IRS Issues Guidance on Uncashed Distribution Checks

by Edward M. Bernard

Last month, the IRS issued new guidance on the tax treatment of uncashed distribution checks from qualified retirement plans. In Revenue Ruling 2019-19, the IRS ruled that a participant's failure to cash the required distribution check she received from a qualified plan did not permit her to exclude the distribution from her taxable income or alter her employer's obligation to withhold taxes from the distribution and report it as taxable income.

Under the facts of the ruling, the participant did not have any amount under the plan that had already been taxed (such as voluntary employee after-tax contributions), had not made any withholding elections, and did not roll over the distribution to another eligible retirement plan or meet any other tax exception.

The new guidance is welcome news for qualified plan administrators. Frequently, qualified plans are required to make distributions to participants. For example, a qualified plan may require automatic distribution of small amounts – typically those that do not exceed $1,000 – or may be required to make minimum distributions to a participant who has reached age 70½. Sometimes, in those cases, a participant who is required to receive a distribution fails to cash the distribution check.

Fortunately, the new guidance clarifies that the participant must include the distribution in his or her taxable income in the year paid, even if he or she fails to cash the distribution check. The new guidance also clarifies that the participant's failure to cash the distribution check does not change the plan administrator's obligation to withhold taxes and report the distribution as taxable income. Therefore, a plan administrator should not try to undo income tax withholding or reporting merely because a participant fails to cash a distribution check.

Unfortunately, the ruling does not address all of the concerns that plan administrators have when participants fail to cash distribution checks. One concern is that the plan still has the funds. A qualified plan document should address the disposition of funds attributable to uncashed distribution checks.

Another concern is that those funds remain plan assets. Plan administrators of ERISA-covered plans therefore have a fiduciary obligation to try to ensure that those assets are paid to the participant entitled to them in accordance with the plan's terms. This has been a focus in recent Department of Labor audits.

The ruling also does not address missing participants. In late 2017, the IRS issued a memo to employee plans auditors regarding the treatment of missing participants and beneficiaries under the required minimum distribution rules, which set forth the steps that retirement plans should take to avoid a determination that they failed to meet the required minimum distribution rules.

The Department of Labor has also issued guidance regarding steps that plan fiduciaries of terminated defined contribution plans must take to try to try to locate missing participants and beneficiaries. In general, under this guidance reasonable steps must be taken, including using certified mail, checking employer records, checking with beneficiaries, and using electronic search tools, to try to locate missing participants and beneficiaries.

Although the ruling does not address all of these questions and concerns, it is another step in the right direction.

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