

ELIZABETH THOMAS DOLD and
DAVID N. LEVINE are Principals and
KIMBERLY BOBERG is Senior Counsel
at Groom Law Group, Chartered in
Washington, D.C.

Employee Benefits Corner

New Pension Withholding Forms

By Elizabeth Thomas Dold, David N. Levine,
and Kimberly Boberg

A necessary requirement of any retirement plan is the reporting of distributions. Historically, a single, simple form, namely Form W-4P, was required. However, the Internal Revenue Service (IRS) has now revamped this reporting process with a new set of two forms—the W-4P and W-4R. The 2022 Forms W-4P and W-4R were issued early in the New Year. These forms control pension withholding, with the Form W-4P to be used for periodic payments, and Form W-4R to be used for non-periodic payments. Importantly, these forms are optional for 2022, but are required beginning January 1, 2023. The legacy 2021 Form W-4P is available for 2022 for both periodic and non-periodic payments, as the IRS has provided a much-needed grace period to get system changes up and running for the new process. A quick look at the pension-withholding rules and the new forms is set forth in Table 1, along with some important questions that these changes raise.

A few important questions immediately come to mind:

Must a plan use the new forms in 2022? The new forms are optional for 2022. Therefore, plan administrators can continue to use the 2021 Form W-4P in 2022 until the new system is ready for rollout. Also, a plan administrator can consider using their own version of a substitute form, but we are still hopeful about the guidance regarding the parameters that must be followed for such forms being sufficient. Specifically, many plan administrators and recordkeepers have built withholding elections into their distribution packages, without the need to complete a separate Form W-4P/R, so it is not simply a matter of substituting a new form for the old form in their distribution packages.

Are the new forms simple to complete? Unfortunately, no. The new Forms W-4P and W-4R are both three pages long, with the Form W-4P including five rather complex steps to navigate before signing on the dotted line. In addition, if a participant (or beneficiary) wants to elect out of withholding on periodic payments, the form requires that the participant (or beneficiary) write-in “No Withholding” on Form W-4P in the space below Step 4(c).

Must retirees who are receiving periodic payments complete a new Form W-4P? Thankfully, no. A new form is not required until the retiree wants to change his or her withholding election. A prior withholding election or the default withholding election of married with three exemptions can continue to be used

TABLE 1.

Type of Payment	Withholding Rate (Code Sec. 3405)	Withholding—Mandatory or Optional	IRS Form	Purpose of the Form	Comment
Eligible Rollover Distribution	20%	Mandatory	W-4R	To select a higher withholding rate (exceeding 20%)	This provides a form to be used for requesting additional withholding for amounts not directly rolled over. This is designed to help participants match their withholding rate with their tax rate so that sufficient taxes are withheld to meet their tax liability. Notably, to make an appropriate withholding determination, the form includes marginal rate tables that we understand will be updated annually (which adds to the complexity of the form).
Non-periodic payment (not eligible for rollover)	10%	Optional	W-4R	To select a higher or lower withholding rate (0–100%)	Only a whole number % rate (and not a flat dollar amount) can be selected on the form. However, a participant cannot elect less than 10% for payments to be delivered outside of the United States and its possessions.
Periodic payments* (not eligible for rollover)	Wage withholding	Optional	W-4P	To make adjustments to reflect the appropriate wage withholding. The default rate is single with no exemptions on the 2022 Form W-4P.	This form is required to be used for new pensioners, or when an existing pensioner in pay status wants to make a change to his withholding elections. This form changes the method under which the withholding rate is determined to more closely align with the W-4 withholding process for wages. Historically, the default withholding rate was married with three exemptions.

* Periodic payments are made in installments at regular intervals (for example, annually, quarterly, or monthly) over a period of more than 1 year.

for these retirees, as the 2022 Form W-4P expressly states that for payments that began before 2022, the current withholding election (or the default rate) remains in effect unless the participant (or beneficiary) submits a new Form W-4P. This relief should extend to payments beginning in 2022 if the plan administrator uses the historic Form W-4P in 2022.

What is the new default withholding rate for periodic payments? The new default withholding rate for periodic payments is changed from married with three exemptions to single with no adjustments. This approach tracks the default for Form W-4 wage withholding. Following the 2017 Tax Cuts and Jobs Act, the IRS removed the existing default withholding rate from its regulations to provide more flexibility in the event that the IRS would want to change the default rate in the future—so now we need to

watch for the IRS forms and publications for any changes to this rate. Therefore, as noted on the form, if a participant (or beneficiary) does not give a Form W-4P to the payer, does not provide a SSN, or the IRS notifies the payer that the participant (or beneficiary) gave an incorrect SSN, the payer must withhold tax from the pension payments as if the participant’s (or beneficiary’s) filing status is single with no adjustments.

What withholding tables apply for periodic payments? IRS Publication 15-T has been updated to provide withholding tables for both the 2021 Form W-4P and the 2022 Form W-4P. Worksheet 1B in the Publication is used to navigate this process. There is also a special “computational bridge” if the plan sponsor/payer wants to convert a pre-2022 Form W-4P into a 2022 Form W-4P for this purpose, which is optional.

Next Steps

Plan sponsors and administrators should talk to their recordkeeper (or in-house tax department) who handles the reporting and withholding, and coordinate the rollout of the new withholding forms. Further, a plan's distribution procedures (and participant and beneficiary distribution packages) should also be updated to incorporate the new forms, and the new default withholding rate for periodic

payments. The withholding notices to participants should also be updated to reflect the new process. Thankfully, plan sponsors, administrators, and recordkeepers have the entire 2022 year to update their systems to make this work. This long period is important because, to the extent that a plan's process is insufficient, there is a risk of withholding obligations on the plan administrator/payer, as well as related penalties for failure to sufficiently withhold and provide notice of the participant's withholding rights.

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