

Administrative Release No. 41

Subject: Withholding on Designated Distributions from Retirement Plans

I. Definitions.

The following terms have the meanings indicated:

A. “Designated Distributions” means the periodic or nonperiodic payments or distributions from or under an employer deferred compensation plan, an individual retirement plan, or a commercial annuity. See § 3405(e) of the Internal Revenue Code.

B. “Eligible Rollover Distribution” means a Designated Distribution in which all or any portion of the balance of a plan is taken in one-lump sum and is not directly rolled over into another eligible retirement plan. See § 3405(c) of the Internal Revenue Code.

C. “Payee” means the recipient of a Designated Distribution or Eligible Rollover Distribution.

D. “Payor” means a person responsible to make withholding on a Designated Distribution or Eligible Rollover Distribution.

II. General.

Section 10-908(f) of the Tax-General Article, Annotated Code of Maryland provides that income tax is required to be withheld from a Designated Distribution that is an Eligible Rollover Distribution. This mandatory Maryland income tax withholding obligation was made by Chapter 444 (H.B. 147), Maryland Legislative Acts of 2005, effective July 1, 2005.

Section 10-907(b) of the Tax-General Article, Annotated Code of Maryland provides that Maryland income tax is not required to be withheld from a retirement distribution that is a Designated Distribution unless the Payee requests income tax to be withheld.¹ This optional Maryland income tax withholding obligation was made by Chapter 433 (H.B. 776), Maryland Legislative Acts of 2007, effective July 1, 2007, to clarify that Designated Distributions are not subject to mandatory Maryland income tax withholding.

¹ This optional Maryland income tax withholding obligation also applies to an annuity or sick pay payment described in § 3402(o) of the Internal Revenue Code. See Md. Code Ann., Tax-Gen. § 10-907(b).

These Maryland income withholding obligations are the subject of this release.

III. Specific: Eligible Rollover Distributions.

A. Withholding Obligation. If the payment to a Maryland resident Payee is a Designated Distribution that is an Eligible Rollover Distribution and the payment is subject to mandatory withholding of federal income tax, then the Payor is required to withhold Maryland income tax from the payment. Thus, Payors must withhold Maryland income tax on Eligible Rollover Distributions.

The Maryland rate of withholding on Eligible Rollover Distribution payments is the sum of 3 percent and the top marginal State income tax rate for individuals (currently 4.75 percent). This means that 7.75 percent of the Eligible Rollover Distribution payment amount must be withheld by the Payor and remitted to the Comptroller.²

B. Filing Requirements. The Maryland income tax withheld must be remitted with the Maryland Employer’s Return of Income Tax Withheld (Form MW506). For a Payor that is a fiduciary, the return should be filed on a quarterly schedule. The Payor of an Eligible Rollover Distribution also must file an annual reconciliation report (Form MW508) with the Comptroller. In addition, the Payor is required to provide annual withholding statements (Form 1099 or other appropriate form) to the Payee and the Comptroller.

If the Payor of the Eligible Rollover Distribution is not currently registered with the Comptroller and has not established a withholding account, an account can be established by filing a Combined Registration Application, available online (at www.marylandtaxes.com). Once registered, an account number will be assigned to the Payor and remittance forms (MW506) will be issued. Payment may also be made online without a charge using direct debit bFile, www.marylandtaxes.com.

² The rate of mandatory withholding on Eligible Rollover Distributions for federal income tax purposes is an amount equal to 20 percent of such distribution. See § 3405(c) of the Internal Revenue Code.

An infrequent Payor of an Eligible Rollover Distribution may open and close its withholding account upon the filing of a return (MW506) and remitting the tax. By doing this, the Payor will not have to continue to file withholding returns (reporting no tax withheld) and instead may file a return only when there is Eligible Rollover Distribution subject to the Maryland income tax withholding requirement. When re-opening a withholding account, the Combined Registration Application may not need to be resubmitted; however, the Payor should contact the Comptroller's Office to request that a closed account be reopened.

IV. Specific: Designated Distributions.

A. Withholding Obligation. If the payment to a Maryland resident Payee is a Designated Distribution, then the Payor may only withhold Maryland income tax if the Payee affirmatively elects to have withholding by the Payor from the Designated Distribution payment. The amount required to be withheld from the Designated Distributions is the amount that the Payee specifically requests. Therefore, the Payee must decide whether the act of withholding should occur by the Payor and determine the amount to be withheld from the Designated Distribution.³

B. Filing Requirements.

1. Election by Payee. A Payee makes an election to initiate withholding by filing the Maryland Form MW507P with the Payor of the Designated Distributions. The Form MW507P 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 Form MW507P with the Payor to adjust the amount of withholding requested.

2. Payor Withholding Returns. 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 (Form MW506). For a Payor that is a fiduciary, this return is filed on a quarterly basis.

The Payor is required to file an annual reconciliation report with the Comptroller (MW508). Also, the Payor is required to provide annual withholding statements (Form 1099 or other appropriate form) to the Payee and to the Comptroller showing gross amount of Designated Distributions and amount withheld during the tax year.⁴

A Payor may use an existing employer 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 online, but must be submitted in paper form by fax to (410) 974-3456 or mailed to the Office of the Comptroller.

Once the Payor is registered, an account number will be assigned and remittance forms (MW506) will be issued. Payment may also be made online without a charge using direct debit bFile, www.marylandtaxes.com.

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³ The federal withholding tax treatment of Designated Distributions includes that these payments are subject to mandatory income tax withholding by a Payor, unless the Payee makes an election to not have withholding made. See § 3405 of the Internal Revenue Code.

If the Designated Distribution is a periodic distribution, 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

⁴ The withholding instructions for Eligible Rollover Distributions as to infrequent Payors (see III.B. above) also may be applicable for an infrequent Payor of Designated Distributions from retirement plans.



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