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Employee Benefits Corner

Tax Reporting Guidance for Uncashed Checks from Qualified Plans

By Elizabeth Thomas Dold and David N. Levine

What to do with uncashed checks from qualified retirement plans has always been a difficult issue. The Department of Labor ("DOL") and the Internal Revenue Service ("IRS") have been working on addressing this long-standing concern for plan sponsors, trustees and recordkeepers. This issue is often raised in both DOL and IRS audits—as everyone is eager to get plan benefits paid to the participant and beneficiary.

The IRS recently released Rev. Rul. 2019-19 to address a baseline issue of whether uncashed checks from a qualified retirement plan are subject to taxation, reporting, and withholding in the year the check is issued, even if the check remains uncashed. The answer, which most do not find surprisingly, is that "yes," a check that was distributed and received by the payee so he or she could cash the check-in the year issued is taxable income to the participant (or beneficiary) and subject to Form 1099-R reporting and withholding rules. This answer does not vary regardless of whether the participant or beneficiary keeps the uncashed check, sends it back to the plan, destroys it, or cashes it in a subsequent year. A review of the Ruling and its findings are summarized below.

The Ruling

The Facts

Employer is the plan administration of Plan X, a qualified retirement plan under Code Sec. 401(a) that does not provide for Roth deferrals. A distribution of $900 is required to be made from the Plan in 2019. The individual has no investment in the contract (*i.e.*, no tax basis), has a calendar year taxable year, and has never made a withholding election with respect to the Plan benefits. The employer makes the $900 distribution by withholding tax under Code Sec. 3405 and mailing a check for the remainder to the individual. Although the individual receives the check and could cash it in 2019, she does not do so. (Note—this is the critical fact of the ruling—that the check was received and could be cashed, which is often difficult to ascertain.) She also does not elect to rollover the amount to another IRA or qualified plan.

The Law

Code Sec. 402(a) provides that, except as otherwise provided, any amount actually distributed to a distributee by an employees' trust described in Code Sec. 401(a) which is exempt from tax under Code Sec. 501(a) is taxable to the distributee, in the taxable year of the distributee in which distributed, in accordance with Code Sec. 72.

Code Sec. 3405 provides for federal income tax withholding rules with respect to designated distributions. The plan administrator shall withhold and be liable for payment of the tax required to be withheld unless the plan administrator directs the payor to withhold the tax and provides the payor with such information as the Secretary of Treasury may require by regulations.

Plan sponsors, trustees and recordkeepers should review their current uncashed check process to see if it aligns with this guidance for unresponsive participants and beneficiaries.

Code Sec. 6047(d) provides that the Secretary of the Treasury shall, by forms or regulations, require the employer maintaining a plan from which designated distributions may be made, or the plan administrator of that plan, to make returns and reports regarding the plan. Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, is used to satisfy this reporting obligation. The 2019 Instructions to Form 1099-R provide that: (1) the total amount of the distribution (before income tax or other withholding) must be reported in Box 1, (2) the taxable amount of the distribution (including income tax withheld) must be reported in Box 2a, and (3) the federal income tax withheld must be reported in Box 4.

The Findings

Taxation

Under Code Sec. 402(a), the $900 is actually distributed from Plan X to the individual in 2019, and since she has no investment in the contract and no other exception applies, the entire $900 is includible in gross income in 2019. The individual's failure to cash the distribution check she received in 2019 does not permit her to exclude the amount of the designated distribution from her gross income in that year under Code Sec. 402(a).

Withholding

The employer, as the plan administrator, withheld tax as required under Code Sec. 3405(d)(2) from the individual's designated distribution. The individual's failure to cash the distribution check she received does not alter the employer's obligations with respect to withholding of tax, and liability for payment of that tax, under Code Sec. 3405.

Reporting

The Plan X distribution to the individual, including both the amount of the check and the amount withheld, is a designated distribution. Accordingly, the employer is required to report that $900 distribution in box 1 of the 2019 Form 1099-R, and the same amount is reported in Box 2a (as the individual did not have any investment in the contract and no other exception applied), and must report the federal income tax withhold in Box 4. The individual's failure to cash the check she received does not alter the employer's obligation with respect to reporting under Code Sec. 6047(d).

Notably, the Ruling indicates that the Department of Treasury and the IRS are continuing to analyze issues that arise in other situations involving uncashed checks from eligible retirement plans. This includes IRAs, 401(a) plans, 403(b) plans, and governmental 457(b) plans. And it expressly identified situations involving missing individuals with benefits under such plans.

Action Steps

Plan sponsors, trustees and recordkeepers should review their current uncashed check process to see if it aligns with this guidance for unresponsive participants and beneficiaries. And stay tuned as the IRS and DOL provide additional guidance with respect to uncashed checks for missing participants.