

# Nine Plan Loan Tips from the IRS

By Lisa K. Loesel

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The IRS is making it even easier to comply with participant loan requirements and other rules, offering helpful pointers to plan sponsors through a variety of media.

For example, the IRS hosted a telephone forum on plan loans on Sept. 12, 2011. EP Examinations Mandatory Review Manager David Boyd and Employee Plans Revenue Agent Kathleen Wack presented this telephone forum, which provided helpful pointers on various participant loan requirements set forth under Code Section 72(p), the accompanying Treasury regulations and the corresponding prohibited transaction rules under Code Section 4975.

Following are summaries of the key topics the forum addressed, as well as some “practice pointers” for plan sponsors and plan administrators to consider when reviewing these key topics. Note that these practice pointers were not discussed during the telephone forum, and

are instead intended as a helpful aid for plan sponsors and plan administrators.

**Reasonable Interest Rate.** In order to avoid classification as a prohibited transaction under Section 4975, a plan loan to a participant must bear a “reasonable rate of interest.” During the telephone forum, the IRS said it generally considers “prime plus 2 percent” to be a reasonable rate of interest. However, the IRS recognized that “there is nothing in stone” regarding the suggested prime plus 2 percent interest rate, and mentioned that plan sponsors could argue that a lower interest rate was reasonable so long as the participant could obtain a loan on the open market with such a lower interest rate.

*Practice Pointer:* Many plan loan programs currently utilize an interest rate that is less than prime plus 2 percent. Plan sponsors and plan administrators should review their plan loan procedures and determine whether the interest rate should be increased accordingly. (See ¶415 and ¶465 of the *Guide* for additional considerations in setting a reasonable rate of interest.) Also note that any increases to the interest rate should only be applied prospectively to new loans, and should not be retroactively applied to any existing loans. Applying a new interest rate to an existing loan would violate the level amortization requirement of Section 72(p).

**Signed Loan Agreement.** The IRS reiterated the importance of having a signed loan agreement on file. Without a signed loan agreement, the loan will not be considered a “legally enforceable agreement,” which is one of the requirements under Treas. Reg. §1.72(p)-1, Q/A-3. The IRS said that both written and electronic signatures are acceptable.

**Spousal Consent.** The IRS reminded callers that a plan is generally not required to obtain spousal consent before approving a plan loan. (The spousal consent rules only apply to plans subject to the qualified joint and survivor annuity rules, such as defined benefit pension plans and money purchase plans.) These rules can be found in Code Section 417(a)(4). However, a plan not otherwise subject to the spousal consent rules is still permitted to request spousal consent as a precondition to issuing a plan loan.

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