Private Letter Ruling Addresses Treatment of Student Loan Repayment Benefit

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PLR Addresses Treatment of Student Loan Repayment Benefit

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On August 17, 2018 the IRS released a Private Letter Ruling (PLR) to a taxpayer that was proposing to offer a student loan benefit program as part of their 401(k) plan. The letter was the result of a 12-month process of back-and-forth correspondence between the taxpayer and the IRS, which I point out only to call to attention the fact that these types of private requests from the IRS take some time. A PLR is applicable ONLY to the taxpayer requesting the review. It cannot be relied upon by any other taxpayer or cited as precedent. However, another taxpayer who has the EXACT same fact pattern (which is usually unlikely) could be fairly confident that it would also be permitted to operate a plan under the terms of the Ruling without negatively affecting the tax-qualified status of their plan. However, any deviation in the operation of the program from what was approved in the PLR would require the taxpayer to request it's own PLR from the IRS based on it's unique set of facts.

The taxpayer that requested the PLR has a 401(k) plan under which any participant who makes a pre-tax or Roth deferral of at least 2% of pay for a pay period receives a matching contribution of 5% of pay for that pay period. The taxpayer asked the IRS to approve a provision whereby a year-end nonelective contribution of 5% of pay would be deposited into the plan for each pay period in which the participant made a Student Loan Repayment (SLR) of at least 2% of pay. Presumably, the goal of this type of SLR provision is to help those employees who are unable to contribute to the 401(k) plan because of student debt and are therefore "losing out" on the matching contribution that other employees who defer into the 401(k) are receiving. This could be a great recruiting and retention tool for employers who are seeking to hire and assist employees that are coping with student loan burdens.

For this particular SLR program, employees who are paying student loans and also deferring part of their pay into the 401(k) cannot get the benefit of both the 5% match and the 5% nonelective contribution – they would only receive the nonelective contribution. However, for any pay periods during which the employee does not make a student loan repayment but does make a 401(k) contribution, the employer will make a year-end matching contribution as a true-up. The PLR goes into detail on how the program will work as far as opting in and out of the SLR; when the matching or nonelective contribution will be made; and the process of calculating the year-end true-up for employees who have had some pay periods with a 401(k) deferral and some pay periods with only student loan repayments. The full text of the PLR can be found at this website: https://www.irs.gov/pub/irs-wd/201833012.pdf.

Actually, what this taxpayer was seeking to do is generally already acceptable inside a qualified plan, as long as it is drafted properly into the document and meets the nondiscrimination requirements. Retirement plans may, under current law, provide for discretionary nonelective contributions to be allocated only to specific employees who meet specific criteria which can be determined by the employer. In requesting the PLR, the taxpayer was seeking assurance from the IRS that providing a nonelective contribution only to employees who make student loan repayments would not cause the plan to run afoul of the *contingent benefit rule*. Under the *contingent benefit rule*, if a qualified retirement plan provides an employer contribution only to employees who defer a portion of pay into the plan, then that employer contribution must be treated as a matching contribution and tested as such. The question in the PLR is "if the employee must make a student loan payment to receive the **nonelective** contribution, then is the nonelective contribution actually a **matching** contribution, in that it is contingent on the employee making the loan repayment?" If the contribution is actually deemed to be a match, not a nonelective contribution, then it is subject to the ACP test with the other matching contributions. The IRS stated in the Ruling that since the nonelective contribution being proposed was only contingent on the employee making a student loan payment (not contributing to the 401(k)), the employer nonelective contribution would not be considered a matching contribution and the plan would not be violating the contingent benefit rule. The nonelective contribution would be tested under 401(a) for nondiscrimination in basically the same way that a plan would test a new comparability (cross-tested) profit sharing allocation. As long as the testing passes, the contribution is permissible.

PLRs that create significant interest, which this one certainly has, can result in broader guidance from the IRS that applies to all plans. In fact, within a few days of the release of the PLR, the ERISA Industry Committee (ERIC) sent a letter to the IRS asking for a Revenue Ruling or other guidance that would broaden the reach of this provision to other taxpayers seeking to implement a similar type of student loan repayment program inside their 401(k) plans. In it's letter, ERIC stated that it believes that current law already allows employers to make contributions to a retirement plan on behalf of employees who are repaying student loan debt, but felt that the IRS should issue a Ruling on the subject to encourage more employers to do so. ERIC referred to a Prudential Financial study that found that 40% of graduates who are paying student loan debt are not able to save for retirement. ERIC also cited statistics from a study from the Center for Retirement Research at Boston College in which it was noted that college graduates with student loans had 50% lower retirement plan assets than graduates with no loans.

We have received calls from advisors and plan sponsors asking our opinion about the PLR and whether we think this type of SLR program will become mainstream in 401(k) plans. We are aware that more and more employers are looking to offer some sort of student loan benefit to their employees. Over 44 million U.S. borrowers have student loan debt, to the tune of about $1.52 trillion. With unemployment at a current low rate of 3.9% (Bureau of Labor Statistics, August, 2018), employers are all vying for the same pool of workers - many of whom are employees with student loans - so it stands to reason that employers who are willing and able to offer a student loan benefit will have a hiring advantage over employers who do not have such a benefit. Right now, employers with a student loan benefit are typically providing a set dollar amount each month or each pay period into the employees pay, which is a taxable benefit to the employee. The appeal of the SLR program inside the 401(k) plan is that it offers a way for employers to provide employees with a <u>pre-tax</u> benefit related to student loans.

Given all of these facts, we do believe that this PLR has focused attention on this type of plan design that will result in more employers wanting to implement similar programs. Our concern at this time is not so much on the legality of such a provision as on the operation of it. There are some challenges that we see to administering a SLR program. For example, how will the employer monitor whether the employee is making the loan payments? What types of loan payments will qualify – for example, there may be instances in which a parent initiated the loan but the child (who is the employee) is actually making the payments. If the payroll system is calculating the employer contribution and the employee should receive either a match or a nonelective, depending on whether or not loan payments are being made, how will the payroll system be programmed to know which contribution applies? What impact will the SLR contribution have on compliance testing? Testing could be an issue if this program ultimately ends up benefitting an unacceptably high percentage of Highly Compensated Employees over non-Highly Compensated Employees. These are important issues that will need to be resolved before most employers are going to be comfortable implementing any sort of SLR program inside their 401(k) plan, and we at RMS are certainly going to be very cautious about suggesting this type of arrangement until recordkeeping systems and payroll providers have made programming changes that can accommodate this type of design.

We will be happy to work with plan sponsors and advisors who want to further pursue some type of SLR program. Our document provider has issued guidance to us on how to draft such a provision into our Volume Submitter document. The bigger issue will be to make sure that the operational details of the administration of this type of design have all been addressed and can be properly monitored.