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# MARYLAND INCOME TAX ALERT

*September 2007*

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Comptroller of Maryland

## Income Tax Withholding on Designated Distributions

The Revenue Administration Division of the Comptroller's Office is providing this notice of amendments to §§ 10-905, 10-907, and 10-908 of the Tax General Article of the Maryland Code Annotated by Chapter 433 (H.B. 776), Maryland Acts of 2007, effective July 1, 2007, which clarify that "**Designated Distributions**" are not subject to mandatory income tax withholding in Maryland, except if the Designated Distributions are Eligible Rollover Distributions.<sup>1</sup> See also new Administrative Release No. 41. (copy attached) Designated Distributions are defined by §3405(e) of the Internal Revenue Code to mean periodic or nonperiodic payments or distributions from or under an employer deferred compensation plan; an individual retirement plan; or a commercial annuity.

The Federal withholding tax treatment of Designated Distributions includes that these payments are subject to mandatory income tax withholding by a payor (plan administrator), unless, the payee (recipient of the distribution) makes an election to not have withholding made. (See I.R.C. § 3405.) If the Designated Distribution is a periodic payment, then Federal withholding is the amount required as if such payment was a payment of wages by an employer to an employee and if the Designated Distribution is a nonperiodic distribution, then Federal withholding is made at 10 percent of such distribution.

The Maryland income tax law now specifically states that the withholding on Designated Distributions is not mandatory. Instead, these payments are only subject to Maryland income tax withholding if the payee affirmatively elects to have withholding made by the payor. Also, the amount required to be withheld from the Designated Distributions is the amount that the payee requests. (Maryland estimated income tax payments made by a payee may be required if withholding is not requested. See Maryland Form 502D.) Therefore, in Maryland, the payee must (1) decide whether the act of withholding should occur and (2) determine the amount to be withheld from the Designated Distributions. (This same Maryland withholding income tax treatment applies to annuity or sick pay payments described in I.R.C. §3402(o). Md. Code Ann., Tax-Gen. §§10-905, 10-907, and 10-908.)

A payee makes an election to initiate withholding by filing the Maryland Form MW507P with the payor of the Designated Distributions, which must include the amount to be withheld. This election will remain in effect until either the payee notifies the payor by written statement providing termination notice to revoke the withholding election or the payee files a new MW507P with the payor to adjust the amount of withholding requested.

A payor is required to withhold the amount the payee requests and remit it to the Comptroller's Office using the Employer's Return of Income Tax Withheld (MW506). Generally, for a payor that is a fiduciary, this return is filed on a quarterly basis. The payor also is required to file an annual reconciliation report with the Comptroller (MW508). In addition, the payor is required to provide withholding statements (Form 1099 or other appropriate form) to the payee and the Comptroller showing gross amount of Designated Distributions and amount withheld during the tax year.<sup>2</sup>

A payor may use an existing withholding account to report and remit withholding on Designated Distributions or, in the alternative, may establish a new separate withholding account (receive a separate Central Registration Number) for reporting and remitting withholding on Designated Distributions. In order to establish a new separate account, the payor should complete a Combined Registration Application registering for a new employer withholding tax account and specifically note on the application that the new account is for withholding on Designated Distributions. Combined Registration Applications registering for a new separate withholding account for Designated Distributions can **not** be filed electronically on-line, but must be submitted in paper form by fax to (410) 974-3456 or mailed to the Office of the Comptroller. Once registered, an account number will be assigned and remittance forms (MW506) will be issued to the payor.

The Maryland Form MW507P and any of the other forms/publications cited in this notice are available at [www.marylandtaxes.com](http://www.marylandtaxes.com). For additional information please contact [taxhelp@comp.state.md.us](mailto:taxhelp@comp.state.md.us), or call 410-260-7980 from Central Maryland or 1-800 MD TAXES (1-800-638-2937) from elsewhere. For the hearing impaired: TTY users call via Maryland Relay at 711 in Maryland or 1-800-735-2258 from anywhere. If you need a reasonable accommodation for a disability, or need the information in this notice in an alternative format, contact the Comptroller's Office.

<sup>2</sup> See Maryland Tax Alert, September 2006, providing withholding instructions also that may be applicable for an infrequent payor of Designated Distributions.

<sup>1</sup> Mandatory Federal and Maryland income tax withholding is required on Eligible Rollover Distributions. See I.R.C. § 3405(c) and Md. Code Ann., Tax-Gen. §10-908(f)(providing that, in Maryland, the payor is to withhold at 7.75% on Eligible Rollover Distributions). See Maryland Tax Alerts, July 2005 and September 2006 for additional information on Eligible Rollover Distributions.