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PENSION ANALYST
COMPLIANCE BULLETIN

IRS issues ruling on student loan repayment benefit in 401(k) plan

On August 17, 2018, the IRS issued a private letter ruling permitting a student loan repayment benefit under a 401(k) plan. While the IRS ruling is directed only to the taxpayer requesting it and may not be used or cited as precedent, it does provide some level of comfort for employers who are considering similar programs.

Background

As student loan debt continues to climb, employers are seeking innovative ways to help employees repay this debt. While some employers have offered student loan repayment programs separate from their retirement plan, there has been recent interest in coordinating student loan repayment benefits with contributions to retirement plans. However, due to concerns about violating the "contingent benefit" rule under the 401(k) rules, plan sponsors have been reluctant to implement student loan repayment benefits within retirement plans. The "contingent benefit" rule prohibits sponsors from making any benefit, other than matching contributions, conditioned upon the employee making, or not making, elective contributions to a plan.

The recent IRS private letter ruling opined that student loan repayment benefits as presented in the fact pattern of the ruling do not violate the "contingent benefit rule."

The student loan benefit program

Under the facts of the ruling, the employer's 401(k) plan, which permits pre-tax, Roth, and after-tax contributions, provides for a regular 5% matching contribution of the participant's compensation for each pay period that the participant makes an elective contribution equal to 2% or more of his eligible compensation for the pay period.

The employer proposed to also offer a voluntary student loan benefit program (the "program") under the plan. The program allows the employer to make a student loan nonelective contribution equal to the matching contribution the employee would have otherwise received if he had made pre-tax, Roth, and/or after-tax contributions instead of making the student loan repayment. In other words, if a participant enrolls in the program and makes a student loan repayment equal to 2% or more of his eligible compensation, the employer will make a student loan repayment nonelective contribution to the plan equal to 5% of the employee's compensation for the pay period. The nonelective contribution is made without regard to whether the participant will make any elective contributions under the plan during the year. While this nonelective contribution would not repay the employee's student loan, it would be a contribution to the employee's retirement plan at a time when the employee may not be able to make elective contributions to the plan.

If the participant does not make a student loan repayment of at least 2% of compensation for a pay period, but does make an elective contribution of at least 2% of compensation for that pay period, the employer will make a "true-up" matching contribution as soon as practicable after the end of the plan year equal to 5% of the participant's compensation for that pay period. If the participant made both a 2% student loan repayment and a 2% elective contribution, the employer would make only the 5% student loan repayment nonelective contribution to the plan on the employee's behalf.

To receive the 5% contribution as either a student loan repayment nonelective contribution or true-up matching contribution, the participant would need to be employed on the last day of the plan year (except in the case of death or disability). Both types of employer contributions will be subject to the same vesting schedule as regular matching contributions. The student loan repayment nonelective contribution will be subject to all applicable plan qualification requirements, including eligibility, vesting, distribution rules, contribution limits, coverage testing, and nondiscrimination testing. The student loan repayment nonelective contribution will not be treated as a match for actual contribution percentage ("ACP") testing purposes. The true-up matching contribution will be included as a matching contribution for ACP testing purposes. If the employee later opts out of enrollment in the program, the employee will resume eligibility for regular matching contributions.

Important considerations and outstanding issues

Prior to implementing a student loan repayment benefit, careful consideration should be given to plan design to ensure such a feature would comply with IRS rules and nondiscrimination tests. Employers should consider the following when determining whether to incorporate a student loan repayment benefit in their retirement plan:

- Participant student loan repayment contributions do not count towards actual deferral percentage ("ADP") testing, and student loan repayment nonelective contributions made by the employer do not count towards ACP testing. Sponsors should consider the impact lower elective contributions and lower matching contributions could have on their ADP/ACP testing results.
- Nonelective contributions must be made on a nondiscriminatory basis, as they are considered "benefits, rights and features" under Code section 401(a)(4). This might create an issue for plans where most of the employees eligible for the contribution are highly compensated employees.
- Employers interested in this type of benefit should review their plan document to determine whether there are plan design features that may not work with a student loan repayment benefit. For instance, special rules that apply to safe harbor 401(k) plans may limit the ability to adopt a student loan repayment benefit similar to the one in the IRS ruling.
- The student loan repayment made by the participant would be made on an after-tax basis.
- The plan document would need to be amended to accommodate the benefit. Pre-approved plan documents may not currently be able to accommodate certain student loan repayment benefits.
- There is a need for broader guidance from the IRS clarifying that these types of contributions can be made to other plan types (e.g. governmental 457(b) and 403(b) plans) and will not affect the plan's tax-qualified status.

Next steps

The recent IRS private letter ruling provides welcome guidance, giving employers more flexibility for assisting employees with the growing student loan repayment crisis. For more information on student loan assistance benefits that Prudential Retirement offers, contact your Prudential representative.

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