

Retirement Plan Loans

Important Information about Taking Loans from Your Retirement Plan



Congress created qualified retirement plans as a means for U.S. workers to save for retirement and provided special tax incentives to companies that adopt plans and to employees that choose to participate. To ensure that workers actually use retirement plan balances as a mechanism to fund retirement and not for current spending, rules were established to discourage participants from taking withdrawals until they reach retirement age. These rules include restrictions on the reasons and timing of withdrawals and include penalties for early withdrawal. One option for withdrawing funds before retirement age without tax and penalty is to withdraw balances in the form of a loan from the plan and repay the loan according to the plan's established loan policy.

Loan Basics

Below are some basics on plan loans:

- **Employer Election** - Employers must choose to allow plan loans. This is done at the time a plan is created, and not all plans permit loans.
- **Loan Terms** - The plan's loan policy along with IRS Regulations govern loan terms, including the minimum and maximum withdrawal amounts, the number of loans allowable, the reasons a loan can be taken, the repayment period, and the interest rate.
- **Maximum Amount** - Generally, loans are allowable for up to 50% of a participant's vested balance up to a maximum of \$50,000. Some plans may also impose minimum loan amounts or other rules (often \$1,000). Special rules apply if a participant has had a loan in the past 12 months.

Loan Repayment Requirements

IRS Regulations require loans to be repaid within 5 years (15 years for a principal residence loan) following a prescribed amortization schedule. The specific loan

terms, including the repayment period, will be included in the promissory note that must be signed by the participant when taking the loan.

Defaulting on a Plan Loan

Failure to repay a loan according to the loan terms results in a default on the note. If a late loan payment is not corrected with a prescribed cure period, the plan is required to default the loan. When this happens, the plan is required to issue a Form 1099-R to the participant showing the unpaid balance as a taxable withdrawal. The participant must report defaulted loan balances as income on their individual income tax return for the year of default and pay federal income tax and an early withdrawal penalty of 10%.

Summary

Plan loans can allow participants to withdraw funds from a plan before retirement; however, it is important for participants to carefully consider the implications of taking the loan, including their ability to repay the balances, the potential tax consequences for failure to repay timely, and the impact that taking the loan may have on the participant's future retirement balance.

Please contact JULY at [888.333.5859](tel:888.333.5859) for more information on plan loans.