The COMMITTEE of ANNUITY INSURERS

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VIA ELECTRONIC MAIL

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Re: *Rev. Rul. 2020-24 – Request for Additional Guidance on Reporting and Withholding for Amounts Escheated from Qualified Plans*

Ms. Weiser and Ms. Carrington:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") to request additional guidance to supplement and clarify Rev. Rul. 2020-24,[1] regarding reporting and withholding with respect to amounts escheated from qualified retirement plans. The Committee believes there is a pressing need for modifications to the relevant information reporting forms and additional guidance on several aspects of the revenue ruling. In particular, we are requesting the following:

(1) Distribution code – A new distribution code should be made available on the applicable information reporting forms to indicate that a distribution from a qualified retirement plan was escheated to a state, and the Service should not propose penalties for incomplete reporting or underpayments of tax relating to amounts that are reported using the new distribution code;

(2) Presumption rules – Guidance should address situations where, due to a lack of information about a payee, the presumption rules under section 1441 treat the payee as a foreign person, including possibly excepting escheated amounts from those presumption rules; and

(3) Previously reported amounts – Guidance should clarify that amounts under a qualified retirement plan that were previously subjected to reporting and withholding requirements are not subjected to those requirements again at the time of escheatment.

[1] 2020-45 I.R.B. 965.

The Committee is a coalition of life insurance companies whose current 31 members (list attached) represent approximately 80% of the annuity business in the United States. The Committee was formed in 1981 to participate in the development of federal policy with respect to annuities. The Committee's member companies are among the largest issuers of annuity contracts to employer-sponsored retirement plans. We previously submitted a letter on the Committee's behalf noting concerns with respect to Rev. Rul. 2018-17,[2] regarding amounts escheated from IRAs. This letter echoes many of those same concerns. We also understand that the American Council of Life Insurance ("ACLI") is submitting a letter regarding Rev. Rul. 2020-24, which the Committee endorses and supports.

(1) New Distribution Code and Change in Penalty Procedures

In many escheatment scenarios, the reason the property is presumed abandoned under state law is the payor lacks full information about the payee. For example, in cases where the plan participant dies, the payor may have only the name of a beneficiary without a Social Security number ("SSN") or address. In some cases, the plan may not even have the name of a beneficiary, such as where the plan provides that the surviving spouse is the participant's beneficiary but the plan has incomplete information about the spouse, or the plan provides for a class of beneficiaries such as children but the participant does not name them. In such cases, the payor often cannot locate the beneficiary even after taking significant steps to do so, which ultimately leads to escheatment.

Rev. Rul. 2020-24 suggests that in these circumstances the payor would be required to report the escheated amount on Form 1099-R and list the beneficiary as the recipient.[3] If the payor lacks information such as the beneficiary's name, address, or SSN, the Form 1099-R would not include that information. Furthermore, without a valid address the payor may not be able to send a payee statement at all, or state privacy law may restrict the payor's ability to do so.[4] Any such failure to include full and correct information on the information return or payee statement, or any failure to furnish the payee statement, may generate an automatic penalty notice from the Service to the payor.[5]

In these and similar circumstances, if the IRS were to propose reporting penalties, the penalties almost certainly would be abated pursuant to the reasonable cause exception in section 6724(a). However, the abatement process can take a considerable amount of time and resources,

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[2] 2018-25 I.R.B. 753.

[3] The presumption rules under section 1441 may alter this result. See the discussion in item (2), starting on page 3 below.

[4] For example, if the payor previously attempted to contact a payee at a particular address and the communication was returned as undeliverable, the payor could be charged with knowledge that the payee does not reside at that address. If the payor were to then send additional communications with "personally identifiable information" – such as financial or tax information – to an address the payor knows is incorrect, the payor could have exposure to liability under state privacy laws. *See generally* STANDARDS FOR SAFEGUARDING CUSTOMER INFORMATION MODEL REGULATION (NAT'L ASS'N INS. COMM'RS 2002).

[5] *See generally* Internal Revenue Manual § 20.1.7, *Information Return Penalties* (Dec. 9, 2019).

both for the payor and the Service. In this sense, Rev. Proc. 2020-24 seems likely to lead to a significant amount of unnecessary expense and effort by payors and the Service to process proposed penalties that ultimately will not be asserted.[6] Furthermore, in many escheatment situations the individual taxpayer may be unaware of the payment and thus may unintentionally omit the associated income from his or her tax return. This could result in IRS penalty notices for the individual, which also seem likely to be abated and thus to lead to unnecessary expense and effort. These problems could be eliminated if the Service were to adopt the following approach:

- Add a new distribution code to Form 1099-R. The code would be used to indicate that the amount reported on the form was escheated to a state. The Information Reporting Program Advisory Committee (IRPAC) has recommended this approach, observing that among other things it could help eliminate confusion and prompt individuals to seek recovery of the amount from the state.[7]

