AMERICAN BENEFITS COUNCIL

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Re: Missing and Unresponsive Retirement Plan Participants

Missing and unresponsive retirement plan participants create significant challenges for retirement plan sponsors seeking to administer their plans in accordance with the Internal Revenue Code ("the Code") and guidance from the Department of the Treasury and Internal Revenue Service ("IRS"). Most often, missing and unresponsive participants create tax compliance challenges when benefits must be distributed to them in accordance with the Code or the terms of a plan. Challenges also occur, however, when plans are required to furnish notices, report income, and/or withhold taxes in connection with benefits owed to missing and unresponsive participants.

The purpose of this letter is to request guidance from Treasury and IRS to address the common tax compliance challenges created by missing and unresponsive retirement plan participants. The Council appreciates the guidance that Treasury and IRS have already issued in the context of missing and unresponsive participants, but additional guidance is needed. The Council also appreciates recent comments from Treasury officials indicating that they are considering guidance in this area and that they would

like to provide additional guidance on missing participants, especially with respect to common withholding and reporting issues.

The American Benefits Council (the "Council") is a national nonprofit organization dedicated to protecting and fostering privately sponsored employee benefit plans. The Council's approximately 440 members are primarily large multistate U.S. employers that provide employee benefits to active and retired workers and their families. The Council's membership also includes organizations that provide employee benefit services to employers of all sizes. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans covering virtually all Americans who participate in employer-sponsored benefit programs.

I. MISSING AND UNRESPONSIVE PARTICIPANT OVERVIEW

Because of changing workforce demographics and the rise of automatic enrollment, an employer's responsibility for dealing with retirement benefits and accounts left behind by former employees has become even more demanding. During career transitions, employees often do not consider how their immediate change in employment will affect their long-term retirement goals. Many employees do not roll over a benefit under a former employer's plan into their new employer's plan. And, many workers neglect to update their contact information on file with a former employer, even if they have a defined benefit plan benefit or defined contribution plan account.

In addition to missing participants, there are many participants who the employer does not believe is missing (that is, the contact information appears to be correct) but the participant simply fails to respond to attempts to contact him or her. In fact, many distribution checks go uncashed even though the employer knows that the participant has not moved. These unresponsive participants present related but slightly different challenges than participants who cannot be located.

Employers must deal with defined benefit pension benefits and 401(k) accounts left behind by former employees who are unresponsive or for whom the employer has no reasonable way of notifying the participant about the status of their benefit. From a tax compliance standpoint, this is most challenging when benefits must be distributed from a plan as a matter of plan qualification and when plan administrators must furnish notices, report income, and/or withhold taxes in connection with benefits owed to missing and unresponsive participants.

The IRS has published missing participant guidance on a few discrete issues. And as summarized below, plan sponsors and administrators have largely incorporated this guidance into their standard policies and procedures. Still, missing and unresponsive participants continue to create tax compliance challenges in circumstances that are not

addressed by existing guidance. Accordingly, we are urging Treasury and IRS to publish guidance that provides plan sponsors and service providers with clarity on how they can satisfy their obligations under the Code with respect to missing and unresponsive participants.

II. Current Practices For Handling Benefits Owed to Missing Participants

When the Code or the terms of a plan require a distribution to be made to a missing or unresponsive participant, employers handle benefits in a variety of ways depending on the circumstances giving rise to the distribution. The following summary provides an overview of how employers currently handle distributions that are owed to missing and unresponsive participants.

Required Minimum Distributions

Missing and unresponsive participants create significant challenges from a tax compliance standpoint when required minimum distributions ("RMDs") must be taken in accordance with Code Section 401(a)(9) and the terms of the plan. The Council appreciates the recent pair of memoranda instructing Employee Plans examiners on how they should review qualified and 403(b) plans that have not forced out RMDs owed to a missing participant or beneficiary, if the plan has taken certain search steps to locate a missing participant. Our members commend the IRS for issuing guidance that provides retirement plan administrators with a set of appropriate steps for locating missing participants and beneficiaries. Nevertheless, we continue to believe this recent guidance requires additional clarification for 403(b) plans, and as we previously recommended in our January 2, 2019 joint letter with industry partners, Treasury and IRS should clarify that its recent missing participant guidance is not intended to override the rules that treat 403(b) contracts and annuities as IRAs for purposes of the RMD rules.

