

Transcript for the Participant Loans Phone Forum

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Moderator: Welcome to the Employee Plan Phone Forum on Participant Loans. As a reminder, today's conference is being recorded. I would now like to turn the conference over to your host Mr. John Schmidt, please go ahead.

J. Schmidt: Thank you, Nancy and hello, everyone. My name is John Schmidt, and I'm the staff assistant for customer education and outreach within the IRS' Employee Plan Division, and I'd like to welcome you to our Employee Plans Phone Forum on participant loans.

Today we'll be hearing from David Boyd, EP Examinations Mandatory Review Manager and Kathleen Wack, Employee Plans Revenue Agent. Both are involved in reviewing pension, profit sharing and other plans submitted to mandatory review for procedural and tax law compliance.

Before we start, I'd like to point out a couple of administrative things. Everyone registered for this forum will receive a certificate of completion by email approximately one week after the forum. You must attend the entire live forum to receive that certificate. Enrolled agents, enrolled retirement plan agents, and enrolled actuaries are entitled to continuing professional education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for continuing professional or educational credit.

For more information regarding this topic on participant loans please visit the retirement plans Web site at www.irs.gov/ep. You may use the search engine that's found in the upper right hand corner of the Web page and enter key words such as participant loans, FAQs on loans or deemed distributions. While at our Web site you might also want to consider subscribing to our free electronic newsletters. A link for newsletters can be found in the left hand navigation bar. We have two newsletters; the *Retirement News for Employers* for small employers sponsoring retirement plans; and the *Employee Plans News* for retirement plan professionals.

Having gotten through those administrative things, it's my pleasure to turn the presentation at this time over to David Boyd.

D. Boyd: Thank you, John. As John stated, my name is David Boyd and I'm the Manager of Employee Plans Examination Mandatory Review located in Nashville, Tennessee. I would also like to welcome you to this presentation. Speaking today will be Kathleen Wack. Kathleen is a Senior Reviewer within Mandatory Review and is also located in Nashville. This presentation is intended to provide a general overview of participant loans. The presentation will focus on IRC 72(p) dealing with taxability of participant loans and IRC 4975 dealing with prohibited transactions. Frequent issues noted on participant loans and how to correct them will also be discussed.

We received a number of questions ahead of today's phone forum and have worked the answers to them into the presentation. If there are any questions that we are unable to address during this phone forum we will make certain that they will be included along with the transcript of this call, which ... will post afterwards. We'll also include a brief session at the end of our presentation to address any questions if time permits.

As with any presentation, please note that the comments expressed by each speaker should not be considered official guidance independent of this presentation. Any statement should not be relied upon for retirement plan purposes without first consulting a tax retirement plan professional.

I would like to now turn over the presentation to Kathleen Wack.

K. Wack: Good afternoon or good morning, everyone. Today we're going to be handling participant loans in our phone forum, and I'm going to start off with the PowerPoint, and I'm sure that all of us every single day dealing with pension plans say, "What does the Plan say?" I ask myself that every single day. I have other agents that ask me that. I have people in the field ask me questions and my answer is usually what does the Plan say? Loans are not permitted from IRAs or from IRA-based plans such as SEPS, SARSEPS and SIMPLE IRA plans. A qualified plan may, but is not required to, provide for loans. Annuity plans that satisfy the requirements of Code Section 403(a) or 403(b) may provide for loans. Government plans may provide for loans. This information came from Code Section 72(p) (4) and Treasury Regulation Section 1.72(p) -1, Q&A-2.

I found the next chart, I thought you might find helpful, and it just gives you a very simple tool with type of plan and whether loans are allowed yes or no. You can see at the top it starts off with all no's, the ones at the bottom are yes. IRAs, SEP and SIMPLE IRAs do not allow for plan loans and the rest, Safe Harbor 401(k), 401(k), Profit Sharing, Defined Benefit, 403(b), and 457(b) do. I got this chart from the Retirement Plans navigator and I included this link, it's on the last page of the PowerPoint presentation.

