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IRS proposes rule on ‘qualified plan loan offset’ rollovers

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Recently proposed IRS [regulations](#) would help retirement plan administrators determine if an offset for an outstanding participant loan receives the extended rollover period for “qualified plan loan offsets” (QPLOs) established by the Tax Cuts and Jobs Act (TCJA) of 2017 ([Pub. L. No. 115-97](#)). Comments on the proposal are due by Oct. 5.

Plan loan offset rollovers

A plan loan offset occurs when, pursuant to the loan terms, a participant’s benefit is reduced to repay the loan. This can occur, for example, when a participant with an outstanding loan requests a distribution or terminates employment with the employer maintaining the plan, and the loan terms require accelerating repayment or treating the loan as in default. A plan loan offset is considered an actual distribution for tax purposes (unlike a deemed distribution). This means a loan offset can occur only if the participant has a permissible distribution event. This also means a plan loan offset can be an eligible rollover distribution.

A participant can roll over a plan loan offset by paying the outstanding loan balance to the plan or the IRA receiving the rollover. Alternatively, a participant can roll over the outstanding note to another employer plan if the new plan permits (but not to an IRA, since IRAs can’t make loans). Like other eligible rollover distributions, the participant typically has 60 days after the loan offset occurs to complete the rollover.

QPLO rollovers

The TCJA provides an extended rollover deadline for a QPLO. Any portion of a QPLO may be rolled over into an eligible retirement plan or an IRA by the participant’s tax filing due date (including extensions) for the taxable year in which the offset is treated as distributed from the plan.

Definition of QPLO

The TCJA defines a QPLO as a plan loan offset that is treated as distributed from a plan to a participant solely because of the plan’s termination or the participant’s failure to meet loan repayment terms due to severance from employment. Under the proposed regulation, a plan loan offset is a severance-related QPLO if both of the following conditions are met:

- The participant has a severance from employment under the 401(k) distribution limitation rules — i.e., the participant ceases to be an employee of the employer maintaining the plan.
- The loan offset occurs during the 12-month period beginning on the date of severance from employment.

Tax reporting

The plan administrator is responsible for reporting whether a distribution is a plan loan offset or QPLO on [Form 1099-R](#). The 2020 [instructions](#) require reporting all plan loan offsets as a normal distribution (and not a deemed distribution) using code 7 in box 7. For a QPLO, the administrator should also enter code M in box 7.

Effective date and reliance

IRS intends for the new rule to be effective for QLPOs treated as distributed on or after the date the final rule is published in the *Federal Register*. However, sponsors and administrators can rely on the proposed rule starting on Aug. 20, 2020.

Related resources

Non-Mercer resources

- [Proposed regulation](#), Rollover rules for qualified plan loan offsets (Federal Register, Aug. 20, 2020)
- [Instructions to 2020 Form 1099-R](#) (IRS, Feb. 14, 2020)
- [Pub. L. No. 115-97](#), Tax Cuts and Jobs Act (GPO, Dec. 22, 2017)

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