Outstanding loan in your employer-sponsored retirement plan

We know that in times of tight credit and tough economic times, Americans may be turning to their qualified employer-sponsored retirement plans (such as a 401(k) plan or 403(b) plan), to tap needed funds. Often this is in the form of a plan loan, if permitted by your plan. Having an outstanding loan in your employer-sponsored plan can have an impact if you retire, sever service, or are forced out of your job. Often an employer plan is rolled into a Traditional IRA to continue deferring taxes.* However, you cannot roll your plan loan portion into your IRA. A loan is not allowed from your IRA, as it would be considered a prohibited transaction.

If you default on a plan loan, the outstanding loan balance may be a deemed distribution, subject to income tax and any possible premature distribution penalty. Unlike a plan loan offset, a deemed distribution of a plan loan is not eligible to roll over. Workers should consult their employer's loan policy for specifics on their plan's repayment policy and/or loan default provisions. Seek the advice of your tax advisor as to the impact a loan, a loan offset, or loan default may have for you and your family should you be faced with a job loss.

Strategies to consider

If you leave your employer with outstanding plan loan amounts, explore your options.

- **Repay the loan.** The plan may give a short period of time (i.e. 30 or 60 days) to repay that outstanding balance. However, if not repaid, the outstanding loan balance is generally subject to income tax and possibly a 10% premature distribution penalty for younger workers.
- **Bank loan.** If you don't have the funds readily available to repay your loan, consider whether obtaining a loan from a bank would be a good financial strategy.
- **Rollover cash to an IRA.** If you are unable to repay your plan loan in full or within the time allowed by your plan, by writing a personal check to your IRA within 60 days of a loan offset you may be able to negate some of the taxes and, perhaps, penalty that would otherwise be triggered. A loan offset occurs when a plan participant's accrued benefit is reduced in order to repay the loan.
- **Continue plan loan payments.** Check with your plan administrator to see if you can continue to make loan payments, even though no longer employed with that employer. This option is not always available.
- **Roll loan to new plan.** If you are now working for an employer that offers an employer-sponsored qualified plan that provides for both rollovers and plan loans, investigate the possibility of rolling your loan into your new plan. The loan payments would generally continue through your new employer's payroll.

Talk to us

Your financial professional at our firm will gladly offer additional information on strategies you'll want to consider for retirement savings accumulated in an ex-employer's plan.

*Traditional IRA distributions are taxed as ordinary income and may be subject to a % Federal tax penalty if distributions are taken prior to age 59½.