Since the IRS released its RMD exam guidance, many employers have drafted policies and procedures to comply with its search steps and some plans have even incorporated this guidance into the terms of their plans. At the same time, however, some employers still distribute RMDs owed to missing and unresponsive participants. Because RMDs cannot be rolled over to an IRA, these distributing plans will often transfer benefits owed to missing participants to an after-tax account established for the benefit of the missing participant.

Automatic Cash-Outs

When the terms of a plan require small account balances or plan benefits in excess of $1,000, but less than or equal to $5,000, to be distributed to employees that have separated from service, plans will transfer those amounts to an IRA in accordance with

Code Section 401(a)(31)(B) on behalf of the former employee if the employee is unresponsive to an employer's request for direction on where the former employee would like such amounts to be transferred.

Automatic Cash-Outs of $1,000 or Less

In the case of mandatory cash-outs of $1,000 or less, plans differ on how they handle benefits owed to missing and unresponsive participants. Some plans will transfer these small amounts to an IRA, consistent with the rules applicable to mandatory cash-outs under Code Section 401(a)(31)(B). Other plans, by contrast, will not distribute small benefits of less than $1,000 if a participant does not provide the employer with direction. In that case, a plan will simply forfeit the participant's benefit, and if the participant ever returns to claim the benefit, the plan will reinstate the benefit. These forfeited amounts are used to offset future contributions and pay reasonable plan expenses. If a participant ever returns to claim the benefit, the plan sponsor will generally make a contribution to the plan to make up any difference.

This "forfeiture and reinstatement" approach is consistent with Treasury Regulation Section 1.411(a)-4(b)(6), which recognizes forfeiture and reinstatement as an acceptable procedure for dealing with benefits owed to missing participants by stating that "a right [will not be treated] as forfeitable – [i]n the case of a benefit which is payable, merely because the benefit is forfeitable on account of the 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."

Corrections

Missing and unresponsive participants also create challenges for plan administrators when attempting to distribute amounts to participants as part of a correction required under the Employee Plans Compliance Resolution System ("EPCRS"). In that circumstance, consistent with EPCRS Section 6.02(5)(d)(i),[1] plan sponsors will typically keep amounts attributable to corrective distributions in the plan if reasonable attempts to locate any missing participants or beneficiaries are unsuccessful. In many respects, this approach is similar to the forfeiture and reinstatement procedures discussed in the prior paragraph, as both methods keep benefits in the plan until a missing participant can be found.

[1] Rev. Proc. 2018-52, Section 6.02(5)(d)(i) ("A Plan Sponsor will not be considered to have failed to correct a failure due to the inability to locate an individual if reasonable actions to locate the individual have been undertaken in accordance with this paragraph; provided that, if the individual is later located, the additional benefits are provided to the individual at that time.").

III. Notices, Reporting, and Withholding

Missing participants also create tax compliance challenges and confusion when the Code requires plan administrators to furnish notices, report information, and/or withhold taxes on distributions owed to missing participants.

Notices and Reporting to Participants

By definition, plan administrators do not have a correct address or other contact information for missing participants. This fact makes it virtually impossible for a plan administrator to: (a) furnish missing participants with required notices, like the special tax notice required by Code Section 402(f); or (b) furnish tax reporting to missing participants, like the reporting required on Form 1099-R. As further discussed below, Treasury and IRS should issue generally applicable guidance that provides relief to plan administrators that cannot comply with their notice and reporting obligations because a participant has gone missing.

This type of relief is particularly critical in order to reduce uncertainty regarding notice and reporting penalties that could otherwise apply in the context of missing participants. For example, Code Section 6722 imposes a $250 penalty for each failure to furnish correct payee statements when a distribution is made from a plan, unless it is shown that such failure is due to reasonable cause and not to willful neglect. In the context of missing participants, this is most relevant to any plan administrator attempting to furnish a Form 1099-R to a payee who is missing. Similarly, Code Section 6652(i) imposes a tax penalty of $100 for each failure to provide the special tax notice required under Code Section 402(f), which provides an explanation of distributions eligible for rollover treatment. Like the penalty imposed under Code Section 6722, no penalty is owed if it is shown that such failure is due to reasonable cause and not willful neglect.