I had to reacquaint myself with a lot of the rules for Employee Plan loans while preparing for this presentation and you might want to look at this link. It's very, very helpful. It takes this chart, and this is just a section of it, and it goes way across and way down and gives you other details on the different types of plans. It also helps employers on how to choose a plan, maintain a plan, correct a plan, and a lot of other helpful hints. Every form that you'd ever want and need is on IRS.gov and a Plan comparison table, which I found really useful.

And 72(p) is a Code Section in the Internal Revenue Code and it's really pretty straightforward, pretty simple. Seventy two is quite long but the ones that we use, I think, most often are 72(p), which is the Treatment of Distribution from a Plan or loans treated as distribution, and later in

my presentation I'll briefly mention 72(t), which is a taxable event that occurs when a distribution happens before someone is age 59½.

What I've done is I've just took 72(p) and I put it into English without doing sections and numbers, and 72(p) says that you need to have a legally enforceable agreement. The first thing that's required is the maximum loan amount. The maximum amount a participant may borrow

from his or her plan is 50% of his or her vested account balance or \$50,000, whichever is less. An exception to this limit is if 50% of the vested account balance is less than \$10,000. In such case, the participant may borrow up to \$10,000. Plans are not required to include this exception. You may have a plan that only allows for 50% of the vested account balance and is not required to have the \$10,000.

The Repayment Period: Generally, the employee must repay a plan loan within five years and must make payments at least quarterly. I think in most cases we do find loans that are the full five years but if they're payroll deduction they're weekly, bi-weekly, monthly, semi-monthly, and in a few cases you do find employees that want to repay the loan in less than five years. We had a few questions that did talk about plans that were two years and three years long but, again, it all depends on what your plan says the payment has to be.

Level Amortization: A plan that provides for loans must specify the procedures for applying for a loan and repayment terms of the loan. Repayment of the loan must occur within five years and payments must be made in substantially equal payments that include principal and interest and that are paid at least quarterly. Loan repayments are not plan contributions.

In the Legally Enforceable Agreement it says that related employers and related plans, all plans of an employer shall be treated as one plan.

Other information that's good to know— and I'll put one thing in before this slide, is that we find in the field a lot is that employers or administrators etc. will keep Legally Enforceable Agreements in their files but they do not have them signed. That's really, really important. There are different ways of signing things now either the old way by having a signature or electronically. It's really, really important that you have— this Legally Enforceable Agreement has to be executed.

Other Information that I put under a category called "Good to Know" is a plan may require the spouse of a married participant to consent to a plan loan, and this is IRC Code Section 417(a)(4).

A participant may have more than one outstanding loan from a plan at a time. However, any new loan when added to the outstanding balance of all of the participant's loans in the plan cannot be more than the plan maximum amount, which is \$50,000. This is in more detail in the Treasury Regs. I believe it's Q&A-20.

A loan that is taken for the purpose of purchasing an employee's principal residence may be able to be paid back over a period of more than five years. Again, this has to be in the plan and this is in Reg Q&A -5, -6, -7, and -8 and it's also mentioned in IRC Code Section 72(p)(2)(B). A plan may suspend loan repayments for employees performing military service.

One thing that I did find this morning when I was re-answering and going over my answers to some of the questions was that there are two types of leaves of absence; one is a military leave of absence; another is a non-military leave of absence. The thing that's interesting and you should keep in the top of your mind is that a military service on the amortization schedule if it's for five years for military service, after the leave of absence that amount of military service time can be added to the term of the loan.

So for example, if someone has a loan and it's a military service loan and they are on military duty for two years when they come back they can add the two years on to the military service. The payments have to stay the same or they have to stay at least the same, they can't go down, or you can always re-amortize it. It's Q&A-20. It's not a re-amortization it's basically redoing the loan.

The plan may also suspend loan repayment during a leave of absence of up to one year. It can never be more than one year. However, upon return the participant must make up the missed payments either by increasing the amount of each monthly payment or by paying a lump sum at the end so that the term of the loan does not exceed the original five year term. This is Q&A -9 of the Treasury Regs 1.72(p)-1.

