Folks:

Take-Away: Uncashed IRA distribution checks can present problems, especially when the IRA owner also has required minimum distribution obligations at the time the check is issued.

Background: The tax treatment of a distribution from an IRA, when the distribution check is not immediately cashed, can provide a surprise to IRA owners. When the IRA custodian writes the check, the tax impact is not affected. If the IRA owner writes the check, and the check is uncashed by the end of the calendar year, the means that the amount will be included in a different tax year than planned. Some situations and examples follow to understand these rules.

1. **Custodian Issues the Distribution Check:** Assume that the IRA custodian issued a check for a requested distribution from an IRA. That distribution will remain on the custodian's books and records for the year that the check was issued, and it must be reported by the custodian to the IRS as a distribution for that year, even if the check remains uncashed by the end of the calendar year. In other words, the custodian's tax reporting requirement remains even if the IRA distribution check remains uncashed.

   Example: Lucy is age 75. Lucy contacted her IRA custodian in December of 2023 and asked for distribution of $50,000. $40,000 of the $50,000 is Lucy's required minimum distribution (RMD) for 2023. Thus, at least $40,000 must be distributed from Lucy's IRA to her before December 31, 2023. Lucy's IRA custodian issues the check to her for $50,000 on December 21, 2023. The check is mailed to Lucy at the address that the custodian has on file for her. However, Lucy recently changed her address, and she failed to tell the custodian of her change-in-address. Consequently, the check was mailed to Lucy's old address. Early in January, 2024 Lucy contacts her IRA custodian and asks it to stop payment on the distribution check and to reissue a 'new' check, since by that time she believed the check to be lost. Lucy's IRA custodian issues to her a new check on January 15, 2024. Lucy receives the 'new' distribution check and promptly cashes the check.

- Lucy did not miss her RMD deadline. While the original check may have been stopped, that stop did not reverse the distribution.
- However, the cash was available from the uncashed check. This cash covered the 'new' check that was reissued to Lucy in January 2024.
- The original check issued for $50,000 in December 2023 represents a distribution to Lucy in 2023.
- The IRA custodian must issue Form 1099-R for $50,000 in 2023.
- Lucy must include the $50,000 in her 2023 income and report it on her 2023 Form 1040.
- When the original IRA distribution check was stopped in early January, 2024, the IRA custodian credited the $50,000 to Lucy's IRA account.
- That credit provided by the IRA custodian is nonreportable by the IRA custodian and it should not be reported on Lucy's tax return.
- The reissued check is a nonreportable transaction, which ensures that Lucy is not taxed twice on the $50,000 amount.

2. **Taxes are Withheld, but the IRA Distribution Check is stopped.** What if the IRA owner elects to have taxes withheld from her IRA distribution? Tax withholding amounts are not reversed when an IRA distribution check is stopped or voided for a valid reason. Rather, the withheld amounts remain as a tax payment to the IRS (and to state taxing authorities as well.)

   Example: Assume the same facts in the first example. Lucy has 10% withheld from her requested $50,000 IRA distribution, or $5,000. Thus, the original check issued to Lucy is for $45,000.

- When the IRA custodian later voids the missing check, $45,000 would have been credited to Lucy's IRA.
- The amount paid for federal income taxes, $5,000, would have remain paid to the IRS.
- When the IRA custodian reissues the replacement check to Lucy in January 2024, that reissued distribution check will be for $45,000.

3. **IRA Distribution Checks Written by the IRA Owner are Problematic:** Some IRA custodians provide a check-writing option for their IRA owners. This check-writing capacity allows the IRA owner to take distributions from their IRA without the need to contact their IRA custodian. While this is a convenience, it can also result in non-distributions for uncashed checks and may cause the IRA owner to miss her deadline to take planned distributions.

   Example: Lucy, age 75, has been using her IRA checkbook to take her RMD since she was 70 ½. To this point, all has gone smoothly. In 2023 Lucy decides to make a qualified charitable distribution (QCD) to her favorite charity for $100,000 which will count as her 2023 RMD. While Lucy hand-delivered the QCD check to the charity in December 2023, she realized that it was still uncashed by the charity when she reviewed her account statement in early February, 2024. When Lucy contacts the charity she is shocked to learn that it deposited checks only every few months due to the low volume of checks that it receives, and thus it has not yet deposited Lucy's check. Upset at learning of this 'policy' of the charity, Lucy demands the charity deposit the check into its account in February, 2024.

   -The problem is that Lucy missed her 2023 RMD because the QCD check did not clear her account before December 31, 2023.
   Even though Lucy wrote the check in 2023, it created a distribution for 2024 because the amount cleared her IRA in 2024. --Lucy's IRA custodian must issue a Form 1099-R for the $100,000 for 2024, and Lucy must report the $100,000 on her income tax return. However, if the $100,000 check qualifies as a QCD, it would be excluded from

Lucy's 2024 income.

- However, Lucy still owes the IRS an excise tax of 25%, unless the shortfall for failing to take an RMD for 2023 is swiftly corrected by her, in which case the excise tax is reduced to 10%.
- Lucy's CPA will have to file Form 5329 to report the 2023 RMD shortfall and calculate the excise tax.
- Lucy's CPA will also request a waiver of the excise tax when he files the Form 5329 because the deadline was missed because of reasonable error.

Conclusion: Many IRA owners assume that IRA transactions that they initiate are timely processed, but that is not always the case. That is particularly so for uncashed IRA distribution checks written against an IRA. Uncashed distribution checks could determine when the amount is included in the IRA owner's taxable income. Having the IRA custodian issue checks is a safer method. Equally important is that all IRA owners should review their account statements and contact their IRA custodian immediately if they discover that transactions are missing.

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