

## UCRS: TAX WITHHOLDING FROM ANNUITY PAYMENTS

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## UCRS: TAX WITHHOLDING FROM ANNUITY PAYMENTS

"The olive grove of Academe, Plato's retirement, where the Attic bird Trills her thick-warbled notes the summer long."

--John Milton

I. INTRODUCTION

Federal and State taxing agencies require reporting of retirement system payments and related tax withholdings, if any, on designated forms. This chapter provides guidance and procedures for such income tax withholdings.

II. PROCEDURES

## A. FEDERAL INCOME TAX

1. Annuity Payments

Unless an annuitant elects otherwise, Federal regulations require that income tax be withheld from payments to annuitants (except for refunds/withdrawals of after-tax contributions) at the "married with three exemptions" rate. An annuitant may elect (1) no withholding, (2) use of a different withholding allowance schedule, or (3) a flat monthly withholding amount by filing University Form MS 15a, Election for Recipients of Monthly Payments--Federal and California State Income Tax Withholding, with the University Benefit Programs Office in the Office of the President. For payments sent to addresses outside the United States, Form MS 15d, Election Form--Federal Tax Withholding from UCRS Benefit Payments Sent to Addresses Outside the United States,

2. Lump-Sum Death Benefit Payments

Lump-sum death benefit payments are subject to mandatory Federal income tax withholding (except for refunds of after-tax contributions) unless the beneficiary elects not to have withholding apply by filing Form MS 15b, Notice of Tax Withholding on UCRS Lump-Sum Death Benefits, or Form MS 15d, Election Form--Federal Tax Withholding from UCRS Benefit Payments Sent to Addresses Outside the United States, with the University Benefit Programs Office in the Office of the President.

3. Other Payments

Federal tax withholding is required on all other retirement system payments as listed in the table in section II.C. (except for refunds/withdrawals of after-tax contributions) unless the recipient files with the University Benefit Programs Office in the Office of the President a Form U1635, Disposition of Accumulations Upon a Break-in-Service, Form U1635A, Refund of Voluntary Contribution Plan Accumulations--Election of Continuing Employee, or Form M/R-22(a), Election Form--Federal Tax Withholding from UCRS Retirement Plan Refunds sent to Addresses Outside the United States, as applicable, requesting no withholding.

4. Accounting Codes for Federal Tax Withholding

Liability account number J-130161, Federal Income Tax Withheld--Annuitant System, is used to record deductions from annuity payments and from lump-sum death benefit payments to beneficiaries. Deductions from refund/withdrawal payments of tax-deferred contributions and/or withdrawals of interest or gain are recorded using liability account number J-130165, Federal Income Tax Withheld--Membership System.

B. CALIFORNIA INCOME TAX

The procedures for withholding California income tax from retirement system payments made to residents of California are presented below. (California income tax withholding does not apply to retirement system payments made to nonresidents of California.)

1. Annuity Payments

Unless an annuitant elects otherwise, State regulations require that tax be withheld from payments to annuitants (except for refunds/withdrawals of after-tax contributions). An annuitant may elect (1) no withholding, (2) use of a different withholding allowance schedule, or (3) a flat monthly withholding amount by filing University Form MS 15a, Election for Recipients of Monthly Payments--Federal and California State Income Tax Withholding, with the University Benefit Programs Office in the Office of the President.

III. PROCEDURES

## B. CALIFORNIA INCOME TAX

1. Annuity Payments (Cont'd.)

If an annuitant makes no election regarding State income tax withholding, but files an election to have no Federal income tax withheld, the annuitant will also be treated as having elected to have no State income tax withheld. If an annuitant makes no election regarding State income tax withholding, but files an election for Federal tax withholding claiming a specific marital status and number of withholding allowances, State tax withholding will be required. If the California tax tables are used in the calculation of State tax withholding, the tax will be calculated using the same marital status and number of withholding allowances claimed by the annuitant for Federal tax withholding purposes.

2. Lump-Sum Death Benefit Payments

Lump-sum death benefit payments to a California resident are subject to mandatory State income tax withholding (except for refunds of after-tax contributions) unless the beneficiary elects not to have withholding apply by filing Form MS 15b, Notice of Tax Withholding on UCRS Lump-Sum Death Benefits, with the University Benefit Programs Office in the Office of the President.

3. Other Payments

California State tax withholding is required on all other retirement system payments as listed in the table in section II.C. (except for refunds/withdrawals of after-tax contributions) unless the recipient files with the University Benefit Programs Office in the Office of the President a Form U1635 or Form U1635A, as applicable, requesting no withholding.

4. Accounting Codes for State Tax Withholding

Liability account number J-130160, State Income Tax Withheld--Annuitant System, is used to record deductions from annuity payments and from lump-sum death benefit payments to beneficiaries. Deductions from refund/withdrawal payments of tax-deferred contributions and/or withdrawals of interest or gain are recorded using liability account number J-130166, State Income Tax Withheld--Membership System.

C. TABLE OF DEDUCTIONS AND REPORTING

The following table lists the various types of retirement system payments made by the University, designates the tax code to be used for each, and provides additional information on deductions and reporting.