Loan versus Distribution: Loans are not taxable distributions unless they fail to satisfy the loan rules of the regulations with respect to amount, duration, and repayment terms. In addition, a loan that is not paid back according to the repayment terms is treated as a distribution from the plan and is taxable as such. Before I go on to Deemed Distributions, these are our favorite little words that we have. The Legally Enforceable Agreement in most terms is called a Bona Fide Loan. I call it a Bona Fide(e). A Bona Fide loan and then we come up with a term specifically for distributions and loans and that's called a Deemed Distribution, so we have two new spelling words, Deemed Distribution, and Bona Fide Loan.

Loans that do not meet legal requirements are considered deemed distributions. If the payments are not made at least quarterly the remaining balance is treated as a distribution that is subject to income tax. If the employee continues to participate in the plan after the deemed distribution occurs he or she is still required to make loan repayments. These amounts are treated as basis and will not be taxable when later distributed by the plan.

There has to be a 1099-R issued for the deemed distribution. It's treated basically the same as the distribution. It's added to the employee's 1040, is taxed as income and they still owe the money back to themselves. It does not automatically go away. However, when they do get the final distribution from the plan any outstanding amount of this particular portion—for example on your 1099-R it will say, "Total Distribution" and it will be deducted from the amount that's taxable. That's what they mean by being treated as basis.

The loan that is in default is generally treated as a taxable distribution from the plan of the entire outstanding balance of the loan. The plan's terms will generally specify how a plan handles a default. A plan may provide that a loan does not become a deemed distribution until the end of the calendar quarter following the quarter in which the repayment was missed. For example, if the quarterly payment was due on March 31, June 30, September 30, and December 31, and the participant made the March payment but missed the June payment the loan would be in default as of the end of June, and the loan would be treated as a distribution at the end of September.

One thing that I did find out when I was researching this is about cure periods. There were a lot of questions about cure periods. There is nothing in the Regs or the Code that says that a plan has to have cure periods. The thing that is in is the timing of the deemed distribution is in the Regs and in the Code and that is required. It has to be in your plan or your loan documents; however, the cure period is totally up to the employer. The IRS does not say you need to have a cure period but this is not a cure period that we're talking about. We're talking about the timing of the deemed distribution or when a default is made when does it become a deemed distribution and when do you need to issue a 1099-R for it.

The participant's relationship to the plan does not affect the participant's ability to take a loan as long as all participants are equally able to take loans under the plan's loan provisions. This is our little bridge over to 4975, which deals with prohibited transactions. In the prior slides, when they're talking about all participants are equally able to take loans under the plan's loan provisions what they're really talking about is a disqualified person, meaning a fiduciary, and that is in Code Section 4975, the definition of what is a disqualified person.

All participants in the plan if they're an employer and they're being paid by—they're the owner of the employer and they're allowed to take a loan and they are participants in the plan they can take it just like any other participant. However, if they default, a disqualified person defaults, they've come into a really expensive issue for themselves tax wise because it's not only a deemed distribution and they have to take it into income but they have to file 5330s. And it's considered a prohibited transaction, and while for a regular participant that's not a disqualified person that money that they've defaulted on is still owed and they continue to make payments on it for disqualified persons having a deemed distribution is not considered correction. So they're going to continue to have to file 5330s and they're going to owe excise tax until they have actually paid that amount of money back to the plan.

In order for a loan to a disqualified person to be exempt and not subject to excise tax under IRC 4975(c) participant loan must be available to participants and beneficiaries on a reasonably equivalent basis; not be made available to highly compensated employees in an amount greater than the amount made available to other employees; made in accordance with plan terms; bear a reasonable rate of interest; and be adequately secured. In most cases for the adequately secured you will see that the security is the amount of the participant's account balance.

Failure to comply with any of the above requirements will require the disqualified person to file one or more 5330s and pay a 15% excise tax on the amount involved. In addition, certain corrective actions including restoration of funds to the plan may very likely be required to avoid penalties. I did discuss that just briefly is that a disqualified person is going to need to pay this money back or they're going to have to continue to file 5330s because the deemed distribution is not considered correction.

