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Tips For Offering Student Loan Benefits Under 401(k) Plans

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Over 44 million Americans have outstanding student loan debt totaling in excess of $1.5 trillion, with the average borrower owing more than $32,000. A 2016 study by the Employee Benefit Research Institute found that families headed by employees ages 45 through 54 with no student loan debt had a median defined contribution plan account balance that was 2.7 times larger than those with student loan debt. In a move that could help employers encourage greater retirement savings among employees with student loan debt, the IRS recently ruled that employer nonelective contributions to a 401(k) plan for employees who make student loan repayments would not violate the Internal Revenue Code’s “contingent benefit rule.” That rule prohibits an employer from making any benefit — other than matching contributions — contingent, directly or indirectly, on an employee’s making, or not making, elective deferrals under the 401(k) plan. As described in further detail below, the IRS’s ruling means that employees who make student loan repayments in lieu of plan contributions would no longer have to lose the economic benefit of the employer matching contributions that they would have received in connection with such foregone contributions.

The guidance came in the form of a private letter ruling which may only be relied on by the employer who requested the ruling. Nonetheless, the PLR is instructive for other employers wishing to provide similar tax-favored benefits for employees who may not otherwise be in a position to contribute to their retirement savings.

In the PLR, the employer’s 401(k) plan provided a 5 percent match on eligible compensation for each pay period in which the employee made an elective deferral of at least 2 percent of eligible compensation. The employer proposed amending the plan to allow employees to opt out of the 5 percent match and, in lieu thereof, receive nonelective contributions to the plan equal to 5 percent of their eligible compensation for each pay period in which they make student loan repayments of at least 2 percent of their eligible compensation. Employees participating in the student loan repayment program would be eligible for a true-up matching contribution for any pay period in which they made elective deferrals to the plan but failed to make the 2 percent student loan repayment necessary to receive the nonelective contribution for such pay period. These nonelective and true-up matching contributions would be subject to the same vesting schedule as regular matching contributions and would be deposited in an employee’s account as soon as practicable after the end of the plan year if he/she were employed on the last day of the plan year — except that the last day requirement does not apply in the case of death or disability. The nonelective contributions would be subject to all plan qualification requirements and would not be treated as a match for 401(m) discrimination testing purposes — but any true-up matching contribution would be. All employees eligible to participate in the student loan repayment plan would be eligible to participate in the program and could opt out prospectively at any time and resume eligibility for regular matching contributions. The employer represented that it had no intention of extending student loans to any employee eligible for the program.

Based on these facts, the IRS concluded that the proposed program would not violate the contingent benefit rule because receipt of the nonelective contributions was conditioned on making student loan repayments and employees could continue to make elective deferrals to the 401(k) plan while participating in the program.

While the PLR confirms that in some cases 401(k) contributions can be linked to student loan repayments, certain plan designs — e.g., safe harbor and/or prototype 401(k) plans — may limit the practicality of adding a student loan benefit to a qualified plan. For example, employers who use safe harbor matching contributions to satisfy nondiscrimination testing are required to match the contributions of all non-highly compensated employees, including those who would be entitled to nonelective contributions under the student loan repayment program. This could result in giving an unintended benefit to non-highly compensated employees who satisfy the requirements for both the employer match for plan contributions and the employer nonelective contributions for student loan repayments. In addition, nonelective contributions made under the program would have to be tested separately for nondiscrimination purposes and, depending on plan demographics, might have to be limited to non-highly compensated employees. The program could also create an incentive for employees who are currently making contributions at the level necessary to receive the maximum employer match to reduce such contributions in favor of making larger student loan payments, since their total employer-funded plan contributions would remain the same. Not only would this decrease the employee's overall retirement savings, but it could also have an adverse effect on nondiscrimination testing.

Employers will need to address several important design questions before implementing this type of program. For example, they will need to decide whether the program will only cover loans incurred for the education of the employee or whether it will also cover loans incurred for the education of the employee's spouse, children, grandchildren or other dependents. Employers will also need to address the types of student loan debt that will qualify for the program. For example, the program could be limited to loans incurred for undergraduate or graduate education or it could also cover loans incurred for continuing education and non-degree programs, as well as primary and secondary school education. The employer should also decide whether the program will cover both governmental and private student loans or if coverage will be limited to one type or the other. In cases where an employee's student loan debt has been consolidated with non-student loan debt, employers will need to decide whether any portion of the employee's repayments of such consolidated debt will be eligible for the program and, if so, how such eligible portion will be determined.

The PLR does not address the type of documentation, if any, that employers should require from program participants to verify that student loan payments have been made. Employers implementing this type of program may want to consider requiring qualifying student loan repayments to be made through payroll deductions or engaging a student loan vendor to assist in administering the program.

An employer interested in implementing a program like the one described in the PLR should carefully consider existing plan provisions, workforce demographics, employer objectives and costs when designing the program. It is important to note that the PLR was issued with respect to a 401(k) plan. Unless and until the IRS issues further guidance on this matter, tax-exempt employers should exercise caution and consult with counsel before implementing a similar program for participants in a 403(b) plan.

Even if the student loan repayment program described in the PLR is not appropriate for all employers, it could draw much needed attention to other proposals in this area. For example, legislation to amend Code Section 127 to allow employers to repay an employee's student loans on a tax-free basis through an education assistance program has been introduced in Congress on multiple occasions but has yet to be put to a vote. The issuance of the PLR could be the catalyst Congress needs to enact this or other legislation that would encourage the wider adoption by employers of student loan repayment programs.

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