Transcript - Guidelines on Computing Maximum Loan Amounts

Hello, my name is Mike Talley. I am an Employee Plans Revenue Agent based in Dallas, Texas. I will be discussing the Internal Revenue Service (or IRS) interim guidelines called, "Computation of Maximum Loan Amount under Internal Revenue Code Section 72(p)(2)(A) – Revised", which were issued on July 26, 2017.

Let me start by giving you some background and then talk about these guidelines.

IRS, Employee Plans received requests from industry stakeholders, such as plan sponsors and their representatives, to clarify how they should apply the limits under Internal Revenue Code Section 72(p) when a qualified retirement plan participant has multiple loans from the plan. In response to these requests, the IRS first issued interim guidance on April 20, 2017, but then made some minor clarifications and reissued them on July 26, 2017.

A qualified retirement plan, like a 401(k), 403(b) or a profit-sharing plan, is not required to allow plan participant loans. The plan sponsor, however, may allow participants to borrow from their plan accounts by specifically allowing loans in the written plan document and making sure the loans meet the requirements of Internal Revenue Code Section 72(p). Otherwise, the amount of the loan is treated as a distribution and the participant generally must pay taxes on the distributed amount.

The general rule of Section 72(p)(1) is that a loan from a plan will be treated as a distribution to the participant, but Section 72(p)(2)(A) provides a notable exception. This section says a loan is **not** a distribution if the plan loan amount when added to the outstanding balance of all loans to the same participant, does not exceed the lesser of:

- $50,000, reduced by any excess of
    - the highest outstanding balance of loans during the one-year period ending on the day before the date on which such loan was made, over
    - the outstanding balance of loans on the date on which such loan was made; or
- the greater of
    - half of the present value of the vested accrued benefit, or
    - $10,000.

Wow, that is a mouthful. Let's break this down and discuss an example of how it works when a participant wants to take out more than one loan.

Under Section 72(p)(2)(A)(i), if the participant's vested account balance is $100,000 or more and the initial loan is $50,000 or less, the participant generally may take out another loan within a one-year period if the total amount of all loans doesn't exceed $50,000. But this $50,000 amount is reduced:

- (first) by any outstanding loan balance, and
- (second) by the excess of the highest outstanding balance of loans during the one-year period ending the day before the second loan is made, over the outstanding balance on the date of the second loan.

That is still a mouthful so let me show how this works using an example and then apply the guidelines to this example. Assume that a plan participant, let's call him Bob, had a vested account balance in your company's profit-sharing plan of $120,000. Assume that Bob borrowed $30,000 in February of 2017, and fully repaid this loan in April of 2017. Also, assume that Bob borrowed another $20,000 in May of 2017, and repaid this second loan in full in July of 2017. If Bob applies for a third loan in December, your plan's administrator may determine that no further loan would be available, because $30,000 plus $20,000 (the total of Bob's first and second loans in the current year) equals $50,000. Alternatively, the plan administrator may identify "the highest outstanding balance" as $30,000 (assuming interest was timely paid), the amount of Bob's first loan in 2017, and permit the third loan in the amount of $20,000.

The guidelines explain how the IRS would view your plan's approval or denial of Bob's third loan request during an audit. Using these guidelines, if your plan was audited by the IRS and the IRS agent reviewed Bob's loans, the agent would accept **either** your plan administrator's denial of Bob's third loan request or the allowance of a $20,000 loan **if** your plan administrator consistently applied the same method to all multiple loan requests and followed all the other Internal Revenue Code Section 72(p) requirements. Examples of other requirements include level amortization, loan repayment within five years, and all other loan requirements as stated in the plan document. To find information on all these requirements, read the Retirement Plans FAQs regarding Loans on IRS.gov.

Just to follow up on some questions we've received, the July 26, 2017, revised guidelines made minor changes to clarify the initial April 20, 2017, guidelines. For example, they:

- Clarified that a loan that violates the requirements of Internal Revenue Code Section 72(p) is **treated** as a distribution but is not an actual distribution from the plan.
- Eliminated the sentence, "At this time, the law does not clearly preclude either computation of the highest outstanding loan balance in the above example."

- Made other minor editorial changes.

The July 26, 2017, guidelines will be incorporated into Internal Revenue Manual 4.71.1.

Thank you for your time today!