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INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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March 22, 2002

Dear [REDACTED]

This responds to a letter you faxed to [REDACTED] of my staff regarding the proper reporting of governmental section 457 plan distributions after Congress' recent enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Although this general information letter<sup>1</sup> cannot furnish definitive guidance, we hope it helps resolve your questions and concerns.

The first point to note is that EGTRRA significantly revises the provisions regarding income tax withholding upon distributions from *eligible governmental* section 457(b) plans. Effective beginning on January 1, 2002, EGTRRA subjects these distributions to the section 3405 provisions that govern income tax withholdings upon distributions from pensions, annuities, individual retirement arrangements (IRAs) and, now, governmental section 457(b) plans. By contrast, distributions from tax-exempt organizations' section 457(b) plans are still subject to the wage income tax withholding rules of section 3401 that also governed governmental section 457(b) plan distributions before this year, since EGTRRA did not change the withholding laws applicable to nonqualified deferred compensation plans of non-governmental tax-exempt organizations.

The second major point to note is that section 3405 and the regulations thereunder provide a separate set of rules for each of three types of distributions: 1) eligible rollover distributions, 2) non-eligible rollover distributions that are periodic payments, and 3) non-eligible rollover distributions that are not periodic payments. The rules specifically applicable to one type of these distributions should not be applied to another type.

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<sup>1</sup> Section 2.04 of Revenue Procedure 2001-1 defines an "information letter" as a statement issued by the Internal Revenue Service that calls attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. This section also provides that an information letter is advisory only and has no binding effect on the Service.

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Section 402(c)(4) of the Internal Revenue Code (the "Code") defines an eligible rollover distribution as any distribution to an employee of any portion of the balance to the employee's credit in an eligible retirement plan such as a qualified retirement plan, a section 403(b) tax-sheltered annuity, and, now, an eligible governmental section 457(b) plan, except for 1) any substantially equal periodic payments made over the recipient's lifetime or for at least 10 years, 2) any amount that is a required minimum distribution (RMD) described in section 401(a)(9), or any hardship distribution. Any amount of an eligible rollover distribution that is not rolled over into another eligible retirement plan or an IRA in a direct rollover is subject to 20% income tax withholding under section 3405(c) of the Code. There is no provision for a participant electing out of the 20% withholding upon an eligible rollover distribution.

With respect to any periodic payment distribution that does not constitute an eligible rollover distribution under these above-described rules, section 3405(a)(1) subjects it to wage-like withholding under the detailed provisions of section 3405(a)(4) unless the recipient files a Form W-4P, Withholding Certificate for Pension or Annuity Payments, either claiming additional exemptions (thereby reducing the amount withheld) or electing out of withholding under section 3405(a)(2). With respect to any non-periodic payment distribution that does not constitute an eligible rollover distribution, section 3405(b)(1) subjects it to the 10% income tax withholding rules unless the recipient files a Form W-4P electing out of withholding under section 3405(b)(2).

In the past, as noted in Notice 2000-38, 2000-33 I.R.B. 174, distributions from any eligible section 457(b) plans and the income tax withholding thereon were, until recently, reported on a Form W-2, Wage and Tax Statement, issued to the participants. Concerning your question regarding the proper reporting, beginning this year, of distributions from an eligible governmental section 457 plan, the Internal Revenue Service is currently studying the effect of the EGTRRA changes, and hopes to issue a revised notice soon explaining whether governmental section 457(b) plan administrators should continue to report such distributions upon a Form W-2, or should start reporting such distributions this year on a Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc<sup>2</sup>.

In your letter, you inquired about withholding upon participants' governmental plan distributions that exceed their RMD. As explained above, assuming that the portion exceeding their RMD is an eligible rollover distribution, the recipients cannot elect out of the 20% withholding by filing a Form W-4P, although they can elect out of withholding upon the RMD portion of their distribution by filing this form.

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<sup>2</sup> The Form W-2G has no applicability to these distributions since it is used only to report certain gambling winnings.

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To determine the proper income tax withholding upon governmental plan distributions of participants who elect to receive lump-sum distributions or periodic payments, you must first determine whether their distributions constitute eligible rollover distributions or non-eligible rollover distributions as explained above, and then apply the specific provisions applicable to the appropriate category of distribution.

Finally, with respect to participants who receive non-eligible rollover periodic governmental plan distributions, as explained above, they are subject to the detailed section 3405(a)(4) withholding provisions unless they file a Form W-4P specifying a lower withholding rate or electing out of withholding, and these distributions are not subject to rules applicable to a different type of distribution such as the 20% withholding applicable to an eligible rollover distribution.

We hope the general information supplied in this letter has been helpful. If you need further assistance, please contact [REDACTED] of my staff at (202) 622-6060.

Sincerely,  
Robert D. Patchell  
Acting Branch Chief, Qualified Plans #2  
Office of the Associate Chief Counsel  
(Tax Exempt and Government Entities)