Any plan participant loan program must provide in form and operation, that loans made to disqualified persons as defined under Code Section 4975(e)(2) meet certain conditions. In general, disqualified persons are officers, directors, 10% shareholders, or highly compensated employees of the plan sponsor or certain related companies as well as their family members, fiduciaries, and certain other persons.

Termination and Participant Loans: Loans to an employee that leaves the company, plan sponsors may require an employee to repay completely the loan if he or she terminates employment. If the employee is unable to repay the loan then the employer will treat it as a distribution and will report it to the IRS on a Form 1099-R. The employee can avoid the immediate income tax consequences if he or she is able to come up with the loans outstanding balance within 60 days and rolls over this amount to an IRA or eligible retirement plan.

One thing that we do see in Mandatory Review and I also saw when I was in the field auditing is that sometimes software programs are set up to issue a 1099-R on the amount of money of the checks. It's not grossed up for the amount of the loan. So let's say for example, there's a \$5,000 outstanding loan balance and—wait a second. The loan balance is \$5,000 and the account balance is \$10,000 and what we'll see is the 1099-R as the \$10,000 and not the \$15,000. So what they're actually doing is they need to gross it up and the distribution is they are not only distributing a loan balance but they are distributing the account balance so the 1099-R needs to be for both.

Ten percent Additional Tax: I mentioned that briefly earlier. In addition there is a 10% additional tax on early distribution from qualified retirement plans if the participant is not age 59 1/2. This is Code Section 72(t).

What I'm going to talk about now is not on your slides but the information is available on irs.gov and these are considered—I don't know where you'd find them but anyway, this concerns the problems that are found most commonly with participant loans and what to do about them.

There is a portion of employee plans in the IRS that's called LESE, Learn, Educate, Self-correct and Enforce Projects, and a few years ago, I think it might have even been last year, the LESE project number II was on small plans and participant loans. What they found in most cases—and this was all self-correction. Most of them did not have to go through VCP or voluntary compliance. Prohibited transactions involving improper loans: They examined 50 plans, which

yielded 17 plans that deemed to be involved in prohibited transactions. As a result, 47 delinquent Form 5330 returns were secured with payment of excise tax and restorative corrections were made, and these corrections ... payment of both loan principal and accumulated interest.

The primary contributory factor that caused the prohibited transactions to occur was the failure to follow the plan terms with the respect to the making of the participant loans, and this would be an operational failure because we all know that not following the terms of the plan could also involve disqualification. This included the failure to limit the dollar amount loan specifically provided by plan terms. Other failures were failure to provide adequate security; making certain loans that were not bona fide participant loans from inception; no loan documentation; no attempt of repayment, etc.

D. Boyd: Kathleen, let me say something at this point for just a moment please. One thing we see quite a bit of and Kathleen just mentioned this about failure to follow the plan provisions. I think you all out there in the practitioner world if you have your own documents that you're used to what's in them but we run into a situation where people will take over the plans. And they just assume that there's a lot of can language in them that they're following, and come to find out we see a lot of problems where they haven't really read the plan and know what's in the plan.

I think that's something that's very critical not just in the area of loans but in any other areas of these plans of operating these plans. We find where they just didn't know what was in the plan document and that is very crucial here so just something to kind of keep your eye on the ball there. When you have somebody else that's coming in to help you with this thing don't assume that you know what's in that plan document. I would definitely behoove you to go out and read it and see specifically what these provisions are before you start trying to administer them. I think it will eliminate a lot of the problems that we're seeing in operation plans.

I'm sorry, go ahead, Kathleen.

K. Wack: No, thank you. That gave me a chance to get a drink of water. Another thing, a big one that we've seen and this was a big one in the LESE project were the participant loans were made from a plan that specifically did not permit participant loans, and as David just said, it's

really important that you make sure that you know what's available.

The failure to comply with 72(p): several loans failed to satisfy 72(p) with adjustments made to the participant Form 1040 to reflect taxation due to deemed distributions. We see that a lot here in Mandatory Review. Mandatory Review, what we do is we are given cases or assigned cases from the field that we call unagreed. And that means that the taxpayer whether it be an employer or somebody with a 1040 does not agree with our position and Mandatory Review either tries to solve the problem or we get these cases ready for Appeals and for Tax Court. That's why we were probably asked to do this presentation because we do see these unagreed ones.