The Code and current IRS guidance indicate that these penalties can be waived if it is shown that a notice or reporting failure is due to reasonable cause. We understand that the IRS is often willing to waive these reporting penalties because missing participants create the type of "reasonable cause" necessary to trigger the waiver. However, existing guidance is inefficient and confusing because waivers must be requested after the reporting penalty is assessed and it is not always clear what steps a plan administrator must take in order to qualify for the reasonable cause waivers.

Reporting and Withholding to the IRS

Missing participants also create uncertainty for plan administrators when they attempt to satisfy their obligations to report income and withhold taxes to the IRS in relation to benefits owed to missing and unresponsive participants. This problem is

slightly different than the complications that arise for plan administrators when attempting to furnish notices and reports to missing participants because plan administrators are actually able to report income and send withheld taxes to the IRS on behalf of missing and unresponsive participants.

Recent IRS guidance addressing the reporting and withholding requirements for payments from IRAs to state unclaimed property funds has provided some insight into how plan administrators should fulfill their reporting and withholding obligations with respect to missing and unresponsive participants. However, even when applying the logic of that IRA guidance to employer-sponsored retirement plans, additional instruction is needed and the IRS should, regardless of any IRA guidance, expressly clarify how the reporting and withholding rules apply to employer-sponsored retirement plans trying to handle benefits owed to missing and unresponsive participants.

Such guidance should specifically clarify how the reporting and withholding rules apply to each of the most common situations that retirement plan administrators face in handling benefits owed to missing and unresponsive participants. These situations include:

1. A check is sent to the participant or beneficiary and is not returned as undeliverable but never cashed.
2. A check is sent to the participant or beneficiary and returned as undeliverable.
3. In connection with one of the first two situations, the plan distributes benefits to an IRA maintained for the benefit of a participant or beneficiary.
4. In connection with one of the first two situations, the plan distributes the benefits to a taxable account (for example because the amount is not eligible for rollover).
5. In connection with one of the first two situations, the plan distributes the benefits to a state unclaimed property fund.
6. Instead of distributing benefits to an IRA or other source, the plan administrator forfeits the benefit pursuant Treas. Reg. § 1.411(a)-4(b)(6), subject to reinstatement.
7. Instead of distributing benefits to an IRA or other source, the plan administrator (in a defined contribution plan) places the funds back into an account for the missing or unresponsive participant or beneficiary.
8. A plan may owe a participant or beneficiary an RMD but, based on the Service's guidance, has decided not to distribute it unless and until the participant or beneficiary is found.

In our experience, most plans generate a Form 1099-R whenever (and only when) a check is issued, even if the check is not cashed, since the funds have been "distributed" from the plan, which is what triggers taxable income and thus reporting. (In addition, withholding will generally have occurred, which must be reported to the Service.)

But the foregoing illustrates that there are a variety of situations, and it is not clear what, if anything, would make a difference in when and how a distribution should be reported. For example, does the reporting depend on whether the check is returned as undeliverable? If the amount is reported on a Form 1099-R, but the check is never cashed, is there further reporting if the amount is later sent to an IRA, taxable account, or state unclaimed property fund? How, if at all, should forfeited amounts be reported?

Guidance specifically addressing questions like this would provide greater certainty for plan administrators that are currently, in good faith, trying to comply with their reporting and withholding obligations in the absence of definitive guidance.

Given the uncertainty created by missing and unresponsive participants, any such guidance should also provide appropriate transition relief for plan administrators and their service providers. As we recently witnessed in the context of the IRS guidance addressing the reporting and withholding requirements for payments from IRAs to state unclaimed property funds, this type of guidance could require significant system adjustments and affected entities should be given the appropriate time to make those adjustments.

IV. RECOMMENDATIONS

Broaden Relief and Clarify Rules Applicable to Missing and Unresponsive Participants

We strongly encourage the IRS to use its recent RMD exam guidance as a model for generally applicable guidance for plan sponsors dealing with missing and unresponsive participants. Specifically, the IRS should publish guidance indicating that the IRS will not challenge a plan administrator for any failure to satisfy certain requirements under the Code because a retirement plan participant is missing or unresponsive, if (a): in the case of a missing participant, the plan takes certain search steps to locate the missing participant; or (b) in the case of a unresponsive participant, the plan has a reasonable basis to believe that the participant's address listed on the plan's records is correct and has made at least three attempts to solicit a response. Such guidance should expressly cover the inability to pay RMDs, distribute small account balances or plan benefits of $1,000 or less, pay corrective distributions, or otherwise satisfy the Code's participant

notice and reporting rules.[2] Such steps should also be deemed to be "reasonable efforts" for purposes of the IRS's informal guidance telling plan administrators that they do not need to report unpaid RMDs on Form 5500, Line 4 as a failure to provide benefits when due, if the participant or beneficiary cannot be located after reasonable search efforts.

