NAGDCA NOTES

Defined Contribution Plan Loan Basics

Many defined contribution plan administrators choose to offer plan loans to participants and beneficiaries. Making retirement funds available through loans offers administrators and participants less rigid regulations than emergency hardship withdrawals, and makes participants more likely to contribute funds to a retirement account if they know they have access to the money if necessary.

While plan loans are attractive in many ways to both employers and employees, there are rules and regulations to follow. Final Treasury Department regulations regarding defined contribution plan loans were released in December 2002, and these regulations apply to loans made on or after January 1, 2004. The following points offer basic information on the rules for administering plan loans.

- Loans must be documented with a legally enforceable agreement that specifies the amount of the loan, the date of the loan, and a specific repayment schedule. Interest rates must be reasonable based on current market standards at the time of the loan. The repayment rules in the regulations require that loan repayments must be made at least quarterly, through level, amortized payments.

- During a twelve month period, the total of all plan loans may not exceed the lesser amount of $50,000 OR 50% of a participant's vested balance.

- Plan loans must be repaid within five years from the date the loan is made, except under specific exceptions involving loans used to purchase a primary residence.

- The regulations allow loan refinancing as long as the $50,000 or 50% amounts are not exceeded. However, plan administrators do not have to offer refinancing on plan loans.

- Participants may take as many loans as the plan administrator allows, as long as the $50,000 or 50% caps are not exceeded. It is the responsibility of the issuer of any loan under Code Section 72(p) to inquire about other loans made from the plan (or any other employer plan) before extending a loan. Allowing multiple loans is a decision left to plan administrators, as it is not prohibited in the IRS regulations.

- If a plan participant fails to follow a loan's repayment terms, the loan then becomes a deemed distribution, and is reported as income subject to taxation.

- If a plan participant with an outstanding loan takes a leave of absence, loan payments may be suspended for up to one year. After one year, payments must resume even if the participant is still on a leave of absence. If a participant is on military leave, payments may be suspended until the conclusion of the participant's military leave. Interest will still accrue during this time. If a participant is on military leave, the highest interest rate that can be applied during the participant's military leave is 6%. Lenders have the option of negotiating higher payments for the remaining term of the loan, or arranging to keep payments at the original level with a larger balloon payment due at the end of the loan's term. If the original loan was for a period of less than five years, the loan can be extended up to the date that would be five years from the date the original loan was made.

For more information on defined contribution plan loans, refer to IRS Code Section 72, or contact NAGDCA Senior Project Coordinator Gina Vessels at gvessels@amrinc.net or 859-514-9218. The Treasury Department regulations referred to in this document are available on-line at http://www.irs.gov/pub/irs-irbs/irb02-51.pdf.

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