- Clarify payee statement requirements. Guidance should clarify that the payor is not required to furnish a payee statement with respect to an escheated amount if, after taking the steps required by state law, the payor cannot obtain an address for the payee or reasonably believes that the last known address is incorrect. Thus, in such cases the payor would not be subject to reporting penalties for not furnishing a payee statement.[8] This would be analogous to other situations in which payors are not required to send statements or other information to payees with known incorrect addresses.[9]

- Change penalty procedures. The Service should adopt procedures so that in cases where a payor files a Form 1099-R with the Service and includes the new distribution code on the form, the Service will not issue reporting penalty notices merely because the

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[6] The Committee's member companies process a significant number of escheatment transactions in their annuity businesses each year, and the dollar amounts involved are quite substantial. In New York alone, the state collected $875 million in unclaimed property for the fiscal year 2019-2020, with 17% of that amount (or about $149 million) coming from insurance companies. *See* Office of the New York State Comptroller, Annual Report of the Office of Unclaimed Funds (SFY 2019-20), *available at* https://www.osc.state.ny.us/files/unclaimed-funds/resources/pdf/annual-report-sfy-2019-20.pdf.

[7] *See*, *e.g.*, IRPAC Public Report, at 10 (2015), available at https://www.irs.gov/pub/irs-utl/2015IRPAC_Public_Report.pdf.

[8] We understand that the ACLI is making a similar request for guidance, which we support.

[9] For example, section 6049(c) normally requires payors of interest to provide payee statements, but not if the payee's address is known to be incorrect, the payor makes a reasonable effort to obtain the correct address, and the payor is prepared to supply the statement when requested. Rev. Rul. 81-64, 1981-1 C.B. 575. Similarly, the regulations under section 6724 generally require payors to make annual solicitations to obtain missing TINs for payees, but that requirement does not apply to "accounts with respect to which the filer has an undeliverable address, *i.e.*, where other mailings to that address have been returned to the filer because the address was incorrect and no new address has been provided to the filer." Treas. Reg. section 301.6724-1(e)(1)(vi)(F).

information return or payee statement includes incomplete information.[10] Similar relief should be provided in analogous situations.[11]

We urge the Service to take these steps with respect to Form 1099-R and in similar situations. In that regard, similar steps would be needed for Form 1042-S unless the Service and Treasury revisit the presumption rules in the section 1441 regulations, as discussed in item (2) immediately below.

(2) <u>Presumption Rules for Payee Status as U.S. or Foreign Person</u>

The regulations under section 1441 require certain presumptions when determining whether an individual is a U.S. person or a foreign person in the absence of documentation. Generally, in such cases a payee is presumed to be a U.S. person unless the payment is made outside the United States with respect to an offshore obligation.[12] In the case of qualified plans and IRAs, however, a payee is presumed to be a *foreign* person if the payor lacks an SSN or a U.S. address for the payee.[13] Payments from a qualified plan to a presumed foreign person are subject to 30% withholding under section 1441 rather than the applicable rate of withholding under section 3405 and must be reported on Form 1042-S rather than Form 1099-R.

As discussed above, in many cases involving escheatment and qualified retirement plans the payor will not have an SSN or address for the payee, such as the beneficiary of a deceased participant. In those cases, the presumption rules could be interpreted as requiring the payor to withhold 30% from the escheated amount and report the escheated amount on a Form 1042-S that identifies the missing person as the recipient. However, Rev. Rul. 2020-24 excludes this scenario from its scope,[14] so there currently is no guidance on this issue.

In the absence of guidance from the Service, some state abandoned property administrators might assert that the payor should not withhold federal income tax from the escheated amount at all, or that the payor should withhold only at a lower rate required by section 3405 rather than at the 30% rate required by section 1441. This would put payors in the

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[10] We understand that the ACLI is requesting confirmation that the reasonable cause exception under section 6724 automatically applies in these situations. We support their request and note that our proposed approach of the Service refraining from asserting penalties would implicitly confirm that the reasonable cause exception applies automatically in these situations.

[11] Although not addressed in Rev. Rul. 2020-24, payors also have obligations under section 3405(e)(10)(B) to notify payees of their rights to elect out of withholding. Penalties can apply under section 6652(h) for failures to provide such notice, unless the failure is due to reasonable cause. This is analogous to the penalties under section 6724 discussed above, so similar relief should apply if a payor fails to provide the notice due to a lack of information about the payee.

[12] Treas. Reg. section 1.1441-1(b)(3)(iii).

[13] Treas. Reg. section 1.1441-1(b)(3)(iii)(C).

[14] The ruling assumes that the individual involved is a U.S. person without discussing the presumption rules. The ruling also notes that under section 3405(e)(1)(B)(iii) a designated distribution does not include a payment that is subject to withholding under section 1441.

precarious position of having to choose between complying with the direction of the state unclaimed property administrator or risking liability to the Service for under-withholding.

