Tax Sheltered Annuity Plan Information for Participants Regarding Policy Loans

Quoting from the answer to Question 11:1 in the 403(b) Answer Book, Fifth Edition, 2000, Panel Publishers:

> "Loans may be offered from an annuity or life insurance contract that qualifies under Code Section 403(b) and will be treated as being made from the employer's 403(b) plan. [IRC § 72(p)(5); Prop Treas Reg § 1.72(p)-1, Q&A 2] The IRS has also ruled privately that a custodial account under Code Section 403(b)(7) may offer loans. A number of requirements must be satisfied, however, in order to prevent a loan from being taxable to the participant as a "deemed distribution" at the time it is made."

Most citations in the Loans section of the above reference text are to Code Section 72(p) and Proposed Treas. Reg. 1.72(p)-1. The complete text of Code Section 72(p) appears below, but the participant is also referred to the reference text cited above and Proposed Treas. Reg. 1.72(p)-1.

A particular annuity or custodial account may or may not have loan provisions. If loans are allowed, the investment company will provide detailed explanations of all rules and regulations that apply to such loans. In addition to a given investment providers rules, the employer's 403(b) plan document may have language concerning the permissibility of loans and the limitation that may apply. Generally, the following basic rules apply:

- The loan must be evidenced by a legally enforceable written agreement.
- The agreement must clearly identify an amount borrowed, a loan term, and a repayment schedule, each of which satisfies applicable requirements.
- Loan amounts are subject to any limits stated in the underlying annuity or custodial account contract. Apart from the plan and the investment, however, loans from 403(b) plans are limited by a 50/50 rule: they generally cannot exceed the lesser of:
  - $50,000;
  - The greater of $10,000 or 50 percent of the participant's present account balance (assuming all contributions have been elective deferrals).
- The loan agreement must require repayment within five years, unless the loan proceeds are used to acquire a dwelling unit that will, within a reasonable time, be used as the participant's principal residence. Generally, principal-residence loans are scheduled for repayment within fifteen years.
- Repayment must be made by substantially level payments at least quarterly.

Quoting from Internal Revenue Code § 72(p)

"(p) **Loans treated as distributions** For purposes of this section—

(1) **Treatment as distributions**

(A) **Loans** If during any taxable year a participant or beneficiary receives (directly or indirectly) any amount as a loan from a qualified employer plan, such amount shall be treated as having been received by such individual as a distribution under such plan.

(B) **Assignments or pledges** If during any taxable year a participant or beneficiary assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified employer plan, such portion shall be treated as having been received by such individual as a loan from such plan.

(2) **Exception for certain loans**

(A) **General rule** Paragraph (1) shall not apply to any loan to the extent that such loan (when added to the outstanding balance of all other loans from such plan whether made on, before, or after August 13, 1982), does not exceed the lesser of—

(i) $50,000, reduced by the excess (if any) of—

(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

(II) the outstanding balance of loans from the plan on the date on which such loan was made, or

(ii) the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) $10,000. For purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (o)(5)(B)).

(B) **Requirement that loan be repayable within 5 years**

(i) In general Subparagraph (A) shall not apply to any loan unless such loan, by its terms, is required to be repaid within 5 years.

(ii) Exception for home loans Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant.

(C) **Requirement of level amortization** Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan (with payments not less frequently than quarterly) is required over the term of the loan.

(D) **Related employers and related plans** For purposes of this paragraph—

(i) the rules of subsections (b), (c), and (m) ofsection 414 shall apply, and

(ii) all plans of an employer (determined after the application of such subsections) shall be treated as 1 plan.

(3) **Denial of interest deductions in certain cases**

(A) **In general** No deduction otherwise allowable under this chapter shall be allowed under this chapter for any interest paid or accrued on any loan to which paragraph (1) does not apply by reason of paragraph (2) during the period described in subparagraph (B).

(B) **Period to which subparagraph (A) applies** For purposes of subparagraph (A), the period described in this subparagraph is the period—

(i) on or after the 1st day on which the individual to whom the loan is made is a key employee (as defined in section 416 (i)), or

(ii) such loan is secured by amounts attributable to elective deferrals described in subparagraph (A) or (C) of section 402 (g)(3).

(4) **Qualified employer plan, etc.** For purposes of this subsection—

(A) **Qualified employer plan**

(i) In general The term "qualified employer plan" means—

(I) a plan described in section 401 (a) which includes a trust exempt from tax under section 501 (a),

(II) an annuity plan described in section 403 (a), and

(III) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403 (b).

(ii) Special rule The term "qualified employer plan" shall include any plan which was (or was determined to be) a qualified employer plan or a government plan.

(B) **Government plan** The term "government plan" means any plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

(5) **Special rules for loans, etc., from certain contracts** For purposes of this subsection, any amount received as a loan under a contract purchased under a qualified employer plan (and any assignment or pledge with respect to such a contract) shall be treated as a loan under such employer plan. "