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## IRS Finalizes Regulations on Qualified Plan Loan Offset Amounts

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The IRS recently released final regulations on “qualified plan loan offset” (QPLO) amounts applicable under 401(k) plans, other qualified 401(a) retirement plans, and §403(a) and §403(b) annuities (collectively, “qualified employer plans”).<sup>1</sup> QPLO amounts are a type of loan offset amount subject to an extended rollover period – longer than the general 60-day period – under the Tax Cuts and Jobs Act of 2017 (TCJA).<sup>2</sup> The final regulations,<sup>3</sup> released on December 7, 2020, after a quiet public comment period, largely adopted the proposed regulations published on August 20, 2020, but would delay the applicability of the regulations to loan offset amounts treated as distributed on or after January 1, 2021. From a compliance perspective, these regulations will primarily affect recordkeepers and administrators of qualified em-

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<sup>1</sup> All section references herein are to the Internal Revenue Code of 1986, as amended (the “Code”), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

<sup>2</sup> Pub. L. No. 115-97.

<sup>3</sup> T.D. 9937, Rollover Rules for Qualified Plan Loan Offset Amounts, RIN 1545-BP46, 86 Fed. Reg. \_\_\_\_, (\_\_\_\_, 2021).

ployer plans, who will need to ensure QPLO amounts are correctly identified and reported on the IRS Form 1099-R.

### BACKGROUND: LOAN OFFSET VERSUS DEEMED DISTRIBUTION

When a participant defaults on loan repayments under a qualified employer plan, whether in the ordinary course of the loan or because the plan requires immediate repayment upon termination of employment, the default is treated as either a “deemed distribution” or a “loan offset,” depending on whether a distributable event occurred.<sup>4</sup> A distributable event could occur in a variety of circumstances, such as (a) where the plan’s terms require that, in the event of the participant’s request for a distribution, a loan be repaid immediately or treated as in default, (b) the participant terminates employment, or (c) an active participant reaches age 59½ where the plan’s terms permit an in-service distribution at this age.

If a distributable event has occurred, then the default will be subject to a “loan offset” whereby the plan offsets the participant’s accrued benefit by the amount outstanding under the loan, in order to repay the loan and to enforce the plan’s security interest in the accrued benefit.<sup>5</sup> Importantly, a loan offset is treated as an actual distribution, which means it would also be an eligible rollover distribution unless ineligible for some other reason, e.g., it constitutes a required minimum distribution (RMD)<sup>6</sup> (but see discussion below regarding waiver of 2020 RMDs).

By contrast, if the participant defaults without a distributable event, then the entire outstanding balance of the loan will be treated as a deemed distribution<sup>7</sup> (after a failure to cure, if the plan so allows

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<sup>4</sup> See Reg. §1.72(p)-1, Q&A-13(a)(1).

<sup>5</sup> See Reg. §1.72(p)-1, Q&A-13(a)(2).

<sup>6</sup> Reg. §1.402(c)-2, Q&A-3(b).

<sup>7</sup> Reg. §1.72(p)-1, Q&A-10(b).

within the confines of Treasury regulations).<sup>8</sup> This deemed distribution cannot be rolled over into an eligible retirement plan.

## QUALIFIED PLAN LOAN OFFSET – EXTENDED ROLLOVER PERIOD

The TCJA added §402(c)(3) to provide an extended rollover period for a QPLO amount. Generally, if a loan offset does not constitute a QPLO, then the participant has 60 days from the date of the distribution to contribute the loan offset amount to an IRA or a qualified employer plan.<sup>9</sup> But under the new §402(c)(3), if the loan offset constitutes a QPLO, the deadline to roll over the QPLO would instead be the deadline to file the participant's tax return (including extensions) for the year in which the QPLO amount is treated as distributed.

For example, if an outstanding loan under a 401(k) plan is actually offset on March 1, 2021, and the requirements for a QPLO are met, the participant may roll over the QPLO amount by April 15, 2022 (assuming no tax filing extensions), allowing the participant more than a year to repay the loan. This extended rollover period would allow more participants who incur plan loan offsets to put their retirement savings back into a qualified retirement plan or IRA, and avoid potential early distribution penalties related to the loan default.

A QPLO is defined under the statute to mean a plan loan offset amount which is treated as distributed from a qualified employer plan to a participant or beneficiary “solely by reason of” either the termination of the plan or the failure to meet the repayment terms of the loan from the plan “because of” the termination from employment of the participant.<sup>10</sup> The statute, however, did not specify how this “because of” causation element is determined.

The final regulations elaborate when a failure to repay the loan as scheduled is “because of” the termination from employment of the participant. Specifically, this standard is satisfied, upon failure to repay the loan as scheduled, if the plan loan offset occurs within the one-year period beginning on the date of

the employee's termination from employment.<sup>11</sup> In addition, the final regulations clarify that a loan offset constitutes a QPLO only if, immediately before the plan termination or termination from employment, as applicable, the loan satisfied the requirements for a non-taxable plan loan under §72(p)(2).<sup>12</sup>

## FORM 1099-R REPORTING

As noted in the preamble to the final regulations, the Instructions to the 2020 Form 1099-R provide that if an employee's accrued benefit is offset to repay a loan, the filer should report the distribution as an actual distribution and not use Code L (for deemed distributions) in box 7. If the loan offset constitutes a QPLO amount, then the filer should enter Code M (for QPLO amounts) in box 7.

## INTERACTION WITH 2020 RMD WAIVER

As mentioned above, QPLO amounts are generally treated as eligible rollover distributions and must be reported on the Form 1099-R as such unless, for instance, the amounts constitute required minimum distributions (RMDs). In this regard, plan administrators and recordkeepers should note that amounts that would have been treated as an RMD for 2020 but for the waiver provided by §2203 of the Coronavirus Aid, Relief, and Economic Security Act<sup>13</sup> (waived 2020 RMDs) are eligible rollover distributions for purposes of the QPLO rules.<sup>14</sup> That means waived 2020 RMDs distributed in 2021 (and, if the taxpayer so elects to apply the QPLO rules earlier, on or after August 20, 2020) that constitute QPLO amounts must be treated as eligible rollover distributions and reported as such on the Form 1099-R.

## EFFECTIVE DATE

To allow plan administrators and recordkeepers more time to establish QPLO compliant administrative procedures, the IRS delayed the applicability of the final regulations to plan loan offset amounts treated as distributed on or after January 1, 2021.<sup>15</sup> Thus, the first Form 1099-R that must reflect the QPLO final regulations will be the form for 2021, which needs to be furnished in 2022. However, taxpayers may choose to apply the final regulations to any plan loan offset amounts that are treated as dis-

<sup>8</sup> If the participant defaults on a loan installment, the default would not be treated as a deemed distribution if the plan administrator allows a cure period (which may not continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due) and the participant makes the installment payment during the cure period. Reg. §1.72(p)-1, Q&A-10(a).

<sup>9</sup> §402(c)(1).

<sup>10</sup> §402(c)(3)(C).

<sup>11</sup> Reg. §1.402(c)-3(a)(2)(iv)(B).

<sup>12</sup> Reg. §1.402(c)-3(a)(2)(iii)(B).

<sup>13</sup> Pub. L. No. 116-136.

<sup>14</sup> See §401(a)(9)(I), §402(c)(4) (flush language).

<sup>15</sup> Reg. §1.402(c)-3(b)(2).

tributed on or after August 20, 2020, the date the proposed regulations were published in the Federal Register.