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BENEFITS BRIEF

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IRS Private Ruling on Student Loan Benefit Under 401(k) Plan Likely to Fuel Interest

<u>Background</u>

In the last few years, many employers have been looking for ways to help their employees cope with their student loan debt. Approaches that various companies have used to help employees include –

- signing bonuses to attract new workers,
- additional compensation based on the amount of debt being paid off, and
- direct payment on outstanding loans.

Still other companies have chosen to provide assistance on a tax-favored basis, *i.e.*, by making tax-deferred contributions to their IRS-qualified 401(k) or other defined contribution plans for affected participants. Interest in this approach increased greatly after June 26 when Abbott Labs announced its "Freedom 2 Save" program on which it had received an IRS private letter ruling.

On August 17, the IRS publicly released a private letter ruling (PLR 201833012, May 22, 2018) regarding an employer's proposal to amend its plan to include a student loan benefit program, which is generally thought to be the one received by Abbott Labs. As discussed below, the IRS concluded that the program, as proposed, would not violate the "contingent benefit" prohibition under the Internal Revenue Code of 1986, as amended (the "Code"), and related regulations.

<u>The Program</u>

Facts – The program is part of the employer's defined contribution plan, which includes a cash or deferred arrangement under Code section 401(k) and permits an employee to make pre-tax, Roth, and after-tax contributions ("elective contributions"). Before the addition of the program, the plan provided for a regular matching contribution equal to 5% of the employee's compensation for each pay period that an employee makes an elective contribution equal to 2% or more of his eligible compensation for the pay period. This regular matching contribution will continue to apply for any employees who do not elect to enroll in the program.

As proposed, all employees will be eligible to enroll in a voluntary student loan benefit program under the plan. If an employee enrolls in the program and makes a student loan repayment equal to 2% or more of his eligible compensation for a pay period, the employer will make a nonelective contribution to the plan equal to 5% of the employee's compensation for that period. This nonelective contribution will be made as soon as practicable after the end of the year, but only if the employee is still employed at the end of the year (unless the termination was because of death or disability).

An employee who enrolls in the program is not required to make a student loan repayment each pay period and can opt out at any time. Further, if an enrolled employee does not make a qualifying student loan repayment, but does make an elective contribution to the plan for that pay period equal to at least 2% of compensation, the employer will make a "true-up" matching contribution after the end of the year equal to 5% of the employee's compensation for that pay period, but only if the employee is still employed at the end of the year (unless the termination was because of death or disability). Note that the same vesting schedule applies for the nonelective contributions and true-up match contributions as regular matching contributions.

Analysis – Section 401(k) plans must satisfy the so-called "contingent benefit rule" (Code sec. 401(k)(4)(A)) to qualify for favorable tax treatment. This rather confusing rule prohibits an employer from conditioning "other benefits" – including welfare benefits, stock options or most any other type of compensation – on an employee's making, or not making, section 401(k) contributions. (The principal exception to this rule are "matching contributions" subject to Code section 401(m).) Fortunately, the IRS ruling says that the program satisfies this requirement.

The IRS' conclusion that the program will not violate the contingent benefit prohibition under Code section 401(k)(4)(A) and Treasury Regulation section 1.401(k)-1(e)(6) is based on three important factors:

- the nonelective contribution under the program is not itself conditioned on the employee making, or not making, elective contributions to the plan,
- because an employee may make elective contributions in addition to student loan repayments, the nonelective contribution is not contingent on the employee electing to make or not make elective contributions in lieu of receiving cash, and
- the plan sponsor will not extend any student loans to employees that will be eligible for the program.

Further, the IRS noted that the applicable plan qualification requirements will continue to apply to the nonelective contribution (e.g., eligibility, vesting, distributions rules, contribution limits, and coverage and nondiscrimination testing rules), and the "true-up" matching contribution will need to be included for purposes of Code section 401(m) testing.

Observations

This IRS ruling provides helpful comfort for employers who provide a similar program for employees who may not be able to contribute to a retirement plan on account of their obligation to make student loan repayments, or to otherwise provide an incentive for employees to repay their student loans. Of course, the letter ruling may not be legally relied upon by taxpayers generally (Code sec. 6110(k)(3)), and other student loan plan designs not covered by the ruling are possible. In all cases, depending on the scope of employees eligible for such a program, compliance with applicable IRS rules, including the nondiscrimination tests, should be carefully considered.

Groom attorneys have been working with a number of clients on possible solutions in this area, including plan amendments and a variety of IRS compliance issues. And because IRS will not issue determination letters on existing plans that are amended to provide student loan benefits, legal counsel's opinion on plan qualification is highly desirable. If you are interested in exploring options, please contact your regular Groom attorney for more information.