



Loan Taxability: Things to Keep in Mind

When a member borrows from their NYSTRS contributions, IRS rules determine whether any portion of the loan is treated as taxable income. In many cases, the taxable amount is small or zero. In other cases, the taxable amount may be higher, depending on how the loan is structured and how repayment aligns with IRS time limits.

One key factor in determining loan taxability is the IRS five-year repayment limit. Each loan is subject to a five-year repayment period that begins on the date the loan is issued. This period ends on the **Tax Period End Date**. For tax purposes, the IRS expects the original loan amount to be fully repaid by that date.

If a member takes out another loan before an existing loan is fully repaid, NYSTRS combines the balances into a single loan for repayment. For IRS taxability calculations, however, the original loan continues to be measured against its original five-year repayment limit. If repayment extends beyond that original deadline, IRS rules may affect how the unpaid balance is counted when determining taxability.

This guide explains how repayment timing may affect loan taxability and illustrates how IRS rules can be applied in different scenarios.

Please Note

The examples shown here are for illustrative purposes only. Actual loan amounts, repayment terms, taxable amounts and withholding requirements vary based on individual circumstances and IRS guidelines. Loan taxability is determined by IRS rules and individual circumstances. If a portion of a loan is taxable, it will be treated as ordinary income for federal tax purposes and is reported on IRS Form 1099-R for the year the loan is issued. Members will receive the 1099-R in January of the following year, regardless of when in the previous year the loan was taken.

Members should consider consulting with a personal tax advisor before applying for a loan. If a taxable amount applies, members may be required to choose whether federal income tax is withheld at the time the loan is issued. If a member is under age 59½, an additional 10% IRS penalty may apply to the taxable portion of the loan for taking an early distribution from their pension in the form of a taxable loan.

Additional information is available in our brochure, *Borrowing From Your NYSTRS Contributions*, or by calling 800-348-7298, ext. 6080.

Loan Taxability and Repayment Timing

Loan taxability is determined by IRS rules and depends largely on whether loans are repaid within the applicable five-year repayment period. When repayment extends beyond the original Tax Period End Date, IRS rules may result in a higher taxable amount. This resource presents some things you may want to consider when taking a loan. Before requesting a loan, members may find it helpful to review estimated repayment options and payoff dates using the Loan Estimate feature in MyNYSTRS.

How Repayment Timing May Affect the Taxable Amount

When a member has an outstanding loan and takes out another loan, the balances are both taken into account for repayment purposes. If the combined loan extends beyond the original loan's Tax Period End Date, the unpaid balance of the first loan may be included twice when taxability is calculated: once as part of the combined loan and again as the balance of the original loan that was not repaid within its five-year period. This treatment can increase the taxable amount at the time the new loan is issued.

Example #1: Repayment Extending Beyond the Tax Period End Date

Mary Member takes a 5-year loan for \$10,000 on Jan. 1, 2027. It must be repaid in full by Dec. 31, 2031 (the Tax Period End Date). On Jan. 1, 2028, Mary wants to borrow another \$2,000 and repay it over 5 years. She still owes \$9,000 on her first loan. The new combined loan is scheduled to be repaid by Dec. 31, 2032 – one year past the original deadline.

What does this mean for Mary? Let's break down the taxability of this new 5-year combined loan:

\$9,000	Balance on original loan
+ <u>\$2,000</u>	Additional amount borrowed
= \$11,000	Total combined loan (to be paid by Dec. 31, 2032)
+ \$30	Service charge
+ <u>\$9,000</u>	Balance of previous loan not repaid within original 5-year term (i.e., Dec. 31, 2031)
= \$20,030	Total considered when calculating taxability
- <u>\$10,000</u>	Minimum amount exempt per IRS guidelines – this could be more depending on circumstances
= \$10,030	Taxable amount at loan issuance

Notice how, in this example, the unpaid balance of the original loan is included twice in the taxability calculation because repayment extends beyond the original Tax Period End Date. Mary's situation demonstrates how extending a loan beyond the original 5-year Tax Period End Date can



lead to a high taxable amount. Something Mary might consider is choosing a shorter repayment term for the second loan, which can reduce or eliminate the taxable portion of a combined loan.

Example #2: Repayment Within the Tax Period End Date

Mary Member takes a 5-year loan for \$10,000 on Jan. 1, 2027. It must be repaid in full by Dec. 31, 2031 (the Tax Period End Date). On Jan. 1, 2028, Mary wants to borrow another \$2,000. She still owes \$9,000 on her first loan. Instead of taking 5 years, she chooses a 4-year repayment term. This keeps the loan within the first loan’s Tax Period End Date and avoids double counting.

Let’s break down the taxability of Mary’s loan with the 4-year repayment term:

\$9,000	Balance on original loan
+ \$2,000	Additional amount borrowed
= \$11,000	Total combined loan (to be paid by Dec. 31, 2031)
+ \$30	Service charge
+ 0	Balance of previous loan not repaid within original 5-year term (i.e., Dec. 31, 2031)
= \$11,030	Total considered when calculating taxability
<u>- \$10,000</u>	Minimum amount exempt per IRS guidelines – this could be more depending on circumstances
= \$1,030	Taxable amount at loan issuance

In this example, instead of selecting a five-year repayment term for the combined loan, she selects a four-year term. This results in a payoff date that falls within the original Tax Period End Date. Because she’s no longer extending the Tax Period End Date, the IRS doesn’t double her unpaid balance. This reduces the taxable amount by \$9,000.

A shorter term means a higher monthly payment – from about \$260 over five years to roughly \$310 over four. Mary pays more each month but avoids a large taxable amount. Because the loan is repaid within the original five-year period, the unpaid balance of the first loan is not counted twice when taxability is calculated.

Repayment Options and Payoff Dates

When requesting a loan, members select either a repayment term or a specific monthly payment amount. The selected option determines the loan’s payoff date. If the payoff date extends beyond the original Tax Period End Date of the first loan, IRS rules may affect how the taxable amount is calculated. Members may request a loan using one of the following options.

Selecting a Fixed Repayment Term

Mary Member takes a five-year loan for \$10,000 on June 1, 2027, with a payoff date of May 31, 2032. On Jan. 1, 2029, she takes an additional loan of \$2,000 and still owes \$8,500 on the original loan. To remain within the original Tax Period End Date of May 31, 2032, the combined loan must be repaid within the remaining 35 months. When reviewing available options, Mary selects a three-year repayment term (30 payments; NYSTRS does not deduct loan payments in July or August). This results in a payoff date before the IRS deadline.

Choosing a Specific Monthly Payment Amount

Instead of selecting a fixed repayment term, a member may choose a specific monthly payment amount. The monthly payment selected determines how long the loan will take to be fully repaid.

Using the same example, Mary could choose a monthly payment amount that results in full repayment of the combined loan by May 31, 2032. Because the payoff date does not extend beyond the original Tax Period End Date, the taxability calculation is based solely on the combined loan balance and applicable IRS exemptions.

Using Loan Estimates in MyNYSTRS

Members can use the Loan Estimate feature in MyNYSTRS to review how different repayment terms or monthly payment amounts affect the estimated payoff date and taxable amount.

On the Loan Estimate page, members can enter different repayment terms (one to five years) or specify a monthly payment amount. The system automatically updates the estimated payoff date and taxable amount based on the information entered.

Running multiple estimates allows members to compare repayment timelines and understand how IRS rules apply to different scenarios.