

Recent IRS Snapshot Regarding Deemed Distributions for Participant Loans Reminds Employers of Risk of Plan Loan Errors

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The IRS recently released an Issue Snapshot (the "**Snapshot**") focusing on participant loans from retirement plans and when certain compliance errors could trigger deemed distributions with respect to such loans. Specifically, the Snapshot lists the following requirements, which if not satisfied, will cause a participant loan to be treated as a deemed distribution:

- Enforceable agreement requirement, which generally requires a participant loan to be a legally enforceable agreement (which may include more than one document) and the terms of the agreement demonstrate compliance with the applicable requirements of the Code.
- Maximum loan amount limit requirement, which generally limits the maximum amount of a participant loan to the amount specified under the Code. The Snapshot also noted the CARES Act allowed modifications to the loan limit for certain loans to "qualified individuals."
- Repayment period requirement, which generally requires the repayment period of a loan be limited to five years, unless the loan is to purchase the principal residence of the participant. The Snapshot also noted the CARES Act allowed extensions to the loan repayment period of certain loans to qualified individuals.
- Level payment amounts and quarterly payments requirement, which generally requires substantially level amortization over the term of a loan, with payments not less frequently than quarterly. The Snapshot also noted a deemed distribution will occur if a participant fails to make any installment payments when due. When a participant fails to make an installment payment, the plan may provide for a cure period that cannot extend beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due.

The issuance of this Snapshot by the IRS reinforces what practitioners in the benefits space know well as plan loan errors are not uncommon. In order to reduce the risk of plan loan errors, plan sponsors should consider auditing their plan operations relating to plan loans at least once a year. This audit should include a review of (i) the loan application process (including the notices provided to participants relating to repayment of the loans), (ii) how loan information is transferred to the payroll department or provider and what procedures are in place to ensure the proper deduction is inputted (especially if it is a manual process), (iii) the process for ensuring the amortization period does not extend beyond five years from the loan origination date, and (iv) the third party administrator's procedures for defaulting loans when an employee terminates.

Employers should also review what employee groups utilize loans most frequently and consider design changes that may reduce the risk of deemed distributions. For instance, if the employer's workforce has frequent turnover, the employer may also want to consider allowing participants to repay loans through ACH (instead of payroll deduction) so that payments can continue post-termination to help reduce the number of deemed distributions that occur when employees terminate employment. An ACH repayment process has both pros and cons, and employers should consult with counsel and their third party administrators before implementing ACH as a repayment method.

By thoughtfully designing the plan's loan program and conducting regular audits of its operations, plan sponsors may reduce the risk of costly compliance errors and help avoid the negative impact deemed distributions can have on retirement savings.

The Snapshot is available [here](#).