

MEMO# 32975

December 10, 2020

IRS Releases Final Regulations on Rollovers of Plan Loan Offset Amounts

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December 10, 2020 TO: ICI Members
Bank, Trust and Retirement Advisory Committee
Pension Committee
Pension Operations Advisory Committee
Transfer Agent Advisory Committee SUBJECTS: Pension
Tax RE: IRS Releases Final Regulations on Rollovers of Plan Loan Offset Amounts

The Internal Revenue Service (IRS) has issued a final regulation[\[1\]](#) to implement the plan loan offset provision that was included as part of the tax legislation enacted at the end of 2017 (the “Act”).[\[2\]](#) The Act extended the time during which certain plan loan offset amounts can be rolled over into eligible retirement plans. IRS’s final regulation is an adoption of the proposed regulation it issued in August 2020, with one important modification relating to the applicability date.[\[3\]](#)

Background

When a plan participant terminates employment with a plan loan outstanding, most plans provide that, if the participant does not repay the loan within a set amount of time, the plan will reduce the participant’s account balance by the unpaid portion of the loan, and the plan will treat that plan loan offset amount as an actual distribution from the plan. Plan loan offsets can occur for other reasons as well.[\[4\]](#) Generally, a distribution of a loan offset amount is an eligible rollover distribution and therefore, a participant (or a spousal distributee) may roll over the amount of the offset into an eligible retirement plan within 60 days of the distribution.

The Act extended the period during which a qualified plan loan offset amount (QPLO) may be contributed to an eligible retirement plan as a rollover contribution. Instead of the standard 60 days after the date of the offset, the participant would have until the due date (including extensions) for filing the individual’s income tax return for the taxable year in which the plan loan offset occurs (*i.e.*, the taxable year in which the amount is treated as distributed from the plan). This extended period is available for plan loan offset amounts that are treated as distributed from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan. A plan loan offset is a QPLO if the distribution is “solely by reason of” (1) the termination of the plan or (2) the failure to meet the repayment terms of the loan because of the employee’s severance from employment.[\[5\]](#)

Final Regulation

Like the proposal, the final regulation confirms that a QPLO is a type of plan loan offset, and therefore, most of the general plan loan offset rules (for example, the withholding rules) apply to QPLO amounts.[\[6\]](#) The final regulation includes examples to illustrate how the QPLO rules interact with the general plan loan offset rules.

Extension period. In the preamble to the proposed regulation, the IRS clarified that, if an amount qualifies as a QPLO, the participant will have an extended period past his or her tax filing due date in which to complete a rollover of the QPLO amount, even if the taxpayer does not request an extension to file his or her income tax return but instead files the return by the unextended tax filing due date.[\[7\]](#) Rather than repeat this discussion, the final regulation references this explanation in the proposed regulation.[\[8\]](#)

QPLO determinations. A plan loan offset is a QPLO if the amount is distributed “solely by reason of” the termination of the plan or the failure to meet the repayment terms of the loan because of the employee’s severance from employment. The regulations provide guidance on making the determination about whether a plan loan offset qualifies as a QPLO.

First, an employee has a severance from employment when the employee ceases to be an employee of the employer maintaining the plan (in accordance with the Treasury regulation section 1.401(k)-1(d)(2)).

Second, the final regulation provides a bright-line rule for determining whether a plan loan offset amount following a severance from employment is a QPLO amount—this requirement is deemed to be met if the plan loan offset:

1. Relates to a failure to meet the repayment terms of the plan loan, and
2. Occurs within the period beginning on the date of the employee’s severance from employment and ending on the first anniversary of that date.

Reporting. In the preamble, the IRS notes that the instructions to the 2020 Form 1099-R provide that administrators should report distributions of QPLOs by entering Code M in box 7.[\[9\]](#)

Effective and applicability dates. The new extension period under the statute became effective for plan loan offset amounts treated as distributed in taxable years beginning after December 31, 2017, and the IRS’s new regulation becomes effective upon publication of the final regulation in the Federal Register. In response to comments it received, the IRS has bifurcated the effective date and applicability date of the new rules. The new rules are applicable to plan loan offset amounts, including qualified plan loan offset amounts, treated as distributed on or after January 1, 2021. Therefore, the new rules will first apply to 2021 Form 1099-Rs required to be filed and furnished in 2022. The IRS explains in the preamble that “[t]his delayed applicability date will give plan administrators and recordkeepers additional time to program systems and otherwise establish procedures for obtaining the exact date of severance from employment of a plan participant and tracking the one-year anniversary of that date.”[\[10\]](#)

The final regulation also confirms that taxpayers (including filers of Form 1099-R) may choose to apply the new rules with respect to plan loan offset amounts treated as distributed on or after August 20, 2020.[\[11\]](#)

endnotes

[1] The final regulations are *available at* <https://www.irs.gov/pub/irs-drop/td-9937.pdf>.

[2] For a description of the tax legislation, see ICI Memorandum No. 30991, dated December 21, 2017, *available at* https://www.ici.org/my_ici/memorandum/memo30991. IRS previously updated the [FAQs](#) on its website to reflect the statutory change.

[3] See ICI Memorandum No. 32722, dated August 28, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32722. The proposed regulations were published at 85 Fed. Reg. 51369 (August 20, 2020), *available at* <https://www.govinfo.gov/content/pkg/FR-2020-08-20/pdf/2020-16564.pdf>. IRS received comments on the proposal from only one organization.

[4] According to Treasury regulations, “[a] distribution of a plan loan offset amount can occur in a variety of circumstances, e.g., where the terms governing a plan loan require that, in the event of the employee's termination of employment or request for a distribution, the loan be repaid immediately or treated as in default. A distribution of a plan loan offset amount also occurs when, under the terms governing the plan loan, the loan is cancelled, accelerated, or treated as if it were in default (e.g., where the plan treats a loan as in default upon an employee's termination of employment or within a specified period thereafter).” Treasury regulation section 1.402(c)-2, Q&A-9(b).

[5] Internal Revenue Code section 402(c)(3)(C)(ii).

[6] §1.402(c)-3(a) (2), A-1(i)(A); *also see* Preamble at page 8.

[7] 85 Fed. Reg. at 51370.

[8] Preamble at page 8 (see footnote 4).

[9] Preamble at page 11 (see footnote 5).

[10] Preamble at page 14.

[11] §1.402(c)-3(b)(2), A-2.