TSA
CONSULTING GROUP

IRS Loan Rules for 403(b) and 457(b) Plans

Many 403(b) and/or 457(b) plan sponsors rely on many vendors to maintain their plan; however, the plan sponsor is always responsible for the plan's operation, including its loan program. Plan sponsors are responsible for determining that each participant loan meets the requirements of the loan program and for enforcing loan repayments. "Hold harmless" agreements between a 403(b)/457(b) plan sponsor and its vendors don't lessen the plan sponsor's responsibility.

Participant loans must meet a number of rules to prevent the law from treating them as a taxable distribution to the participant. There are two primary areas of concern.

1) Does the written 403(b)/57(b) plan allow for participant loans?

The 403(b)/457(b) written plan must first contain language allowing loans to participants. Since many 403(b)/457(b) plans attempt to coordinate a loan program with many different vendors, it's important to outline how the loan program is to be operated. This applies to 2009 and subsequent years.

Some plans have multiple vendors, some of whom allow plan loans and others who don't. A written plan must ensure that the plan loans meet certain requirements. In addition, the underlying vendor documents that allow loans must be consistent with the written plan.

2) Do the participant loans meet the Internal Revenue Code Section 72(p) requirements?

In general, a loan to a participant must satisfy the following conditions to avoid being treated as a taxable distribution:

- The plan must base the loan on a legally enforceable agreement.
    - This must generally be a paper or electronic document.
    - The loan terms must comply with the IRC Section 72(p)(2) requirements.
    - The loan agreement must include the date and amount of the loan, and a repayment schedule that would ensure that the participant repays the loan timely.

- The plan administrator must limit the loan amount to the lesser of:
    - 50% of the participant's vested account balance at the time of the loan, or
    - $50,000.
    - An exception allows a participant to borrow up to $10,000, even if it exceeds 50% of the participant's account balance.
    - If the participant previously took out another loan, then the plan administrator must reduce the $50,000 limit of the loan by the highest amount owed by the participant on other participant loans from the plan (or any other plan of the employer or related employer) during the one-year period ending the day before the loan.

- The participant must repay the loan within 5 years, unless the participant used the loan to purchase his or her principal residence. If purchasing a primary residence and loan repayment is beyond 5 years, evidence must be provided to indicate the loan is for purchasing a primary residence.

- Generally, the loan terms must require the participant to make substantially level payments, at least quarterly, over the life of the loan. (There are exceptions for a leave of absence or military service.)

TSACG requires a Transaction Routing Request form to accompany all submitted transactions. A PDF copy can be downloaded online via the following link: https://www.tsacg.com/forms/.