What I did do as attachments to the Web site were retirement plans frequently asked questions regarding loans. If you have any questions in a lot of cases they can be your answer. It's on just a couple sheets of paper. It's really informative and it's an easy read. You might even just look through it really quickly. The Fix-it Guides have really come along for almost everything having to do with the IRS period, not just employee plans.

The ones that I attached for you were common plan mistakes, plan loan failures, and deemed distribution. That is right on for what we're talking about today, and another one is participant loans and 401(k) plans. These are both from VCP and they're very, very helpful. Another one that is available but really doesn't have to do with plan loans but it's hardship distributions, and if you ever have to do a hardship distribution it is still a distribution it's not a plan loan. There's a Fix-it Guide on that also.

We do have quite a bit of time left and we did get, I think we're up to 15 questions so I'm going to do my best to get through as many of these questions as I can, and they were very, very helpful for me in trying to figure out how much time to just spend on 72(p).

As David said, if we don't get to all of the questions we will post them and I have gotten, I think, an additional four or five today. And the people did say that they realized that they were submitted but later than the cutoff but we will address them. And just remember that these answers are based on my research and so I did the best I could with the information that was available but please do not say, "Well, Kathleen said so, so that's the way it is."

Our question number one was very, very interesting. It says, "In the past our 403 investment provider managed, approved and administered all plan loans. Once PPA 06 put the fiduciary responsibility for loans on the plan administrator I got far more involved in the loan process. I learned our retirement plan had a few serious serial loan defaulters. We changed the rules to only one loan outstanding at a time but one participant still takes a loan, defaults, pays the taxes, takes another loan, defaults, pays the taxes, etc. Once the plan investment company issues a 1099 the loan report drops the person as having an outstanding loan and 50% of their entire balance is available for them again to take a loan."

I'm afraid if we do limit loans for these serial defaulters an employee could challenge my company saying we breached our fiduciary responsibility by allowing him/her to take repeated loans, lose it at the racetrack, default, and then do it all over again. I would like to amend our plan prospectively to state that once an employee defaults he/she can no longer take another loan. Is that possible? I really do not want to penalize everyone by removing the loan provision."

There should not be a problem with prospectively instituting a loan policy that precludes future loans to participants who have previously defaulted. Also, the reference to PPA06 is actually the 2009 final IRC 403(b) regulations. That is the site where the fiduciary loan responsibility was put on the plan administrator because there were too many administrators and too many loans were being taken over and over and over again, and they weren't being all put together. I also had some further sites, the effect on subsequent loans, a loan that is a deemed distribution under 72(p) and has not been repaid is considered outstanding for purposes of applying 72(p)(2)(a) to determine the maximum amount of any subsequent loan to the participant or beneficiary.

So the statement in the question where the loan report drops the person as having an outstanding loan there is something seriously wrong with the system. I believe this is a systemic issue, and the loan report should not drop the defaulted amount as an outstanding loan. Also, you might want to look at the final Treasury Regs of 72(p) Q&A-19(b) (3) indicates that once a participant defaults on a loan any subsequent loans if allowed and if limits allow must have payments through payroll withholding, and they cannot waive this or say, "I'll pay it back myself" or anything. If there has ever been a default on a loan all subsequent have to be done through payroll withholding.

Another interesting question was one that was received later and that has to do with leave both military leave. And this one happens to be a non-military leave of absence and the question reads, Participant A with a 401(k) account balance of \$500,000 as of July 1, 2011— and it's being considered Participant A— "A" takes out her only participant loan as of July 1, 2011 for \$12,000. Payments are due monthly at \$500 a month for 24 months beginning August 1, 2011.

On September 1, 2011 Participant A goes on a non-military leave of absence until March 1, 2012, that's seven months, and the plan suspends the loan payments during this seven-month period. The interest is paid by the participant. When she returns on March 1, 2012 at the end of her seven months, "A" recommences payment of \$500 a month with interest but the term of the loan is extended to 31 months. (This is an error and I think I briefly discussed that earlier is that on a non-military leave of absence you can't add the amount of leave onto the loan term.)

