, 2019.) The rules under the proposed regulations relating to tax withholding on retirement plan distributions that apply when a recipient furnishes a payor with a non-U.S. address are not surprising and in many respects follow prior IRS guidance. However, in light of the technical requirements and potential liability applicable to required tax withholding on retirement plan distributions, procedures for withholding should be reviewed in order to ensure continued compliance.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

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