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IRS finalizes rule on ‘qualified plan loan offset’ rollovers

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Jan. 6, 2021

IRS has finalized its rule on 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). The final rule adopts the proposal with one modification to the applicability date.

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, a participant typically has 60 days after the loan offset occurs to complete the rollover.

QPLO rollovers

The TCJA extends the 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.

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Definition of QPLO

The TCJA defines a QPLO as a plan loan offset that is treated as distributed to a participant solely because of the plan’s termination or the participant’s failure to meet loan repayment terms due to a severance from employment. The final rule clarifies that 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 within 12 months of the severance date.

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.

Applicability date and reliance

The final rule applies to plan loan offset amounts, including QPLOs, treated as distributed on or after Jan. 1, 2021. However, taxpayers may rely on the rule for plan loan offsets treated as distributed on or after Aug. 20, 2020.

Related resources

Non-Mercer resources

- Final QPLO rollover regulation (Federal Register, Jan. 6, 2021)
- Pub. L. No. 115-97, Tax Cuts and Jobs Act (GPO, Dec. 22, 2017)

Mercer Law & Policy resources

- IRS proposes rule on ‘qualified plan loan offset’ rollovers (Aug. 21, 2020)

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