IRS Releases New Escheatment Guidance

Handling unclaimed account balances has always challenged plan administrators and financial organizations. Even some government-approved options—such as rolling over plan assets to an IRA—can create difficulties when distributing missing or unresponsive individuals' account balances. Escheating (i.e., reverting) assets to a state's unclaimed property fund is also an option—especially for smaller account balances—but it's usually considered a last-ditch effort by plan administrators and financial organizations who have tried but failed to locate missing account owners and their beneficiaries.

In January 2019, the U.S. Government Accountability Office (GAO) released a GAO 19-88 report that found reporting and withholding inconsistencies among plan administrators who escheated plan assets to a state's unclaimed property fund. The GAO found that some plan administrators withheld taxes on escheated plan assets, but others did not. The GAO also found that administrators could benefit from additional guidance on reporting escheated assets and on whether individuals could later roll over escheated amounts to an IRA.

In response to the GAO's recommendations, in October 2020 the IRS issued Revenue Ruling (Rev. Rul.) 2020-24 and Revenue Procedure (Rev. Proc.) 2020-46. This guidance builds on previous pronouncements in Rev. Proc. 2016-47, which provided self-certification procedures for rollovers, Rev. Rul. 2018-17, which explained how financial organizations should report escheated IRA assets, and Rev. Rul. 2019-19, which laid out reporting and withholding requirements for uncashed checks.

This *Retirement Spotlight* summarizes Rev. Rul. 2020-24 and Rev. Proc. 2020-46 and explains how they interact with other IRS and Department of Labor (DOL) guidance.

Highlights of Rev. Rul. 2020-24

In Rev. Rul. 2020-24, the IRS provides the following escheatment example and determines that the distribution is subject to withholding and reporting requirements.

- A 401(a) qualified retirement plan administrator escheats an individual's $900 account balance to a state unclaimed property fund. (This amount is beneath the $1,000 threshold that would require an automatic rollover to an IRA.)
- The account does not include employer securities, nondeductible employee contributions, designated Roth amounts, or accident or health plan benefits.
- The plan administrator does not have a withholding election on file for this individual.

Withholding Requirements – The IRS states that the $900 distribution is a "designated distribution" and is subject to the withholding requirements under Internal Revenue Code Section (IRC Sec.) 3405. A designated distribution is defined as any taxable payment from a deferred compensation plan (which is broadly defined), an IRA, or a commercial annuity. The IRS also notes that the following payments are not considered designated distributions.

- Wages
- Payments to a nonresident alien or corporation
- Dividends on employer securities

Because the $900 designated distribution is considered an eligible rollover distribution, the plan administrator must withhold 20 percent ($180) for federal income taxes.

Reporting Requirements –The IRS ruling verifies that plan administrators must report this type of distribution on IRS Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* Although the escheated assets are being paid to the state's unclaimed property fund, the plan administrator must report the $900 distribution amount in Box 1, *Gross distribution,* and the $180 federal withholding amount is reported in Box 4, *Federal Income tax withheld*. While Rev. Rul. 2018-17 verifies that financial organizations should report escheated IRA assets under the missing individual's name and Social Security number, Rev. Rul. 2020-24 is silent on this issue. Additional guidance may be needed.

Transition Relief – Although many plan administrators already follow the withholding and reporting requirements described in Rev. Rul. 2020-24, the IRS is providing a transition period for those who need time to prepare. Plan administrators must comply with this guidance by the earlier of 1) the first payment date that occurs on or after January 1, 2022, or 2) the date it becomes "reasonably practicable" to comply.

Highlights of Rev. Proc. 2020-46

IRC Secs. 402(c)(3)(B) and 408(d)(3)(I) authorize a waiver of the 60-day rollover requirement in certain circumstances, such as when a financial organization makes a mistake or if a family member dies or becomes seriously ill. Previous IRS guidance (Rev. Proc. 2016-47) included a sample letter that may be provided to a plan administrator or financial institution to identify the reason for extending the normal 60-day period in order to complete an otherwise eligible rollover.

Rev. Proc. 2020-46 modifies Rev. Proc. 2016-47 by adding another reason to the self-certification letter: "a distribution was made to a state unclaimed property fund." So individuals who recover escheated retirement plan assets can use this self-certification to document their rolling over such assets to an eligible plan. Self-certification applies only to the waiver of the 60-day rollover rule, so individuals cannot use this process on a distribution that is otherwise ineligible for rollover treatment, such as a required minimum distribution (RMD). Rev. Procs. 2020-46 and 2016-47 apply to eligible rollovers from 401(a) plans, 403(a) and 403(b) annuity plans, governmental 457(b) plans, and IRAs.

Key Takeaways

This latest IRS guidance should be evaluated in light of existing DOL guidance. The DOL considers escheatment a less desirable option and believes that ERISA preempts state escheatment laws for active retirement plans. The

DOL makes its position clear in Field Assistance Bulletin (FAB) 2014-1, which addresses fiduciary duties with respect to missing participants of *terminated* retirement plans. In FAB 2014-1, the DOL indicates that plan administrators should roll over unclaimed balances to an IRA when possible. As a last resort, plan administrators of terminated retirement plans may escheat any unclaimed balances to a state's unclaimed property fund. Although the DOL has not issued any guidance for active retirement plans, escheatment may still be an option for ineligible rollover distributions, such as RMDs.

Some in the industry have asked for additional guidance on missing plan participants (such as a safe harbor for retirement plans with missing participants). Although the DOL has yet to release additional guidance, the IRS has included missing participant guidance in its 2020-2021 Priority Guidance Plan. Congress has also recently introduced legislation that proposes to create a national online "lost and found" database to connect individuals with unclaimed retirement account benefits.

Meanwhile, escheatment is a viable option only after pursuing all reasonable steps to locate a missing or unresponsive plan participant or IRA owner. The IRS's guidance addresses how to withhold and report on escheated assets, but it doesn't address *whether or when* escheatment should be used. Questions also remain on how to treat escheated assets once they're rolled over to an eligible plan. For example, consider an individual who recovered escheated assets and rolled them over to an IRA. Would the assets be taxed when distributed from the IRA, or would they be considered basis in the IRA? If the assets are treated as after-tax basis, how would the IRA owner document this? And those considering escheatment should be aware of the substantial variation in rules from state to state.

Although questions remain, plan administrators who escheat plan assets should ensure that their systems are set up to apply the correct withholding amount and to report the distribution properly. Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.