

# IRS PROPOSES REGULATIONS REGARDING WITHHOLDING ON DISTRIBUTION PAYMENTS MADE OUTSIDE OF THE UNITED STATES

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In many cases, distributions made from a deferred compensation plan, individual retirement plan, or commercial annuities are subject to withholding under the graduated income tax rates under Section 3405 of the Internal Revenue Code. Deferred compensation plans are pension, annuity, profit sharing, or stock bonus plans or any other plan deferring the receipt of compensation. Under Section 3405, recipients may make an election to have nothing withheld from the distribution. As part of the Tax Reform Act of 1986, Code Section 3405(d)(13) was added that prohibited an election to not have amounts withheld for distributions that are delivered outside of the United States. In 1987, the IRS issued Notice 87-7 providing initial guidance on determining whether a payment is delivered outside of the United States. At that time, the IRS indicated that regulations would be forthcoming to be effective as of January 1, 1987. Note, these rules do not apply to distributions of the United States source income to nonresident aliens, including those from qualified plans, that are subject to the flat rate withholding under the rules of Section 1441 or that would be subject to Section 1441 other than by reason of application of a provision in a tax treaty.

The IRS has now issued proposed regulations on this point and has provided some examples that provide additional guidance. The proposed regulations would be effective upon issuance, but the proposed regulations indicate that payors may continue to rely on Notice 87-7 or on the proposed regulations until regulations are finalized.

In the proposed regulations, the IRS expands upon the three categories of payments identified in Notice 87-7 that are used in determining if a distribution is made outside of the United States.

*Payees with addresses outside of the United States.* If the payee has provided a residence address outside of the United States, withholding is required and an election not to withhold may not be made. The proposed regulations indicate that payees with a military (APO or FPO) or diplomatic foreign post office (DPO) address are considered domestic addresses for this purpose.

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Employee Benefits

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*Payees with addresses within the United States.* Withholding is required unless the payee elects not to withhold. Under the proposed regulations, the election of no withholding is not valid if the payee instructs the payor to (i) send the distribution to a financial institution or person located outside the United State, (ii) send the distribution to an institution or person located within the United States with further instructions directing that the funds be forwarded to a financial institution or person outside of the United States, or (iii) send the distribution to a financial institution or person with payment instructions that reference a code (International Automated Clearing House Transaction (IAT), International Bank Account Number (IBAN), or Society for Worldwide Interbank Financial Telecommunication (SWIFT) Business Identifier Code (BIC) that is linked to a financial institution or person located outside the United States.

*Payees who have not provided an address.* If the payee has not provided a resident address, the payor is required to withhold income tax and an election not to withhold may not be made.

IRS Notice of Proposed Rulemaking, Withholding on Certain Distributions Under Section 3405(a) and (b) <https://www.federalregister.gov/documents/2019/05/31/2019-11292/withholding-on-certain-distributions-under-section-3405a-and-b>

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