

Section 3405.-- Special Rules for Pensions, Annuities, and Certain Other Deferred Income
(Also, § 408)

Rev. Rul. 2018-17 Withholding and Reporting With Respect to Payments From IRAs to State Unclaimed Property Funds

ISSUES

(1) Under the facts presented, is the payment by Trustee Y of Individual C's interest in IRA O to the State J unclaimed property fund, as required by State J law, subject to federal income tax withholding under § 3405 of the Internal Revenue Code?

(2) Is the payment by Trustee Y subject to reporting under § 408(i)?

FACTS

Individual C has an interest in IRA O, a traditional IRA trustee by Trustee Y. Individual C, a U.S. person under § 7701(a)(30)(A) with a calendar year taxable year, has not made a withholding election with respect to her interest in IRA O. State J law requires Trustee Y to pay Individual C's interest in IRA O to the State J unclaimed property fund under which a claim for property may be made by the owner.¹ In 2018, Trustee Y pays Individual C's interest in IRA O, which has a value of \$1,000, to the State J unclaimed property fund.

For purposes of this revenue ruling, an "IRA" is an individual retirement plan under § 7701(a)(37) (that is, an individual retirement account as defined in § 408(a) or

¹ This revenue ruling does not address whether the payment to the State unclaimed property fund otherwise complies with applicable law (for example, it does not address compliance with any applicable search requirements under State law).

individual retirement annuity as defined in § 408(b)), and a “traditional IRA” is an IRA that is not a Roth IRA under § 408A, a simplified employee pension under § 408(k), a SIMPLE IRA under § 408(p), or a deemed IRA under § 408(q).

LAW AND ANALYSIS

(1) Withholding

Section 3405 provides federal income tax withholding rules with respect to designated distributions. Under § 3405(e)(1)(A), a designated distribution means, except as provided in § 3405(e)(1)(B), any distribution or payment from or under an employer deferred compensation plan, an IRA, or a commercial annuity. As relevant here, under § 3405(e)(1)(B)(ii), a designated distribution does not include the portion of a distribution or payment that it is reasonable to believe is not includible in gross income.² For this purpose, the flush language under § 3405(e)(1)(B) provides that any distribution or payment from or under an IRA (other than a Roth IRA as defined in § 408A) is treated as includible in gross income.

Section 3405 requires federal income tax to be withheld from two types of designated distributions from IRAs, each with its own withholding rules: periodic payments under § 3405(a), and nonperiodic distributions under § 3405(b). Under § 3405(e)(3), a nonperiodic distribution is a designated distribution that is not an annuity or similar periodic payment. In the case of a nonperiodic distribution under

² Under § 3405(e)(1)(B)(iii), a designated distribution also does not include a payment that is subject to withholding under the withholding rules applicable to payments to nonresident aliens and foreign corporations. See § 1441 (Withholding of Tax on Nonresident Aliens), § 1442 (Withholding of Tax on Foreign Corporations), and § 1.1441-4(b)(1)(ii) (Exemptions from Withholding for Certain Effectively Connected Income and Other Amounts).

§ 3405(e)(3), § 3405(b)(1) provides that the payor shall withhold from such distribution an amount equal to 10 percent of the distribution. Section 3405(b)(2) provides that an individual may elect not to have § 3405(b)(1) withholding apply with respect to any nonperiodic distribution.

Section 35.3405-1T provides rules regarding § 3405, including general rules on withholding requirements and specific rules addressing withholding on periodic and nonperiodic distributions, notice and election procedures, and reporting and recordkeeping. Section 35.3405-1 provides rules regarding the medium through which notices required under § 3405 may be provided.

The payment of Individual C's interest in IRA O, a traditional IRA, to the State J unclaimed property fund, as required by State J law, is a payment from an IRA that is treated as includible in gross income (pursuant to the flush language of § 3405(e)(1)(B)) for purposes of § 3405(e)(1)(B)(ii). Thus, the payment is a designated distribution for purposes of § 3405. The payment from IRA O is not an annuity or similar periodic payment under § 3405(e)(2). Thus, it is a nonperiodic distribution as defined in § 3405(e)(3). Because Individual C has not made a withholding election with respect to the payment, a 10 percent withholding rate applies to the payment pursuant to § 3405(b)(1), and Trustee Y must withhold federal income tax of \$100 (10% of Individual C's \$1,000 interest in IRA O).

(2) Reporting

Section 408(i) provides that the trustee of an individual retirement account and the issuer of an endowment contract described in § 408(b) or an individual retirement annuity must make such reports regarding such account, contract, or annuity to the

Secretary and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions (and the years to which they relate), distributions aggregating \$10 or more in any calendar year, and such other matters as the Secretary may require.

Section 1.408-7(a) provides that the trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year shall make a report of the distribution for such year. Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., is used to satisfy this reporting obligation.

Pursuant to § 408(i), Trustee Y must report the \$1,000 distribution from IRA O (\$900 of which is paid to the State J unclaimed property fund and \$100 of which is remitted as federal income tax withholding) on a 2018 Form 1099-R identifying Individual C as the recipient.

HOLDINGS

(1) Under the facts presented, the payment by Trustee Y of Individual C's interest in IRA O to the State J unclaimed property fund, as required by State J law, is subject to federal income tax withholding under § 3405.

(2) The payment by Trustee Y is subject to reporting under § 408(i).

TRANSITION RELIEF

A person will not be treated as failing to comply with the withholding and reporting requirements described in this revenue ruling with respect to payments made before the earlier of January 1, 2019, or the date it becomes reasonably practicable for the person to comply with those requirements.

DRAFTING INFORMATION

The principal author of this revenue ruling is Cynthia Van Bogaert of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). Ms. Van Bogaert may be reached at (202) 317-4102 (not a toll-free number).