

Notice 87-7

The Internal Revenue Service provided guidance for persons that make distributions from deferred compensation plans, individual retirement accounts or commercial annuities with respect to their duty to withhold from such distributions for the payee's income tax liability. The duty to withhold has been expanded by the Tax Reform Act of 1986.

Section 3405 of the Internal Revenue Code of 1986 requires the payor of periodic or nonperiodic distributions made pursuant to an employer deferred compensation plan, individual retirement plan or commercial annuity to withhold an amount from the distribution for payment of the payee's income taxes. The section also provides that the payee may elect to have nothing withheld from the distribution. However, the Tax Reform Act of 1986 added new Section 3405(d)(13) which prohibits such election for distributions delivered outside of the United States. The new section applies to distributions made after December 31, 1986.

In the following paragraphs, rules are set forth to enable payors to determine whether they must withhold when making distributions within the meaning of Section 3405. As used herein, the term "payee" is defined as the individual who is the beneficiary of the employer deferred compensation plan, individual retirement plan or commercial annuity.

For purposes of Section 3405(d)(13), payors must be concerned with three categories of payees: (1) payees who have provided the payors with a residence address outside of the United States; (2) payees who have provided the payors with a residence address within the United States; and (3) payees who have not provided the payors with a residence address. The treatment of each category of payee is set forth below.

1. Payees with addresses outside of the United States. If a payee has provided the payor with a residence address outside of the United States, the payor is required to withhold from distributions made to the payee after December 31, 1986. Rules on determining amounts to be withheld are set forth in Section 3405(a) and (b).

2. Payees with addresses within the United States. If a payee has provided the payor with a residence address within the United States, the payor is required to withhold from distributions made to the

payee unless the payee has elected no withholding in accordance with the applicable provisions of Section 3405.

3. Payees who have not provided an address. If a payee has not provided the payor with a residence address, the payor is required to withhold from distributions made to the payee after December 31, 1986. Included within this category is a payee who has provided the payor with an address for the payee's nominee, trustee or agent without also providing the payee's residence address.

If a payee is subject to withholding under the rules set forth above, then the payor must withhold under the rules of Section 3405. However, the payor need not withhold in such a case if the payee certifies under penalties of perjury that he or she is not a U.S. citizen who is a bona fide resident of a foreign country nor a person to whom Section 877 of the Code applies (relating to persons who expatriate for a principal purpose of avoiding U.S. tax).

Regulations will be promulgated reflecting the rules set forth above, and will be effective as of January 1, 1987. If the regulations modify any of these rules, such modifications will be applied solely on a prospective basis (unless the taxpayer elects otherwise). Such prospective modifications may include a limitation of payors' ability to rely on a domestic residence address alone as a basis for not withholding.