Participant Loans

Phone Forum

September 12, 2011

What does the Plan say?

1. Loans are not permitted from IRAs or from IRA-based plans such as SEPs, SARSEPs and SIMPLE IRA plans.
2. A qualified plan may, but is not required to provide for loans.
3. Annuity plans that satisfy the requirements of Code § 403(a) or § 403(b) may provide for loans.
4. Governmental plans may provide for loans.

Code §72(p)(4); Reg. §1.72(p)-1, Q&A-2

Plans that may provide for loans

Type of Plan	Loans Allowed
Payroll Deduction IRA	No
SEP	No
Simple IRA	No
Safe Harbor 401(k)	Yes
401(k)	Yes
Profit Sharing	Yes
Defined Benefit	Yes
403(b)	Yes
457(b)	Yes

Legally Enforceable Agreement

Maximum Loan Amount - The maximum amount a participant may borrow from his or her plan is 50% of his or her vested account balance or $50,000, whichever is less. An exception to this limit is if 50% of the vested account balance is less than $10,000: in such case, the participant may borrow up to $10,000. Plans are not required to include this exception.

Legally Enforceable Agreement

Repayment Periods - Generally, the employee must repay a plan loan within five years and must make payments at least quarterly.

Legally Enforceable Agreement

Level Amortization - A plan that provides for loans must specify the procedures for applying for a loan and the repayment terms for the loan. Repayment of the loan must occur within 5 years, and payments must be made in substantially equal payments that include principal and interest and that are paid at least quarterly. Loan repayments are not plan contributions.

Reg. § 1.72(p)-1, Q&A-3

Legally Enforceable Agreement

Related employers and related plans - all plans of an employer shall be treated as 1 plan.

Good to Know

A plan may require the spouse of a married participant to consent to a plan loan.

Code section 417(a)(4)

Good to Know

A participant may have more than one outstanding loan from the plan at a time. However, any new loan, when added to the outstanding balance of all of the participant's loans from the plan, cannot be more than the plan maximum amount.

Good to Know

A loan that is taken for the purpose of purchasing the employee's principal residence may be able to be paid back over a period of more than 5 years.

Code § 72(p)(2)(B)(ii); Reg. § 1.72(p)-1, Q&A-5,-6, -7, and -8

Good to Know

A plan may suspend loan repayments for employees performing military service.

Reg. § 1.72(p)-1, Q&A-9(b)

Good to Know

A plan also may suspend loan repayments during a leave of absence of up to one year. However, upon return, the participant must make up the missed payments either by increasing the amount of each monthly payment or by paying a lump sum at the end, so that the term of the loan does not exceed the original 5-year term.

Reg. § 1.72(p)-1, Q&A-9(a)

Loan vs. Distribution

Loans are not taxable distributions unless they fail to satisfy the plan loan rules of the regulations with respect to amount, duration and repayment terms, as described above. In addition, a loan that is not paid back according to the repayment terms is treated as a distribution from the plan and is taxable as such.

Code § 72(p); Reg. § 1.72(p)-1, Q&A-1

Deemed Distributions

Loans that do not meet legal requirements are considered "deemed distributions." For instance, if the loan repayments are not made at least quarterly, the remaining balance is treated as a distribution that is subject to income tax. If the employee continues to participate in the plan after the deemed distribution occurs, he or she is still required to make loan repayments. These amounts are treated as basis and will not be taxable when later distributed by the plan.

Timing of Deemed Distribution

A loan that is in default is generally treated as a taxable distribution from the plan of the entire outstanding balance of the loan (a "deemed distribution"). The plan's terms will generally specify how the plan handles a default. A plan may provide that a loan does not become a "deemed distribution" until the end of the calendar quarter following the quarter in which the repayment was missed. For example, if the quarterly payments were due March 31, June 30, September 30 and December 31, and the participant made the March payment but missed the June payment, the loan would be in default as of the end of June, and the loan would be treated as a distribution at the end of September.

Reg. § 1.72(p)-1, Q&A-10(a)

Participant Loans and Prohibited Transactions

The participant’s relationship to the plan (e.g., being an owner of the plan sponsor) does not affect the participant’s ability to take a loan, as long as all participants are equally able to take loans under the plan’s loan provisions.

Participant Loans and Prohibited Transactions

In order for a loan to a disqualified person to be exempt and not subject to excise tax under IRC § 4975(c), the participant loan must:

1. be made available to participants and beneficiaries on a reasonably equivalent basis,
2. not be made available to highly compensated employees in an amount greater than the amount made available to other employees,
3. be made in accordance with plan terms,
4. bear a reasonable rate of interest, and
5. be adequately secured.

Failure to comply with any of the above requirements will require the disqualified person to file one or more Form 5330 returns and pay a 15 percent excise tax on the amount involved. In addition, certain corrective actions, including restoration of funds to the plan, may very likely be required to avoid additional penalties.

Participant Loans and Prohibited Transactions

Any plan participant loan program must provide, in form and operation, that loans made to disqualified persons, as defined under Code § 4975(e)(2), meet certain conditions. In general, disqualified persons are officers, directors, 10% shareholders, or highly compensated employees of the plan sponsor (or certain related companies), as well as their family members, fiduciaries, and certain other persons.

Participant Loans and Termination

Loans to an employee that leaves the company. Plan sponsors may require an employee to repay completely a loan if he or she terminates employment. If the employee is unable to repay the loan, then the employer will treat it as a distribution and will report it to the IRS on Form 1099-R. The employee can avoid the immediate income tax consequences if he or she is able to come up with the loan's outstanding balance, within 60 days and rolls over this amount to an IRA or eligible retirement plan.

10% additional tax

In addition, there is a 10% additional tax on early distributions from qualified retirement plans, if the participant is not age 59 ½.

Code § 72(t)

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