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Employee Benefits Corner

IRS Blesses a Student Loan Employer "Match" Contribution

By Elizabeth Thomas Dold and David N. Levine

As the student loan debt numbers continue to rise, employers are looking for ways to help. More traditional methods involve employer payments outside a qualified plan to help pay down employer debt, but these arrangements typically bring in taxable W-2 wages, subject to employment taxes. But recently, the Internal Revenue Service (Service) has blessed in a private letter ruling (LTR 201833012, May 22, 2018—widely viewed as the Abbotts Labs program) an arrangement that takes what would otherwise be designated as matching contributions within a 401(k) plan, and permits the employer to use these same funds to provide a "match" (designated as a non-elective employer contribution) for a participant's repayment of student loans. This arrangement avoids current taxation, encourages employees to repay their student loans, and provides a valuable benefit in the form of tax-deferred retirement savings. The ruling focuses on the key Internal Revenue Code issue, called the contingent benefit rule, which generally prohibits employers from making an employer contribution contingent on the participant's decision to make or not to make a 401(k) deferral to the plan. The program set forth in the ruling is described below, followed by a review of the legal analysis, and how other plan sponsors can consider similar programs, even though they cannot technically rely on the ruling.

The Program

The employer sets up a voluntary program for employees with student loan debt, which debt was not borrowed from the employer. All employees are eligible to participate in the program, and can terminate their participation at any time. Upon entering the program, the employee is subject to special rules under the 401(k) plan. The 401(k) plan, which is not a safe harbor plan, is amended to provide for these special rules. Specifically:

- *Eliminate the Existing Matching Contribution*. The existing 401(k) plan provides for a matching contribution equal to 5% of the employee's compensation for each pay period when an employee makes a 401(k) deferral equal to at least 2% of his or her compensation for such pay period. This match is eliminated for all participants in the program.

- *Addition of Non-Elective Employer Contribution*. The plan adds a new mandatory (not discretionary) non-elective employer contribution equal to the same 5% of the employee's compensation for each pay period when an employee makes a student loan repayment equal to at least 2% of his or her compensation for such pay period. This non-elective contribution shall be made as soon as practicable following the end of the plan year, provided that the employee is still employed at the end of the year (unless due to death or disability). The same vesting schedule shall be applied as applies to the pay period match.
- *Participant Is Still Eligible for 401(k) Deferrals*. The participant remains eligible to make 401(k) deferrals at any time, but they will not be eligible for the pay period matching contribution. However, the participant will receive a true-up matching contribution for any pay period that the participant made 401(k) deferrals and not student loan repayments.
- *True-Up Matching Contribution*. A matching contribution shall be made following year-end for the pay periods that the participant in the program made 401(k) deferrals but not student loan repayments. This true-up matching contribution is the same 5% of compensation for the pay period when an employee makes a 401(k) deferral equal to at least 2% of compensation for such pay period, provided that the employee is still employed at the end of the year (unless due to death or disability). The same vesting schedule shall be applied as applies to the pay period match, and this true-up match will be subject to 401(m)/ACP non-discrimination testing.

The Law

The ruling addresses one issue—the contingent benefit rule, which prohibits conditioning "other benefits" on an employee's making, or not making, a 401(k) deferral, except for matching contributions as defined under the Code.

Code Sec. 401(k)(4)(A) states that "[a] cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election."

Reg. §1.401(k)-1(e)(6) states: "[a] cash or deferred arrangement satisfies this paragraph (e) [additional requirements for qualified cash or deferred arrangements] only if no other benefit is conditioned (directly or indirectly) upon the employee's electing to make or not make elective contributions under the arrangement. The preceding sentence does not apply to (A) any matching contribution (as defined in section 1.401(m)-1(a)(2)) made by reason of such an election." For this purpose, "other benefits" is a rather broad concept, as the regulations say it includes, but not limited to, a number of listed items (such as benefits under a defined benefit plan, non-elective contributions under a defined contribution plan, health benefits, vacation pay, life insurance, non-qualified deferred compensation).

The Service cites the Code and Regulations noted above and reasons that the non-elective contributions are conditioned on whether or not an employee made a student loan repayment during a pay period, but are not conditioned—directly or indirectly—on the employee making 401(k) deferrals. Importantly, an employee who makes student loan repayments is still allowed to make 401(k) deferrals. Therefore, the Service held that the non-elective employer contribution was not conditioned on the employee electing or not electing to make 401(k) deferrals, and the program does not violate the contingent benefit rule. This conclusion is based on the representation by the employer that the employer will not extend any student loans to employees that will be eligible for the program.

Next Steps

Plan sponsors and recordkeepers interested in providing an innovative plan design to help address the student loan crisis should take a closer look at this private letter ruling, and consider how the same or similar arrangement might be implemented. Notably, for safe harbor 401(k) plans, a design that uses additional employer funds (rather than reducing the match as was the case here) will likely be required to retain safe harbor status. Typically the devil is in the details, regarding what loans are eligible, how best to document the loans and the loan repayments, what the current plan document can facilitate and the impact on the opinion, advisory or determination letter, and performing any necessary coverage and non-discrimination testing to ensure that this benefit does not favor highly compensated employees. But that said, this is a positive first step to endorsing these types of arrangements, and more guidance is being requested both through broader guidance from the Service that can be relied upon, as well as legislative remedies to facilitate loan repayments.