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Qualified Plan Uncashed Check Guidance Issued Related to Tax Obligations

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On August 14, 2019, the IRS issued Revenue Ruling 2019-19, providing guidance to both tax-qualified plan administrators and participants on the tax treatment of plan distribution checks that are not cashed.

Background

In recent years, the issue of uncashed distribution checks has gained increased attention (and scrutiny) from the DOL and IRS and, as a result, has become a primary concern for plan administrators. Despite the best efforts of plan administrators to ensure that terminated participants receive their funds, it is common for checks to go uncashed, particularly in those situations where distribution was mandatory (e.g., account balances that are less than $1,000 and minimum required distributions).

A distribution from a tax-qualified plan generally is subject to income tax withholding and reported on IRS Form 1099-R for the year of distribution, and the participant must include the amount of the distribution in gross income for that year. However, when a check goes uncashed, one question that plan administrators commonly face is what to do about the income tax withholding and Form 1099-R reporting, i.e., should the plan administrator issue a corrected Form 1099-R for the uncashed check and recoup the tax withholding, reversing the transaction.

The Ruling

The ruling lays out a specific situation where a plan administrator is required to make a distribution under $1,000 to a plan participant in 2019. The plan administrator sends a check to the participant for the amount of the mandatory distribution, less applicable withholding taxes. The participant receives the check but does not cash it or roll over any portion of the distribution.

The ruling addresses three concerns relating to the uncashed check, one related to income inclusion for the participant and two addressing the plan administrator's withholding and reporting obligations. Specifically, the ruling concludes that:

1. The distribution is taxable to the participant and must be included in the participant's gross income for 2019. The participant cannot escape this tax liability by not cashing the check in 2019 for whatever reason (even if the check is cashed in a later calendar year).

2. The fact that the participant did not cash the check in 2019 does not change the plan administrator's withholding requirements. The plan administrator must withhold and be liable for depositing the applicable withholding tax (or direct the third-party payor to withhold the tax as permitted under law).

3. The plan administrator must report the distribution and the federal income tax withheld on a Form 1099-R for 2019 to satisfy its reporting obligations. This obligation is unchanged by the fact that the distribution check was not cashed in 2019.

Key Takeaways

The ruling provides welcome clarification to plan administrators but does not address some of the more complex issues that arise when distribution checks from a tax-qualified plan remain uncashed. For example, the ruling seems to draw a distinction between a participant who simply refuses to cash a check versus a participant who is truly missing and does not receive the distribution check. The facts on which this ruling is based make it clear that the participant could have cashed the check but chose not to do so. However, it does not appear that the holdings in the ruling would also apply in the case of a participant who never actually received the distribution check (e.g., because of a bad address).

Accordingly, if a check is returned to the plan uncashed, demonstrating that it was never received, the administrator may still have an obligation to reverse the reporting and withholding on the distribution. In reality, in many cases a check is neither cashed nor returned. If the check is mailed to a presumptively good address, it appears that the administrator may assume the check was received and simply uncashed.

Both the DOL and the IRS have indicated that additional guidance relating to missing participants and uncashed checks is forthcoming. Further, the ruling specifically states that the IRS will continue to analyze issues that arise in other situations involving uncashed checks, including situations involving missing participants.

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