In addition to this general relief, we also recommend that Treasury and IRS clarify how the reporting and withholding rules apply to the most common ways that retirement plan administrators handle benefits owed to missing and unresponsive participants. This recommendation is consistent with a recommendation recently made by the Government Accountability Office ("GAO") in a report examining the transfer of 401(k) accounts to state unclaimed property funds.[3] In that report, GAO concluded that IRS has not clarified what, if any, tax reporting and withholding requirements apply to those transfers and this lack of guidance creates uncertainty for retirement plan service providers. Accordingly, GAO recommended that IRS consider clarifying: (1) if transfers of unclaimed savings from employer-based plans (such as 401(k) plans) to states are distributions; (2) what, if any, tax reporting and withholding requirements apply; and (3) when such requirements, if any, apply. The Council fully supports these GAO recommendations and asks for broader clarification on how the reporting and withholding rules apply to *all* of the most common ways that retirement plan administrators handle benefits owed to missing and unresponsive participants.

Critically, the requested guidance must account for the unique challenges created by unresponsive participants. While existing IRS guidance for RMDs and corrective distributions under EPCRS provides valuable relief in the case of missing participants, such relief does not directly contemplate the challenges posed by unresponsive participants. Also, while the search methods described in the IRS's existing missing participant relief make sense if an employer cannot locate a former employee, those same procedures do not make sense as a condition for relief when a participant simply refuses to respond to solicitations from the plan.

Finally, we also encourage IRS to remove any requirement to use certified mail as a condition for any missing participant relief. If a plan's records indicate that mail sent to a participant has been returned as undeliverable, it does not make sense for a plan administrator to resend additional solicitations by certified mail. Our members find that

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[2] With regard to notice and reporting penalties, IRS should develop procedures that allow plan administrators to proactively certify that they have appropriately searched for missing participants who are supposed to receive notices or reports in connection with a distribution. This would avoid the inefficiencies created by the current system for requesting "reasonable cause" reporting relief after penalties have already been assessed and could, for example, be accomplished by adding a new reporting code to the Form 1099-R filed on behalf of a missing participant to the IRS.

[3] GAO-19-88, *Retirement Accounts: Federal Action Needed to Clarify Tax Treatment of Unclaimed 401(k) Plan Savings Transferred to States* (January 2019).

certified mail adds unnecessary costs and is an ineffective tool for locating missing participants.

Forfeiture and Reinstatement

Treasury and IRS should reaffirm that forfeiture and reinstatement is an acceptable method for handling amounts that must be distributed to missing and unresponsive participants, except as otherwise provided by the Code. This approach is not only consistent with Treasury Regulation Section 1.411(a)-4(b)(6), it is also consistent with IRS guidance on distributing amounts owed to missing participants as part of a correction under EPCRS. In recent years, the Department of Labor ("DOL") has informally challenged the use of forfeiture and reinstatement as an acceptable method for handling benefits owed to missing participants. We strongly disagree with that position and encourage IRS to coordinate with DOL to clarify that forfeiture and reinstatement procedures are not only consistent with the Code's qualification requirements, but also consistent with a plan fiduciary's obligations under Title I of ERISA.

Missing Spouses

Although not directly applicable to missing and unresponsive *participants,* Treasury and IRS should also clarify how the Code's spousal consent requirements apply to employer-sponsored retirement plans when a spouse reasonably cannot be located. Treasury Regulations expressly clarify that spousal consent is not required for a participant to waive a plan's qualified joint and survivor annuity ("QJSA") or qualified preretirement survivor annuity ("QPSA"), when the spouse cannot be located to the satisfaction of the plan administrator. *See* Treasury Regulation Section 1.401(a)-20, Q&A-27. However, existing Treasury and IRS guidance is not so clear in other cases when spousal consent is required and the spouse cannot reasonably be located. For example, Treasury and IRS should confirm that spousal consent is likewise not required to change a beneficiary, if the spouse cannot be located to the satisfaction of the plan administrator.

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Sincerely,

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