Loan Taxability

How to Get Your Best Loan Estimate

NY STRS

What makes borrowing against your NYSTRS contributions taxable?

- A loan may be taxable if the total amount borrowed exceeds the limits allowed by the IRS.
  - Limits are based on a variety of criteria, including the present value of your retirement benefit and any current loans you may have including loan balances with a 457 or 403(b) plan.

- To avoid taxability, your total loan debt must be paid within 5 years of the date the **original** loan was issued.
  - *Example:* If an existing loan is being combined with a new loan, any remaining balance on the combined loans must be paid within the original 5-year period or it will be taxed at the time the new (combined) loan is issued.
  - This issue date is called the "Tax Period End Date" and is available on your original loan disclosure or by contacting NYSTRS.

Example of a taxable loan

- Mary Member takes a 5-year loan for $10,000 on 1/1/2017.
  - This loan is a 5-year loan to be paid in full on 12/31/2021.

- On 1/1/2018 Mary Member wants to borrow another $2,000 and repay it over 5 years. She still owes $9,000 on her first loan.
  - This new combined loan is scheduled to be repaid by 12/31/2022.

Why the high taxable amount and how to avoid it

- The taxable amount is high because the original loan is not being repaid within its 5-year term.
  - Because Mary is refinancing the balance of the original loan beyond 5 years, this balance must be considered <u>twice</u> under IRS regulations.

- However, if Mary agrees to pay off the new (combined) loan by the "Tax Period End Date" previously described, she can <u>significantly reduce</u> the taxable amount.
  - As long as Mary pays off her total loan debt by 12/31/2021, she can avoid the higher taxability.

Taxability calculation for a new 5-year combined loan

$9,000	Balance on original loan
+ 2,000	Additional amount borrowed
$11,000	Total combined loan *(to be paid by 12/31/2022)*
+ 30	Service charge
+ 9,000	Balance of previous loan not repaid within original 5-year term *(e.g., 12/31/2021)*
$20,030	Total considered when calculating taxability
- $10,000	Amount exempt per IRS guidelines *(this amount is a minimum of $10,000 but can be more depending on circumstance.)*

$ 10,030 Taxable at Issuance

Taxability calculation for a new 4-year combined loan

$9,000	Balance on original loan
+ 2,000	Additional amount borrowed
$11,000	Total combined loan *(to be paid by 12/31/2021)*
+ 30	Service charge
+ 0	Balance of previous loan not repaid within original 5-year term *(e.g., 12/31/2021)*
$11,030	Total considered when calculating taxability
-$10,000	Amount exempt per IRS guidelines *(this amount is a minimum of $10,000 but can be more depending on circumstances.)*
$ 1,030	**Taxable at issuance**

Taxability significantly reduced!

- By changing the term of her new loan from 5 years to 4 years, Mary was able to reduce the taxable amount by **$9,000**.

- **The trade off:** Because the term is shorter, the monthly payment is higher.
  - Generally, a loan of $11,000 will cost approximately $260 per month for 5 years. The same loan will cost approximately $310 per month for 4 years.

Another Option:
Selecting a specific monthly payment

- You have two options when choosing repayment terms:
  1. Choosing a fixed term of 1, 2, 3, 4 or 5 years. **OR**
  2. Selecting a specific monthly payment amount.
     - By choosing a specific monthly payment, you can control the term length and pay off the loan in the number of months you choose.
     - In keeping with the Mary Member example, she would need to choose a monthly payment amount that will pay off the new (combined) loan on or before 12/31/2021.

Example of adjusting term length to reduce or avoid taxability

- Mary takes a 5-year loan on 6/01/2018 for $10,000.
  - The loan is scheduled to be paid in full by 5/31/2023.

- On 1/1/2020 Mary wants to borrow another $2,000. She still owes $8,500 on her current loan.
  - Mary knows the new (combined) loan must be repaid by 5/31/2023 to minimize the taxability. This means she must have it paid off in 35 months.

When requesting the loan estimate, she asks to see:

- A 3-year repayment term.
  - This repays the loan in 30 months (10 payments per year; no payments in July or August), well within the 35-month window.
  - Her payments would be $385 per month.

Example of adjusting term length to reduce or avoid taxability (cont.)

- A term with a fixed monthly payment amount of $340.
  - This repays the loan in 35 months.
  - Because this pays off the loan by 5/31/2023, she has limited her taxability.

How to arrive at a monthly payment amount that limits taxability

- It may require running multiple estimates to find the least taxable option that fits your needs.
  - That's why we give you the "Start Over and Choose Different Options" choice when requesting a loan!

- Try various scenarios both for term and specific repayment amount.
  - It is worth the time and effort to explore different options to avoid a large tax liability.

How to calculate different payment options

- Look for this on the Loan Estimate page in MyNYSTRS:

Loan Taxability

Loans / Loan Application

⚠ The loan you requested includes a taxable portion of $ The taxable portion of the loan will be reported as ordinary income for federal income tax purposes, and it will be reflected in a 1099-R that will be issued to you in January.

Don't want to pay federal income tax on your loan?

It may be possible to reduce or eliminate the taxability of your loan by choosing a lower loan amount or a shorter repayment term. Refer to our loan taxability *tutorial* and watch our short video *Loan Truths... And Consequences* for important information. For the maximum loan amount that is non-taxable at the time of issuance, try the Maximum Non-Distribution Loan option.

Choose a Different Loan Type

Summary: What to consider when borrowing from your contributions

- When taking a new (combined) loan, the taxable amount is directly impacted by the original loan repayment date.
- Changing the “Repayment Term” or “Monthly Repayment Amount” on your estimates can help reduce loan taxability.
- Requesting a smaller loan can also reduce taxability.
- Do multiple loan estimates before deciding on loan terms.
- It is not always possible to avoid a combined loan being taxable, but generally that tax can be reduced by paying it off sooner.

For eligibility restrictions and other Important information, see the *Borrowing From Your Contributions* brochure.

Questions?
Call (800) 348-7298,
Ext. 6080.