

## Publications

### *Labor and Employment Alert: Addressing Student Loan Debt in a 401(k) Plan: Recent IRS Private Letter Ruling Provides New Options for Employers*

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### Background

On August 17, 2018, the Internal Revenue Service (IRS) published Private Letter Ruling 201833012, which directly addressed an employer's ability to provide a student loan repayment benefit in its 401(k) plan. This ruling comes at a pivotal moment. The amount of student loan debt in the United States keeps increasing. The average student loan debt for a Class of 2017 graduate was \$39,400, an increase of 6% from the Class of 2016.

Many employers want a program to attract and retain employees facing this financial burden. This ruling opens opportunities for employers to help their employees save for retirement while the employees repay student loan debt. The program described in the private letter ruling helps their employees save for retirement, but doesn't help the employees directly to repay the debt.

It is important to note that, an IRS private letter ruling cannot be relied upon as guidance by any taxpayer other than the one who requested the ruling. Therefore, while employers can use this ruling as an indicator of the IRS's position, it is not binding law.

### Overview of the Plan's Features

The taxpayer in the ruling specifically asked the IRS to address its "Student Loan Benefit Program" (program) in its 401(k) plan. The most relevant features of that plan and the program are as follows:

- The employer provides a matching contribution to employees who make elective contributions to the plan. If an employee contributes at least 2% of his or her eligible compensation to the plan each payroll period, then the employer makes a matching contribution equal to 5% of the employee's eligible compensation during the payroll period. [This match is richer than the level offered by most plans.]

- All employees who are eligible to participate in the plan may elect to participate in the program. Participation in the program is voluntary and employees may opt out prospectively at any time.
- If an employee chooses to participate in the program, then that employee will not receive the regular payroll period match that would otherwise have been made in connection with any 401(k) contributions the employee actually contributes to the plan.
- If an employee chooses to participate in the program and is employed on the last day of the plan year, then the plan will make the following contributions to the plan:
  - If the employee makes a student loan repayment equal to at least 2% of his or her eligible compensation during a payroll period, then the employer will make a non-elective contribution equal to 5% of the employee's eligible compensation for that payroll period.
  - If the employee does not make a student loan repayment equal to at least 2% of his or her eligible compensation during a payroll period, but does make 401(k) contributions that equal or exceed that amount, then the employer will make a true-up matching contribution equal to 5% of the employee's eligible compensation for that payroll period.
  - Note under this structure, an employee who contributes 1% to the plan and 1% for loan repayment would receive neither the non-elective contribution nor the true-up match. This feature would discourage 401(k) contributions for employees who don't pay 2% of their pay to either source.

### IRS's Ruling

The IRS only ruled on the narrow issue that this structure does not violate the contingent benefit prohibition under section 401(k) of the Internal Revenue Code. Under that provision, an employer may not condition another benefit upon an employee's election to make or not make elective contributions to a 401(k) plan. [Note: this rule does not apply to matching contributions.] This rule prevents employers from encouraging employees to make or not make elective contributions by linking valuable benefits to their contribution or lack of a contribution.

The IRS ruled that the program here would not violate the contingent benefit rule. The IRS noted that the employer's non-elective contributions were conditioned on whether or not the employee made a student loan repayment, not on whether or not the employee made elective contributions to the plan. The IRS found that the nonelective contribution was not "conditioned" on the employee making elective contributions to the plan and therefore the program did not violate the contingent benefit rule.

### WARNING

The ruling does not address all potential issues that may arise when an employer designs this type of feature. The IRS makes it clear that any student loan repayment program in a 401(k) plan would still have to meet all requirements applicable to plans, including eligibility, vesting, distribution rules, contribution limits, coverage and nondiscrimination testing. This means that employers will have to keep overall compliance in mind when designing this feature in their 401(k) plans.

While the non-elective contribution will likely be provided primarily to non-highly compensated employees, and therefore will pass discrimination testing, the impact on the testing for deferrals and matching contribution is more unpredictable. This match structure would NOT qualify for any of the safe harbor testing provisions.

### What this Means for Employers

The ruling creates more options for employers who are considering addressing student loan repayment in their 401(k) plans. Employers can use this ruling as a model on how to design their own repayment programs to comply with the contingent benefit rule. Just as importantly, the ruling demonstrates that the IRS is acknowledging this issue and considering ways to help employers address it. Additionally, this ruling provides employers with a tax-advantageous method of addressing student loan debt. If an employer simply repaid an employee's student loans directly, or provided the employee cash to repay a student loan, this would be taxable income to the employee and reported on a Form W-2. Under a 401(k) plan, however, this money generally will not be taxable and can continue to grow tax-free until the employee's retirement.