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LEGAL DEVELOPMENTS

Student Loan Benefit Within a 401(k) Plan Gets IRS Approval

In a 2018 Private Letter Ruling, the IRS took a positive first step toward facilitating innovative 401(k) plan design features that can alleviate the student debt crisis in a tax-favored way.

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The Internal Revenue Service (IRS) recently published a private letter ruling—PLR 201833012, dated May 22, 2018—which holds that an employer (widely thought to be Abbotts Labs) can provide a non-elective employer contribution contingent on a participant making a student loan repayment outside the plan. While there are a number of various approaches available to employers to address the student loan crisis, this is the first piece of IRS guidance that endorses a tax-favored approach to promote eliminating student loan debt. The particulars of this IRS-blessed arrangement are set forth below, followed by an analysis of the "contingent benefit rule," which was the focus of the ruling.

The Plan Design

The program was described as follows: The employer has an existing 401(k) plan (which is not a safe harbor plan) that provides for a matching contribution equal to 5 percent of the employee's compensation for each pay period when an employee makes a 401(k) deferral equal to at least 2 percent of his or her compensation for such pay period. The employer proposed to amend the 401(k) plan to eliminate the pay period matching contribution for each participant who enrolls in a voluntary student loan program, for which all employees are eligible. The pay period match is then replaced with a non-elective employer contribution equal to the same 5 percent of the employee's compensation for each pay period when an employee makes a student loan repayment equal to at least 2 percent of his or her compensation for such pay period. This non-elective contribution is made as soon as practicable following the end of the plan year, provided the employee is still employed at the end of the year (unless termination was due to death or disability). Importantly, the participant is still eligible to make 401(k) deferrals at any time. To the extent that the participant enrolls in the student loan program (which enrollment can be terminated at any time) and continues to make 401(k) deferrals, he or she shall be entitled to a true-up matching contribution at year-end for the pay periods during which the participant made 401(k) deferrals, but not student loan repayments, provided that the employee is still employed at the end of the year (unless termination was due to death or disability). This true-up matching contribution is the same 5 percent of compensation for the pay period when an employee makes a 401(k) deferral equal to at least 2 percent of compensation for such pay period. The plan amendment will provide for the same vesting schedule that applies for the pay period match to be extended to the true-up match and non-elective employer contributions.

The Legal Analysis—Contingent Benefit Rule

401(k) plans have long been subject to a rather broad rule that prohibits conditioning "other benefits" on an employee's making, or not making, a 401(k) deferral, except for matching contributions as defined under the Internal Revenue Code (Code).

Specifically, Code section 401(k)(4)(A) provides 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."

Treasury Regulations Section 1.401(k)-1(e)(6) similarly provides that: "[a] cash or deferred arrangement satisfies this paragraph [(e)'s 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." In general, the regulations describe "other benefits" as including, but not limited to, benefits under a defined benefit plan, nonelective contributions under a defined contribution plan, health benefits, vacation pay, life insurance, nonqualified deferred compensation, etc.

After citing the Code and Treasury Regulations, the IRS determined that the non-elective contributions under the program were conditioned on whether or not an employee made a student loan repayment during a pay period, but, importantly, were not conditioned (directly or indirectly) on the employee making 401(k) deferrals. Moreover, an employee who makes student loan repayments (and receives the non-elective employer contribution) was still allowed to make 401(k) deferrals, and, therefore, the non-elective contribution was not conditioned on the employee electing or not electing to make 401(k) deferrals. Assuming that the employer will not extend any student loans to employees who will be eligible for the program, the IRS ruled that the proposed amendment does not violate the contingent benefit rule.

Conclusion

This is a positive first step to facilitating innovative 401(k) plan design features to help combat the student debt crisis in a tax-favored way. Although the private letter ruling can only be relied on by the employer that sought the ruling [IRC § section 6110(k)(3)], it is indicative of the IRS' position on a rather complex rule.

Therefore, plan sponsors looking for new ways to help their employees with student debt should review this program and discuss available options with their recordkeepers and plan advisors. Although the ruling does not address the administrative issues and other tax compliance complexities, largely around tracking the loan repayments on eligible loans and coverage and nondiscrimination testing to ensure that the contributions do not favor highly compensated employees, it is an important first step in endorsing these types of programs. ■