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Employee Benefits Corner

IRS' Version of Missing Participant Guidance

By Elizabeth Thomas Dold and David N. Levine

The IRS issued two new pieces of guidance that work together to address missing participants in a qualified plan. Specifically, the IRS issued Rev. Rul. 2020-24 and Rev. Proc. 2020-46 to add to their existing portfolio on missing participant guidance. This guidance focuses the treatment of escheatment to the state unclaimed property funds with respect to:

- Reporting and withholding requirements and
- Indirect rollover relief.

This follows in the line of existing missing participant guidance, which includes required minimum distribution relief under Code Sec. 401(a)(9), reporting and withholding on uncashed checks under Rev. Rul. 2019-19, Internal Revenue Manual guidance, and reporting and withholding of escheatment payments from IRAs under Rev. Rul. 2018-17.

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This new guidance follows section 411(a) of the Internal Revenue Code and regulations on forfeitures. Generally, a participant's vested accrued benefit must be nonforfeitable. However, there are two key exceptions under Reg. §1.411(a)-4(b)(6) for missing participants and beneficiaries. Under the first exception, it is permissible to forfeit the vested accrued benefit due to an inability to find the participant or beneficiary to whom payment is due, provided that the plan provides for reinstatement of the benefit if a claim is made by the participant or beneficiary for the forfeited benefit. Under the second exception, which is addressed here, a benefit which is lost by reason of escheat under applicable state law is not treated as a forfeiture.

Notably, the Department of Labor has been very active in plan examinations to ensure that missing participants are located and their benefits paid out, and often escheatment is not the solution. Moreover, Employee Retirement Income Security Act of 1974 (ERISA)-covered plan benefits are generally thought to be beyond the reach of state unclaimed property laws by reason of ERISA preemption under ERISA section 514. The IRS guidance is quick to point out that it does not address whether the payment to the state unclaimed property fund otherwise complies with applicable law. For example, it expressly states that it does not address compliance with any search requirements applicable under state law and does not address matters arising under Title I of the ERISA for which the Department of Labor has subject matter jurisdiction. Therefore, this guidance should not be viewed as a push to escheatment but rather limited to the tax implications if amounts are escheated and later recovered.

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Reporting of Escheatment Payments

Rev. Rul. 2020-24 extended the general reporting and withholding requirements for qualified plan payment on Form 1099-R to escheated pension payments from qualified retirement plans under Code Sec. 401(a). This reporting and withholding approach is consistent with the approach taken in Rev. Rul. 2018-17, which imposed similar tax withholding and reporting obligations on IRA payors when they pay over such accounts to state unclaimed property funds.

The self-certification process replaces the need to file for a private letter ruling to ask for a waiver of the 60-day period to complete an indirect rollover.

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Code Sec. 3405(e)(1)(B) defines the term "designated distribution" for purposes of the rules for withholding on pension payments. For this purpose, the term does not include a distribution or payment that is reasonable to believe is not includible in gross income. And, under the facts of the new ruling—no Roth 401(k) amounts, no employer securities in the plan, the plan does not provide health benefits under Code Secs. 104 or 105, and no investment in the contract by the participant (*e.g.*, after-tax contributions)—it was not reasonable for the employer to believe that the payment of any portion of the participant's accrued benefit was excludible from gross income. Based on this reasoning, the IRS ruled:

- The payment from the 401(a) plan to the state fund was subject to federal income tax withholding under Code Sec. 3405 (presumably, 20% mandatory withholding if the amounts were eligible rollover distributions).
- The distribution was reportable on Form 1099-R in the year of payment to the state fund. The gross amount of the distribution (including the federal withholding) is reported in box 1, and the applicable federal income tax withholding is reported in box 4. Presumably, the payor would also be required to send a copy to the last known address of the participant.

Fortunately, the IRS applies these holdings only to payments made after the earlier of January 1, 2022, or "the date it becomes reasonably practicable for the person to comply." It is unclear how the IRS plans to administer the latter position, but it does give plan providers some needed time to review and amend their processes as needed.

Indirect Rollover Relief

The IRS also issued Rev. Proc. 2020-46 that updates the self-certification process for late indirect rollovers set forth in Rev. Proc. 2016-47 to add escheatment to the list of events that may justify a late indirect rollover. This issue was first raised following Rev. Rul. 2018-17 mandating reporting and withholding on IRA payments made to a state unclaimed property fund. This issue has now become even more pressing following Rev. Rul. 2020-24 described above with now escheated qualified plan payments treated as plan distributions and therefore starting the clock on an indirect rollover.

