RETIREMENT PLAN LOANS

Frequently asked questions from participants

FREQUENTLY ASKED QUESTIONS

I have a loan from my 401(k) plan and I am quitting my job. What happens to the loan?

This depends on your employer's policies. Your employer might require that you repay the loan entirely upon termination of employment or within three months of termination. Failure to do so will cause the loan to go into default. It will then be treated as taxable income to you. You will be responsible for income taxes, as well as any applicable penalties.

Can I make payments on the loan by sending a check to my former employer?

Maybe. Again, this depends on the employer's policy. Some employers allow this, and others do not. If your employer does allow this, you must remember to make the payments according to the payment schedule. Failure to make the payments on time will cause the loan to default and become taxable. You are responsible for making the payments; your employer is not required to remind you.

Can I roll my loan over to my Individual Retirement Account (IRA)?

No.

My new employer's plan allows loans. Can I transfer my loan to the new plan?

Maybe. This depends on the policies of both your old employer and your new employer. Both may allow this, in which case you can do so. You will need to contact the appropriate person at your new company to determine how you go about this and exactly what information they will require from your former employer. Keep in mind, however, that neither employer is required to permit a transfer of your loan. If either employer does not allow this, you cannot transfer the loan directly to the new plan.

If I cannot transfer the loan to my new plan, and my old employer will not accept monthly payments, what can I do to keep from paying taxes on it?

You must completely repay the loan before you take a distribution from your old employer's plan, and before the loan goes into default.

Can I take a loan from my new employer's plan to repay the loan from the old plan?

This depends on your new employer's plan. If it allows loans, you may borrow from it to the extent you qualify under the terms of the plan. If your new employer's plan accepts rollovers, you may be able to roll over your old plan's funds to the new plan, and then borrow from that rollover. If you can arrange a temporary loan to repay the old plan loan first, you can avoid taxes on the old loan and repay the temporary loan with proceeds from the new plan loan. Again, this depends on the terms of your new employer's plan.

Why is this so complicated?

The Internal Revenue Service governs plan loans. Since retirement plan money has not been taxed, the IRS wants to be sure that loans are not abused in a way that allows employees to avoid paying taxes on funds they receive. Both your old employer and your new employer face substantial financial penalties from the IRS if they do not properly follow these rules. Do not expect this to be as simple or quick as transferring funds between bank accounts. Your employers must follow these rules and protect the tax benefits of their plans for all their employees.