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Firm Requests Guidance on Pension and IRA Withholding

DATED JUN. 6, 2022

SUMMARY BY TAX ANALYSTS

Groom Law Group has requested guidance on pension and IRA withholding and confirmation that Form W-4P, "Withholding Certificate for Periodic Pension or Annuity Payments," and Form W-4R, "Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions," will remain optional for 2023.

FULL TEXT PUBLISHED BY TAX ANALYSTS

June 6, 2022

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2022-21), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Notice 2022-21 Guidance Plan Request — Forms W-4R and W-4P

Dear Sir or Madam:

In light of the brand new withholding form for pension and IRA withholding (and a total revamp of the existing withholding form) that was just issued this year, we, on behalf of our clients (which include plan recordkeepers, governmental plan sponsors, and IRA custodians) respectfully request that pension and IRA withholding guidance be provided. Given the late hour of any such guidance, we also strongly request the new Forms W-4P and W-4R remain optional for 2023. Importantly, the forms were just issued in final form in January of this year,

without a formal notice and comment process, and to date there has been no guidance on how to address paper substitute forms and only informal guidance on electronic substitute forms.

Background

This issue is worthy of inclusion on the 2022-2023 Guidance Priority List, as it impacts tens of millions of taxpayers — in fact, everyone who has an IRA or otherwise participates in a qualified employer plan will be impacted. Clear guidance on what withholding requirements and parameters are required to be met will help facilitate sufficient withholding, which is in the best interest of the Service and the taxpayer, and clear guidelines promote sound public policy.

Although the forms are new, and are currently mandated for 2023, there has been no change to the underlying statutory provisions of the Code. For the withholding that is now determined on the new Form W-4R, those statutory provisions have historically been interpreted to provide for optional withholding. However, as there has been no explanation of the forms as part of a regulatory process, there is a real concern that these withholding options must now be offered, and that there can be little to no deviation from the IRS form to gather this election.

For example, it was not common for IRA custodians to offer a right to withhold between 1-9%, as Code section 3405(b) only requires that you withhold at 10% unless the IRA owner/beneficiary elects out of withholding altogether. Similarly, although Form W-4P could have been used historically to add a flat dollar amount to be withheld in addition to the mandatory 20% withholding under Code section 3405(c) (for eligible rollover distributions paid directly to a participant), this was not commonly used by plan administrators. These system changes take time to develop, test, and roll out, which creates administrative burdens on employers and the retirement industry. In light of the current world and market economy and ongoing pandemic, such an extensive overhaul is ill-advised at this time.

Relief Requested

1. Make Forms W-4R and W-4P Optional for 2023

Guidance is needed to understand the scope of the new withholding requirements, and the parameters for use of a substitute form, as most pension/IRA withholding elections are embedded within the existing distribution process. The final forms were just published this year, and Form W-4P still appears not to be final as it contains a “reserved” line. Additionally,

changing to the new default withholding for Form W-4P (while retaining the existing default for retirees that commenced payments before 2023) is a real challenge for the withholding systems. Further, although IRS Publications are often used for purposes of providing guidance on IRS forms, with the nature and extent of the changes to these withholding forms and the fact that the industry is continuing to try to understand and implement these rules properly, there is just not sufficient time to properly implement, test, and roll out the new forms (and new default W-4P withholding) by January 2023. This is particularly true as state reporting and withholding rules are also impacted by these changes and all parties involved will need sufficient time to update their procedures. Therefore, making the forms optional for 2023 (as was done for 2022) makes perfect sense (and is needed). Moreover, to the extent that plan sponsors and recordkeepers are able to roll out the forms early, we ask for a good faith compliance standard for any withholding obligations, and related penalties, pending additional guidance in this area (which given the nature of the changes should ideally be via proposed regulations to provide proper notice and comment).

2. Provide Guidance on What Withholding Provisions Are Required via Form W-4R

Arguably, the withholding on Form W-4R is optional withholding under Code section 3402(p), and therefore its offering should be entirely optional, at the election of the plan administrator or IRA custodian. For example, must a plan offer withholding greater than 20%, or must IRAs offer 1-9% (or over 10%) withholding on nonperiodic payments? The statute and the existing regulations would appear to say no, and therefore any requirement to offer and accept this new Form W-4R (or an exact replica) should be established through a proper notice and comment period via regulations (and not through IRS Publications that do not have the same level of reliance or procedural protections). See, e.g., Code sections 3405, 3402(p); Treas. Reg. sections 31.3402(p)-1(b)(1)(iii) (no request for withholding shall be effective until the *employer accepts* the request); 31.3405(c)-1 (a distributee and the plan administrator or payor are permitted to enter into an agreement, in accordance with applicable forms and instructions, but it is not effective until the plan *administrator/payor accepts* the request). Clarification on these points (via proposed regulations) is critical as we develop systems to comply with the IRS form.

3. Provide Flexibility for Substitute Forms W-4P and W-4R

Providing clear guidance, after notice and comment, regarding the scope of substitute forms is critical in this area, where historically any reasonable withholding election approach was not

challenged. The IRS Publications refer to an “exact replica” of the IRS form for an electronic process, but an exact replica may not facilitate additional withholding, as the forms are complex and overly burdensome. Moreover, a number of the restrictions are somewhat arbitrary, and including data (like the Marginal Tax Rate Table on Form W-4R) that must be updated each year makes the process even more onerous.

There are a number of different mediums used to obtain a withholding election, as it is typically included as part of the distribution package and is therefore obtained through the use of a substitute form, which could encompass paper, Web App, online, phone, etc. Careful consideration should be given on how to continue to facilitate this withholding election process in light of the new forms and the level of variance permitted through the use of a substitute form. For example, reading the form verbatim through a telephone call is not practical or useful, not to mention that it is confusing to the taxpayer — please imagine trying to read the Marginal Tax Rate table over the phone or the time associated with reading the entire form.

Several items stand out that have historically been permitted, but that may be impractical with the “exact replica” notion and should continue to be permissible, including:

- Checking the box upfront on the withholding certificate form to not have withholding apply (or to specify a specific %/\$ amount to be withheld)
- Truncation of SSNs for privacy concerns
- Stand-alone flat dollar amounts on Form W-4R, unless in violation of the 20% withholding rule (and whole or fractional withholding percentages)
- Streamlined Form W-4P and W-4R steps/text (including skipping steps, as long as the taxpayer has an ability to complete all the steps if requested, and skipping text that is not applicable to the taxpayer)
- A percentage amount to be withheld as an additional amount on Form W-4P.

Lastly, it should be made clear that there is no obligation on the payor to review or verify the calculations entered on Form W-4P (or otherwise collect and review the underlying supporting documentation).

* * *

We appreciate your immediate attention to this important matter. If you have any questions, please contact us at 202-857-0620.

Respectfully submitted,

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Groom Law Group

Washington, DC

DOCUMENT ATTRIBUTES

CODE SECTIONS	SEC. 3405 SPECIAL RULES FOR PENSIONS, ANNUITIES, AND CERTAIN OTHER DEFERRED INCOME
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