Generally, a taxpayer may only roll over an eligible rollover distribution from an IRA or eligible employer plan to another plan or IRA within 60 days of receiving the distribution. But, beginning in 2016, to ease the burden on many taxpayers who miss the 60-day window for an indirect rollover, the IRS permitted a taxpayer self-certification claiming eligibility for a waiver of that period, if specified requirements are met. The taxpayer may use the model self-certification provided by the IRS (which has been updated) or may use a letter that is materially similar.

This updated late rollover relief is effective as of October 16, 2020, and the prior Rev. Proc. 2016-47 is superseded, and Rev. Proc. 2020-46 now applies. This new guidance largely mirrors the prior guidance, except that it adds the following (12th) valid reason for missing the 60-day rollover deadline: the distribution was made to a state unclaimed property fund.

The guidance continues to make the point that this relief is limited to the 60-day rollover deadline, and does not provide relief for other IRS rules (*e.g.*, one-per-12 month limit on indirect rollovers between IRAs, rollover of required minimum distributions, and payments to nonspouse beneficiaries that are not permitted to be indirectly rolled over).

Self-Certification Process

The self-certification process replaces the need to file for a private letter ruling to ask for a waiver of the 60-day period to complete an indirect rollover. However, the IRS still reserves the right to challenge rollover treatment claimed

via self-certification, and to assert claims for interest and penalties. The Form 5498 that is filed with the IRS by the IRA provider flags this late contribution.

The participant must make a written certification to a plan administrator or IRA trustee that he or she is eligible to make a rollover after the 60-day period, and the following conditions must be met. First, the IRS must not have previously denied a waiver request with respect to any part of the distribution in question. Second, the contribution must be made to the receiving plan or IRA as soon as practicable after the barrier to the rollover has been removed. This requirement is deemed to be met if the contribution is made within 30 days after the reason(s) no longer prevent the participant from making the contribution. Third, at least one of the following 12 valid reasons for missing the 60-day rollover deadline must apply:

- An error by the receiving or distributing financial institution;
- The check (if applicable) was misplaced and never cashed;
- The distribution was deposited into and remained in what the taxpayer mistakenly thought was an eligible retirement plan;
- Severe damage to the participant's principal residence;
- The death of a member of the participant's family;
- A serious illness of the taxpayer or a member of the participant's family;
- Incarceration of the participant;
- Restrictions imposed by a foreign country;
- A postal error;
- The distribution was originally made on account of a tax levy and the levy proceeds have been returned to the participant;
- The party making the distribution delayed in providing the necessary information to complete the rollover, despite the participant's reasonable efforts to obtain the information; or
- The distribution was made to a state unclaimed property fund.

The participant may use the model self-certification provided by the IRS or may use a letter that is materially similar. A copy of the certification should be kept in the participant's files and be available if requested on audit.

A plan administrator or IRA trustee who receives a self-certification satisfying the applicable conditions may rely on that certification in accepting a rollover that would otherwise be outside of the 60-day window, so long as the administrator or trustee does not have actual knowledge that would contradict the information in the certification. A copy of the certification should be retained with the plan records.

Next Steps

Plan sponsors, and their recordkeepers, should review their plan procedures to see if the escheatment process is used. And, only if it is, then they should update their escheatment process as necessary to reflect the standard Form 1099-R reporting and withholding rules by no later than for payments made after 2021. This has been particularly difficult for processes that escheat in-kind, as that makes it difficult to obtain the necessary withholding. Thankfully, no action is required to correct any reporting and withholding prior to the effective date of the guidance. Also, to the extent missing participant amounts are simply forfeited to the Plan's forfeiture account (under the first exception noted above), this guidance does not apply and therefore there is no similar reporting or withholding requirement for the returning of such funds to the plan (or the plan's forfeiture account). However, we still await guidance on what the proper reporting and withholding requirements would be for (1) the initial uncashed distribution where the participant is missing and not merely unresponsive, and (2) when the payments are later restored when the participant or beneficiary is found.

Moreover, Plan sponsors, and their recordkeepers, should review their rollover procedures and update them accordingly. This applies to all plan sponsors, regardless of their missing participant approach, as there is now an updated model self-certification letter that should be used and all references to Rev. Proc. 2016-47 should be replaced.

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