

A-5: Section 72(p)(2)(B)(ii) provides that the requirement in section 72(p)(2)(B)(i) that a plan loan be repaid within five years does not apply to a loan used to acquire a dwelling unit which will within a reasonable time be used as the principal residence of the participant (a principal residence plan loan). For this purpose, a principal residence has the same meaning as a principal residence under section 1034.

Q-6: In order to satisfy the requirements for a principal residence plan loan, is a loan required to be secured by the dwelling unit that will within a reasonable time be used as the principal residence of the participant?

A-6: A loan is not required to be secured by the dwelling unit that will within a reasonable time be used as the participant's principal residence in order to satisfy the requirements for a principal residence plan loan.

Q-7: What tracing rules apply in determining whether a loan qualifies as a principal residence plan loan?

A-7: The tracing rules established under section 163(h)(3)(B) apply in determining whether a loan is treated as for the acquisition of a principal residence in order to qualify as a principal residence plan loan.

Q-8: Can a refinancing qualify as a principal residence plan loan?

A-8: (a) *Refinancings*. In general, no. However, a loan from a qualified employer plan used to repay a loan from a third party will qualify as a principal residence plan loan if the plan loan qualifies as a principal residence plan loan without regard to the loan from the third party.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q&A-8 and is based upon the assumptions described in ASSUMPTIONS FOR EXAMPLES:

Example. (a) On July 1, 1999, a participant requests a \$50,000 plan loan to be repaid in level monthly installments over 15 years. On August 1, 1999, the participant acquires a principal residence and pays a portion of the purchase price with a \$50,000 bank loan. On September 1, 1999, the plan loans \$50,000 to the participant, which the participant uses to pay the bank loan.

(b) Because the plan loan satisfies the requirements to qualify as a principal residence plan loan (taking into account the tracing rules of section 163(h)(3)(B)), such plan loan qualifies for the exception in section 72(p)(2)(B)(ii).

Q-9: Does the level amortization requirement of section 72(p)(2)(C) apply when a participant is on a leave of absence without pay?

A-9: (a) *Leave of absence*. The level amortization requirement of section 72(p)(2)(C) does not apply for a period, not longer than one year, that a participant is on a leave of absence, either without pay from the employer or at a rate of pay (after income and employment tax withholding) that is less than the amount of the installment payments required under the terms of the loan. However, the loan must be repaid by the latest date permitted under section 72(p)(2)(B) and the installments due after the leave ends (or, if earlier, after the first year of the leave) must not be less than those required under the terms of the original loan.

(b) *Example*. The following example illustrates the rules of paragraph (a) of this Q&A-9 and is based upon the assumptions described in ASSUMPTIONS FOR EXAMPLES:

Example. (a) On July 1, 1997, a participant with a nonforfeitable account balance of \$80,000, borrows \$40,000 to be repaid in level monthly installments of \$825 each over five years. The loan is not a principal residence plan loan. The participant makes nine monthly payments and commences an unpaid leave of absence that lasts for 12 months. Thereafter, the participant resumes active employment and resumes making repayments on the loan until the loan is repaid. The amount of each monthly installment is increased to \$1,130 in order to repay the loan by June 30, 2002.

(b) Because the loan satisfies the requirements of section 72(p)(2), the participant does not have a deemed distribution. Alternatively, section 72(p)(2) would be satisfied if the participant continued the monthly installments of \$825 after resuming active employment and on June 30, 2002 repaid the full balance remaining due.

Q-10: If a participant fails to make the installment payments required under the terms of a loan that satisfied the requirements of Q&A-3 of this section when made, when does a deemed distribution occur and what is the amount of the deemed distribution?

A-10: (a) *Timing of deemed distribution*. Failure to make any installment payment when due in accordance with the terms of the loan violates section 72(p)(2)(C) and, accordingly, results in a deemed distribution at the time of such failure. However, the plan administrator may allow a grace period, and section 72(p)(2)(C) will not be considered to have been violated until the last day of the grace period. Any such grace period shall be given effect for purposes of section 72(p)(2)(C) only to the extent it

does not continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due.

(b) *Amount of deemed distribution*. If a loan satisfies Q&A-3 of this section when made, but there is a failure to pay the installment payments required under the terms of the loan (taking into account any grace period allowed under the preceding paragraph (a) of this Q&A-10), then the amount of the deemed distribution equals the entire outstanding balance of the loan at the time of such failure.

(c) *Example*. The following example illustrates the rules in Q&A-10(a) and (b) of this section and is based upon the assumptions described in ASSUMPTIONS FOR EXAMPLES:

Example. (1) On August 1, 1998, a participant has a nonforfeitable account balance of \$45,000 and borrows \$20,000 from a plan to be repaid over five years in level monthly installments due at the end of each month. After making all monthly payments due through July 31, 1999, the participant fails to make the payment due on August 31, 1999 or any other monthly payments due thereafter. The plan administrator allows a three-month grace period.

(2) As a result of the failure to satisfy the requirement that the loan be repaid in level installments pursuant to section 72(p)(2)(C), the participant has a deemed distribution on November 30, 1999, which is the last day of the three-month grace period for the August 31, 1999 installment. The amount of the deemed distribution is \$17,157, which is the outstanding balance on the loan at November 30, 1999. Alternatively, if the plan administrator had allowed a grace period through the end of the next calendar quarter, there would be a deemed distribution on December 31, 1999 equal to \$17,282, which is the outstanding balance of the loan at December 31, 1999.

Q-11: Do sections 72 and 4980A apply to a deemed distribution as if it were an actual distribution?

A-11: (a) *Tax Basis*. If the employee's account includes after-tax contributions or other investment in the contract under section 72(e), section 72 applies to a deemed distribution as if it were an actual distribution, with the result that all or a portion of the deemed distribution may not be taxable.

(b) *Sections 72(t) and (m)*. Section 72(t) (which imposes a 10 percent tax on certain early distributions) and section 72(m)(5) (which imposes a separate 10 percent tax on certain amounts received by a 5-percent owner) apply to a deemed distribution under section 72(p)