IRS PROVIDES GUIDANCE ON PLAN LOAN OFFSETS

Hodgson Russ Employee Benefits Newsletter
October 1, 2020

Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Amy Walters

Practices & Industries

Employee Benefits

The Tax Cuts and Jobs Act of 2017 (TCJA) provided certain participants with more time to rollover certain types of plan loan offsets. The Internal Revenue Service (IRS) has issued proposed regulations, which may currently be relied on, providing guidance on which participants qualify and the application of the provisions.

At the time a plan loan becomes immediately due and payable and the loan is not repaid by the participant, the loan is treated as either a “deemed distribution” or a “loan offset.” Usually this repayment failure occurs when a participant severs employment or the plan terminates. If the participant has a distribution event at the time the loan is not repaid, it is treated as a “loan offset” and an actual distribution. In most situations this loan offset distribution would qualify as an eligible rollover distribution. A deemed distribution, which might occur if the participant stops making loan repayments but has not severed employment, would not be an eligible rollover distribution.

Generally, an eligible rollover distribution must be contributed to an IRA or to an employer plan within sixty-days of the distribution. This sixty-day timing rule made it difficult for many participants to accomplish a rollover of loan offsets. TJCA provided participants with additional time to rollover loan offsets amounts.

Under TCJA, a Qualified Plan Loan Offset (QPLO) may be contributed to an IRA or employer plan at any time up to the deadline, with extensions, for the participant to file his or her tax return. For example, if a QPLO occurred in 2020, the participant would have until October 15, 2021 in order to complete the rollover.

In order to be a QPLO two requirements must be met. First, the loan must have been a loan that otherwise met the requirements for participant loans under Internal Revenue Code § 72(p). Second, the distribution must have occurred solely because either (i) the employer plan was terminated or (ii) the participant incurred a severance from employment that caused the loan offset to occur. The proposed regulations help clarify this second requirement by providing that the requirement is met if the failure to meet the repayment terms of the loan occurs with the first year following termination of employment. For example, many plans now permit terminated participants to continue loan repayment following termination of employment. If a terminated participant made these loan repayments for five months following termination of employment and then the loan offset occurred, this would still be a QPLO. Proposed Regulation § 1.402(c)(3).