The Service's guidance should be expanded to provide certainty on whether or not reporting and withholding requirements apply in these circumstances. If the Service determines that such requirements apply, additional guidance should adopt one of the following approaches:

(a) Provide an exception to the presumption rules – Guidance should provide an exception to the normal presumption rules, so that in all cases amounts escheated from qualified retirement plans would be subject to the same withholding and reporting requirements, namely, withholding under section 3405 and reporting under section 6047(d). This approach is warranted because the escheated amount would be paid to a state, which the payor knows with certainty is not a foreign person (even if the presumed owner's address is foreign). We would further note that the regulations under section 1441 provide that if the payee is an exempt recipient, such as a state government, the payee generally is presumed to be a U.S. person.[15]

(b) Modify Form 1042-S if the presumption rules apply – Alternatively, if the Service decides not to provide an exception to the presumption rules for escheated amounts, additional guidance should clarify and confirm how those rules apply. If escheated amounts must be reported on Form 1042-S, for the reasons discussed in item (1) above we would request that a new code be made available on the form to indicate that the amount being reported was escheated. In that regard, we note that Form 1042-S currently does not provide for "distribution" codes, so a different type of code would need to be added. Penalty relief as described in item (1) above also would be needed.

(3) Escheatment of Amounts Previously Subject to Reporting and Withholding

Guidance should clarify that amounts that were previously subjected to reporting and withholding requirements are not subjected to those requirements again at the time of escheatment. These situations can arise in a variety of scenarios involving qualified retirement plans. For example:

- Following a plan participant's death, the payor mails a check for the entire balance to the beneficiary's last known address in November 2021. The payor withholds tax from the distribution and reports the payment on Form 1099-R in January 2022. The check is never cashed and the amount escheats to the state in 2025.

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[15] *See* Treas. Reg. section 1.1441-1(b)(3)(iii)(A).

- The situation is the same as above, except the payor possesses a valid withholding certificate on which the payee has properly elected out of withholding.[16] As a result, the payor reports the distribution in January 2022 but does not withhold tax. The mailed check is never cashed and the amount ultimately escheats to the state.

Rev. Rul. 2020-24 does not expressly address these types of situations where the relevant reporting and withholding requirements are satisfied with respect to an amount and later the same amount is escheated to a state. We are concerned that the ruling could be read as suggesting that in these situations withholding and reporting is required again at the time of escheatment. Such a result – duplicative withholding and/or duplicative reporting for the same amount – would seem inappropriate. We request clarification that Rev. Rul. 2020-24 does not require withholding or reporting in such cases.

In addition, we observe that in situations like those described above the potential for double taxation arises because the Service has implicitly adopted the position in Rev. Rul. 2020-24 (as well as in Rev. Rul. 2018-17 for IRAs) that an amount that is escheated to a state is taxable to the individual in the year it is paid to the state. We disagree that this would necessarily be true. Section 402(a) provides that an amount "actually distributed to any distributee" is taxable to them. An escheatment does not result in an amount being actually distributed to the individual; rather, the amount is actually distributed to a state unclaimed property fund. Thus, section 402(a) seems inapplicable unless the individual can be viewed as having *constructively* received the amount that was actually distributed to the state.

In that regard, it may not always be appropriate to apply constructive receipt principles to treat an individual as having received an escheated amount. For example, lack of knowledge of a payment can prevent constructive receipt.[17] In addition, even if the individual were viewed as having constructively received the escheated amount in the year it was paid to the state, the amount may have been properly taxable to the individual in a prior year.[18] Accordingly, it may be reasonable to conclude that an amount is not includible in the individual's gross income in the year of escheatment. In that regard, withholding is required only with respect to a "designated distribution," which does not include "the portion of a distribution or payment which it is reasonable to believe is not included in gross income."[19]

Based on the foregoing, we question the underlying premise in Rev. Rul. 2020-24 (and in Rev. Rul. 2018-17) that escheated amounts are subject to withholding under section 3405.

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[16] *See generally* Treas. Reg. section 35.3405-1T, D-32 (allowing an election out of withholding for a nonperiodic distribution to apply to subsequent distributions). *See also* Treas. Reg. section 35.3405-1T, C-4 (similar for periodic payments). Of course, payees cannot elect out of withholding for eligible rollover distributions.

[17] *See*, *e.g.*, Davis v. Commissioner, T.C. Memo 1978-12; Mudd v. Commissioner, T.C. Summary Opinion 2004-1; Furstenberg v. Comm'r, 83 T.C. No. 43 (1984); Decker v. United States, 72 A.F.T.R.2d 93-5362 (D. Conn. 1993).

[18] *See*, *e.g.*, Rev. Rul. 2019-19, 2019-36 I.R.B. 674 (plan participant cannot avoid section 402(a) by choosing not to cash a check actually received).

[19] Section 3405(e)(1)(B)(ii).

Nonetheless, if the Service adheres to that position in its published guidance, we request clarification that such withholding is not required twice – meaning in cases where taxes were previously withheld from the amount in question before it was escheated to a state.

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We appreciate your consideration of our request for additional guidance to supplement and clarify Rev. Rul. 2020-24. We will follow up with you regarding our request. In the meantime, please let us know if you have any questions or if we can provide any additional information. You can reach either of us at 202-347-2230 or at the e-mail addresses below.

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Attachment (List of CAI Members)

cc: William Evans (Treasury Department)
Stephen Tackney (IRS)
Cynthia Van Bogaert (IRS)

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The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.