On May 1, 2012 Participant A again goes out on non-military leave of absence. Under the regulations is the plan, in this case, allowed to suspend repayment of the loan until April 30, 2013—that would be at the end of the two years—or do the Regulations require loan payments

resume on October 1, 2012, which would result in a suspension of payments for the total 12 months allowed?

The answer is the original term on the loan is 24-months. While the term of the loan for military leave is extended by the period of military service the same does not hold true for a non-military leave of absence. In this example, Participant A has until June 30, 2013 to repay the loan.

Q&A-9 of the Treasury Regs does state that the loan including interest that accrues during the

leave of absence must be repaid by the latest permissible term of the loan. The latest permissible term of this this loan could have been five years according to 72(p). However, the participant chose to have the term of the loan as two years, and because it's such a short term if the participant and the plan allow it they should refer to Treasury Reg Section Q&A-20 regarding refinancing of an existing loan. If the person did come back and it was on the last day they would need to repay the entire amount of the loan on that day if they hadn't refinanced the existing loan. If they did not do that then it would immediately become a deemed distribution.

We have one question that's five pages long. I think I will skip that one for right now. Question three says, "Many of the investment platforms set up a default interest rate based on prime, which is used for all plan loans. I know of one platform that automatically sets loans up at prime plus 1% without checking with the plan administrator to see what interest rate they believe to be current marketable rates. Please address what the IRS views as an acceptable market interest rate and the plans exposure if the investment platform automatically assigns a less than marketable rate to plan loans.

Employee plans uses—and this will be included in the transcript but we would use www.federalreserve.gov/releases/h15 and those give interest rates on a daily basis. We normally add 2%. The answer additionally says, "If the interest rate does not constitute a reasonable interest rate and the loan is made to a disqualified person as defined in IRC 4975(e)(2) then the participant loan would constitute a prohibited transaction under IRC 4975(d)(1) and would be subject to excise tax. The exception for prohibited transactions with respect to loans made to participants or disqualified persons requires the loan bear a reasonable rate of interest. In addition, the prohibited transaction exemption requires that loans be available to all such participants or beneficiaries on a reasonably equivalent basis.

Generally, the prime interest rate is a rate that banks only give to their very best customers and rare, very rare at that. For this reason as a general rule the Service generally considers prime plus 2% as a reasonable interest rate for participant loans, and I hope that helps you. Again, it's www.federalreserve.gov/releases/h15, and this is used over and over and over again. All of our Internal Revenue agents in employee plans have been given this Web site to update their computer program that they use to calculate excise taxes for Form 5330.

Let's try to find a shorter question.

D. Boyd: Kathleen, let me say something while you're looking for other questions. There is nothing in stone as far as this prime plus 2% but that is what we deem to be a reasonable rate. There could be, I guess, an argument that you could make or somehow that you could offer a rate that's less than prime plus two that would be reasonable but you'd have to make that argument. Could this taxpayer, could this individual, this participant go out and get a loan for less than that in the open market?

I guess that's a question you need to ask yourself and if the answer is no than I think prime plus two is reasonable. If you can show documentation that participant can go out and get a loan at a lower rate then that's what you'll need to be able to prove to the agent that's out there looking at this particular loan, so just something to kind of keep in mind. Like I said, it's nothing that's etched in stone but it is a general guideline that we go by here at the Service.

K. Wack: The next question, if the plan makes a loan in excess of the maximum permitted, the IRS correct procedures under VCP indicate that the participant is generally responsible for making correct payment. For example, returning the excess loan amount plus interest to the plan; however, participants rarely return an excess payment. Participant fails to make the corrective payment to the plan and the plan sponsor issues a participant Form 1099-R reporting that portion of the loan as a deemed distribution. Has the loan failure been corrected or must the plan sponsor make a correct payment to the plan in order to fully correct the loan failure?