DESCRIPTION OF PAYMENT	TAX CODE	SUBJECT TO DEDUCTIONS FOR		TAX ID # REQD	REPORTED ON	
		FED TAX	STATE TAX		FEDERAL FORM	STATE FORM
* Annuity Payments	7	(1) Yes	(1) Yes	Yes	1099R	1099R
Lump-Sum Death Benefit Payments to Beneficiaries	8	(2) Yes	(2) Yes	Yes	1099R	1099R
Refund of UCRS Basic Plan Accumulations	8	(3) Yes	(3) Yes	Yes	1099R	1099R
*** Refund/Withdrawal of After-Tax Contributions	R	No	No	Yes	1099R	1099R
Refund/Withdrawal of Tax-Deferred contributions	8	(4) Yes	(4) Yes	Yes	1099R	1099R
withdrawal of Interest and/or Gain (After-Tax or Tax-Deferred Program)	8	(4) Yes	(4) Yes	Yes	1099R	1099R

Footnotes

- (1) Tax withholding is required unless the recipient files a Form MS 15a or Form MS 15d with the retirement system requesting no withholding. (California income tax withholding does not apply to retirement system payments made to nonresidents of California.)
- (2) Tax withholding is required unless the recipient files a Form MS 15b or Form MS 15d with the retirement system requesting no withholding. (California income tax withholding does not apply to retirement system payments made to nonresidents of California.)
- (3) Tax withholding is required unless the recipient files a Form U1635 or Form M/R-22(a), requesting no withholding. (California income tax withholding does not apply to retirement system payments made to nonresidents of California.)
- (4) Tax withholding is required unless the recipient files a Form U1635, Form U1635A, or Form M/R-22(a) requesting no withholding. (California income tax withholding does not apply to retirement system payments made to nonresidents of California.)

### III. FEDERAL PENALTY TAX ON EARLY DISTRIBUTIONS

#### A. EXPLANATION

For tax years beginning after 1986, the Federal government imposes a 10% penalty tax on early distributions from qualified retirement plans. The employee must pay the 10% penalty tax on the taxable portion of the distribution in addition to any income tax due on the distribution. "Early distributions" are defined as distributions made to an employee who has not yet reached age 59½. For purposes of this tax, a "qualified retirement plan" includes a qualified pension plan (University Basic Retirement Plan and after-tax Voluntary Contribution Plan), a section 403 (b) tax-sheltered annuity plan (tax-deferred Voluntary Contribution Plan) or custodial account, or an individual retirement account. (Previously, the 10% penalty tax applied only to early withdrawals from an individual retirement account [IRA]).

The penalty tax does not apply to refunds or withdrawals of after-tax contributions.

#### B. EXCEPTIONS

Exceptions to the 10% penalty tax include:

- 1) distributions made to a beneficiary because of the employee's death;
- 2) distributions made because of the employee's disability;
- 3) distributions made because the employee separated from service after age 55, providing such employee met the early retirement provisions of the University plans;
- 4) distributions made for certain large medical expenses that would be deductible for Federal income tax purposes;
- 5) distributions made in substantially equal payments over the employee's (or the employee's and the employee's beneficiary's) life or life expectancy (after separation from service); and
- 6) certain distributions made under a qualified domestic relations order.

## C. DEFERRED ANNUITY CONTRACTS

The early withdrawal tax for a deferred annuity is increased from 5% to 10% for tax years beginning after 1986. Prior to 1987, the early withdrawal tax did not apply to distributions made about equally over the life of the taxpayer or over a period of at least 60 months after the annuity starting date. For tax years beginning after 1986, the tax does not apply only if distributions will be made over the life of the taxpayer or the lives of the taxpayer and his or her beneficiary.

IV. REPORTING AND REMITTANCE OF TAX WITHHELD

## A. REPORTING DURING THE YEAR

The same requirements regarding reporting and remittance of income tax withheld from payroll payments apply to income tax withheld from retirement system payments. (See Accounting Manual chapters [P-196-28](#), Payroll: Federal Taxation of Citizens, and [P-196-77](#), Payroll: State Tax Withholding from Employees.)

## B. YEAR END REPORTING

Form W-2P is issued to all annuitants; Form 1099R is issued to all recipients of other retirement system payments. Both reporting forms show benefits paid and, as appropriate, taxes withheld.

V. RESPONSIBILITIES

The University Benefit Programs Office in the Office of the President is responsible for processing any authorization requests, Forms MS 15a, Forms MS 15b, Forms MS 15d, Forms U1635, Forms U1635A, and Forms M/R-22(a). The University Benefit Programs Office in the Office of the President is also responsible for reconciling the liability accounts, for remitting the taxes withheld, and for preparing the quarterly and annual reports.

VI. REFERENCES

Internal Revenue Service Publication No. 15 (Circular E): Employer's Tax Guide.

Internal Revenue Service Publication No. 553: Highlights of 1986 Tax Changes.

VI. REFERENCES (Cont'd.)

Internal Revenue Service Publication No. 575: Pension and Annuity Income.

State of California, California Personal Income Tax Withholding Guide, published by the Employment Development Department.

University of California Benefit Programs Publication, IRS Tax Rules, September, 1987.

Accounting Manual chapters

P-196-11	Payroll: Accounting for and Tax Reporting of Mandatory Deductions and Insurance Benefit Contributions
P-196-28	Payroll: Federal Taxation of Citizens
P-196-77	Payroll: State Tax Withholding from Employees

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Historical note: The policy on Federal tax withholding from annuitants was originally stated in a letter dated 11/9/70 from H. D. LaRue to Personnel Director Walker and Accounting Officer Mundell. Revised: 1/1/72, 11/20/74, 11/1/80, 11/1/87, and 6/30/04; analyst--Kathy Henmi.