New Rules for Loan Offset Defaults

The Tax Cuts and Jobs Act extends the deadline for completing a rollover of certain plan loan default amounts.

It is very common for a tax qualified retirement plan that allows for participant loans to require that the outstanding balance of the loan become payable in full if the participant is no longer in employment with the plan sponsor. If the participant does not pay back the entire outstanding balance within the plan's "grace period", the outstanding balance becomes a taxable distribution to the participant. This type of loan default is called a "loan offset" default because the default pays off, or "offsets" the participant's loan balance.

Even after the loan is defaulted, the participant can still avoid taxation if they use funds from outside of their plan account and rollover the default amount to an IRA or new plan if the new plan permits rollovers. Under prior regulations, the rollover must be completed within 60 days of the loan offset. In many cases, however, a participant in this situation does not have the funds to complete the rollover in such a short period of time, and if they did have the funds would most likely have simply paid the loan off before the default occurred.

The recently passed *Tax Cuts and Jobs Act* ("Act") extends the deadline for completing the rollover for loan offsets that occur as the result of the participant's separation from service with the plan sponsor, or in the event of a plan termination.

Under the new regulation, the participant has until the tax filing deadline (including extensions) of their personal tax return, for the year in which the default occurred.

For example, assume a participant with an outstanding loan balance has a separation from service with the plan sponsor on January 15, 2018. Further assume that the plan's loan procedures provide a grace period that ends on the last day of the quarter following the quarter in which the last payment was missed. The participant does not have the funds to pay back the outstanding balance of the loan, so the loan offset default occurs on June 30, 2018.

Under the old regulations, if the participant did not use funds from outside of their plan account to rollover the loan default amount within 60 days of June 30, 2018, the default amount would be a taxable distribution and would increase their taxable 2018 income. Additionally, unless an exception applied, the participant would owe an additional 10% penalty for the premature retirement plan distribution.

Under the new regulations, assuming the participant's tax year is the calendar year, the participant would have until April 15, 2019 (or longer if their 2018 filing is on extension) to complete the rollover. In this case, the participant would have over a year to save up enough funds to affect the rollover and avoid paying taxes and potential penalties on the loan offset. Hopefully this new regulation will allow more participants to retain the tax deferred status of their retirement savings.

It is important to note that the extended rollover deadline does not apply to all loan offsets. Please do not hesitate to contact our office if you have any questions, and feel free to have your participants contact our office if they are faced with the possibility of a loan default.

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