The answer prepared is the revenue procedure 2008-50 Section 6.07 related to relief and correction and loan amounts made in excess of the maximum amount permitted under 72(p) requires that the participant repay the excess. Therefore if the participant fails to return the excess it does not appear any relief under 72(p) would apply and normal rules apply with regard to taxation to the participant.

This is a difficult one. They took out a loan for too much, probably spent it and now they have to repay it. It gets real difficult and there's also another interesting thing. I will give you that link that you can find on the Web site and it's in the CFR 2008, and it does give some information on security interest and this is from ERISA saying that the security interest cannot be less than 50% of the loan balance.

So for example, with the \$10,000 rule if you've got \$15,000 and half of that can be a loan that would be \$7,500. The CFR says that the security interest cannot be less than that so when we up it and say, "Okay, well the security interest is only \$7,500 but we are allowing a loan of \$10,000 then you're \$2,500 off from your security interest" which could become a prohibited transaction. That's something else to think about and I will post that for you. It's a little complicated but if you ever run into that you might find it interesting to read.

Another question is about 403(b) plans, it says, "Can a 403(b) plan offer loans to former employees who are not currently making contributions to the plan? I was not able to find a definitive answer on this question and everyone that I asked and all the favors that I pulled in said what does the plan say. So I'm going to do some more looking, and I will try to come up with a better answer for that but for right now I would say that the Plan has to allow for former employees to take a loan from the plan.

The same person said is spousal consent required if the total account balance subject to 401(a)(11) is more than \$5,000 but the loan amount is less than \$5,000? The answer is yes spousal consent is still required. Spousal consent is required if the total accrued benefit at the time of the loan is in excess of the cash out limit, i.e. \$5,000, and this is specifically entered and you can get more detail in your Treasury Regs 1.401(a)-20 Q&A-20.

The same person had one more question, in a defined contribution plan if a security interest is placed in a participants account balance for the extent of the loan than is this considered adequately secured? For example, if a participant takes a \$2,000 loan and the plan administrator places a security interest of \$2,000 out of the total account balance is this considered adequately secured?

The answer is if you are referring to the additional security interest for subsequent loans as required by Treasury Reg Section 1.72(p)(1) Q&A-19 in the event of an additional participant loan made after prior defaulted loans by the participant then the answer is no. If you are referring Q&A-19 the answer is no. The loan has to be secured by an additional security interest other than the participants vested account balance. With regard to providing that this additional amount be deposited into the participant's account would be improper as it does not relate to the proper employer contribution and allocation per plan terms.

David could you do question nine for me?

D. Boyd: Sure. This question is for the September 12th Teleconference on plan loans. I know ... and we'll go into this. The Regs indicate that a deemed distribution must be declared no later than the end of the quarter following the quarter in which the missed payment occurred. Assumed due to system constraints the nine days is measured from the date the last payment is posted is this acceptable in that the default is deemed to occur a few days earlier than the last possible date?

Example, payment are due 1/23 and 1/30. The 1/23 payment is posted on 1/26 and the 1/30 payment and all subsequent payments are not made. Clearly the January 30th payment due date is the trigger even but can the nine days be counted from January 23rd because that was when it was due if the rules applied on administratively consistent basis and clearly communicated? In the example the deemed date always occurred before the close of the following quarter.

The answer to that—it's ... yes. The plan administrator does not have to even provide for cure periods therefore, if your cure period ends earlier than that provided by the regulations it is acceptable. I would direct you to the Regs under 1.72(p)-1 Q&A-10.

K. Wack: Thank you. Okay we have a longer one here with two scenarios. During a recent IRS phone forum on EPCRS plan correction issues it appeared to be stated that balloon payments should not be made at the end of a plan loan term. This seems to contradict 72(p) Q&A-9, which states that 72(p) (2) would be satisfied if the participant continued the monthly payments of \$825 after assuming active employment after a bona fide leave of absence and on June 30, 2008 repaid the full balance remaining.

Are balloon payments at the end of the loan term still permissible when there's a leave of absence? Are balloon payments permissible outside the leave scenario? For example, a participant has missed five payments due to payroll delay. (On a side, I question what payroll delay means.) Payments are delinquent but never past the cure period and therefore the loan is not in default. The payments continue to the end of the loan terms then a balloon payment will be due at the end of the loan term. In the above example, where a participant has fallen behind on their loan payments outside of a leave of absence can you confirm that re-amortization is not possible other than in conjunction with a VCP filing?

Just when we thought 72(p) was pretty straightforward we end up with things like this in real life, so that's our fun. The answer is the answer depends on whether it's a leave of absence due to military or non-military reasons. Non-military leave of absence, yes a balloon payment can be made at the end of the original loan term with regard to missed payments due to a leave of absence due to non-military leave of absence put it that way. Note that for non-military leave of absence, loan payments must be repaid by the latest permissible term of the loan and the amount of the installments due after the leave of absence ends must not be less than the amount required under the terms of the original loan. For the example, in the Regulation an original five year loan, the installment payments must be at least equal to the amounts required under the original loan terms with the full balance paid on the date that the original loan term ends.

Military leave of absence per IRC 414(u)(4), no a balloon payment is not permitted. A military leave of absence results in the terms of the loan being extended by the length of the leave of absence. However, when returning to employment the requirement is that the remaining payments be amortized over substantially equal installments through the end of the extended loan term.

So to reiterate, the question was quite lengthy but it did have to do with balloon payments. In non-military leave of absence yes a balloon payment can be made at the original term with regard to missed payments. On military leave of absence no a balloon payment is not permitted. On a military leave of absence, like I've discussed a few times, is that the period of the military

leave of absence is added onto the original term of the loan, and then the payments have to be equalized or substantially equal installments through the end of the extended loan term.

I'm assuming that means when they get back from their military leave of absence that you take whatever amount of the loan is required plus interest and turn that into equal installments. On the question itself it does not say anything about this really being a leave of absence so I will have to do some more research and find out if the balloon also is because of the five payments missed due to payroll delay. I'm not sure what payroll delay means, and if you are the person who wrote this question and you want to explain payroll delay to me I'll take that into consideration, of course, I'll answer it.

The second part is a participant on a monthly payroll cycle but switched to bi-weekly payroll. However, loan was not re-amortized at a new payroll frequency so same payment was coming out of bi-weekly pay as was coming out of monthly pay. The participant was paying off the loan more than twice as fast as the amortization schedule provided. Now, the question of what options is available to correct this. Can you comment on each of these?

We're reaching almost the end so I don't know that I have enough time to finish this.

D. Boyd: Go ahead and answer it. I think you can get a couple of them in there, Kathleen.

K. Wack: My options are A and B. The amortized loan from today leaves overpayments in the plan and therefore has reduced payments going forward, or returns overpayments to participant and re-amortize to new payroll frequency. If alternate B is not feasible is there any situation in which amounts can be removed from the plan and returned to the participant?

Okay, the shorter one on number B, you should be able to re-amortize from this point forward just ensure that you satisfy all requirements of 1.72(p)(1) Q&A-20, and that was the one that had to do with refinancing. In general, it would not be proper to return plan assets to a participant.

The question to number one is this question relates to the participant who missed five payments due to payroll delay but made correction within the cure period, will not be treated as a deemed distribution, Q&A-10 of the Treasury Regs. Therefore the five missed payments must be made to the plan by the end of the quarter following the quarter in which the payment was missed. It is not acceptable to make this correction via balloon payment at the end of the loan term. I'm sorry I was going to go back and research that and they already answered it so with the five missed payments you've got to make those according to when this becomes a deemed distribution, and you can submit to a VCP filing for Section 11.03 of Rev. Proc. 2008-50 is beyond cure period for correction. Re-amortization is only permitted to the extent where generally loans collectively, old loans, new loans, re-amortized satisfy the need to (p) (2) -A, -B, and -C.

I think we're done. David?

D. Boyd: Yes. Thank you, Kathleen. There are some other questions that we've got that we haven't gotten to here but as I said we will have those posted along with the transcript, the question along with the answers to those along with the others we've got. In fact, I've gotten several more that have come in during this call so we'll make sure we include all those in the response that we give ... the transcript.

Moderator: And that does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference Service. You may now disconnect.