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TOPIC: IRS Blesses Employer’s 401(k) Plan Designed to Provide Retirement Benefits Tied to Student Loan Repayments

MARKET TREND: In an IRS Private Letter Ruling (“PLR”) issued last year, PLR 201833012, the IRS blessed a 401(k) plan design in which employees who repay student loan debt instead of making 401(k) employee contributions can receive employer retirement contributions to make up for missed 401(k) matching contributions. Incorporating a student loan repayment (“SLR”) feature into a 401(k) plan may effectively balance the need for employees to focus cash flow on student loan repayments without losing employer-provided retirement contributions. The PLR provides a helpful roadmap for employers seeking to provide an attractive benefit to retain employees at minimal additional costs.

SYNOPSIS: The SLR feature allows participants to earn credit toward receiving employer contributions by repaying student loan debt in lieu of 401(k) elective contributions. A key compliance concern raised by incorporating an SLR feature into a 401(k) plan is the so-called “contingent benefit rule,” which prohibits 401(k) plans from conditioning, directly or indirectly, certain benefits on a participant making (or not making) 401(k) contributions. In the PLR, the employer seeking the ruling sought to amend its existing 401(k) plan, which provided a 5% matching contribution to participants with elective contributions of at least 2% of eligible compensation. The proposed SLR program provides participants a 5% nonelective employer contribution for any pay period in which the employee makes SLRs equal to at least 2% of the employee’s eligible compensation, regardless as to whether the employee makes any elective contributions to the 401(k) plan. While PLR 201833012 is limited to the facts of the request and authoritative only as applied to the requesting employer, the ruling confirms that the 401(k) plan described in the ruling would not violate the contingent benefit rule.

TAKEAWAYS: The SLR feature outlined in the PLR provides a helpful model for plan sponsors considering a relatively low-cost means of enhancing their retirement benefit packages. However, there are pros and cons to adding an SLR feature to a 401(k) plan, and depending on the plan design, it may not be practical. Also, because the ruling is limited to the requesting employer, plan sponsors should consult with plan counsel to review the risks associated with this unique benefit option.

The Student Loan Debt Challenge

Today, student loan debt stands as the second largest consumer debt category behind mortgage debt. [\[1\]](#) Over 44 million Americans owe approximately \$1.5 trillion in student loan debt. It is estimated that 40% of student loan borrowers may default on their loans by 2023.[\[2\]](#) As of 2017, one-fifth of student loan borrowers were behind in making payments.[\[3\]](#) Student loan debt is only a few billion dollars away from tripling over the past decade.[\[4\]](#)

Recent statistics show that employees are choosing to pay off student loan debt instead of saving for retirement.[\[5\]](#) Research also shows that employers that support employees in paying down their student loan debt enjoy greater employee retention.

Many employers have been brainstorming how they can help address employee student loan debt.^[7] Despite growing employer interest in addressing the student loan debt crisis, recent data indicates that only about 4% of employers offer a form of SLR benefits.^[8]

Usually, employees burdened with student debt and related cash flow constraints must choose between 401(k) elective contributions (and the related company match) or paying down their debt. Some employers can provide an SLR benefit in the form of additional taxable compensation to help cover the debt, but this type of SLR program would increase the costs of providing employee benefits.

The Abbott Laboratories 401(k)-SLR Program

In June 2018, Abbot Laboratories, an R&D company based in Illinois, announced a new type of SLR feature it would offer participants through its 401(k) plan.^[9] Their program allows employees to choose between repaying student loans or making elective contributions to their 401(k) plan without adversely impacting employer retirement contributions to the 401(k) plan. As a result, without creating extra out-of-pocket expense to the company, the program allows employees to repay student loan debt while also building retirement savings through a qualified retirement plan.

A major area of employer concern with SLR arrangements incorporated into a 401(k) plan relates to the contingent benefit rule. The contingent benefit rule provides that a cash or deferred arrangement is not qualified if certain benefits are conditioned (directly or indirectly) on the participant making elective deferrals under the 401(k) plan.^[10] This prohibition does not apply to matching contributions (as defined in Section 401(m) and 26 C.F.R. § 1.401(m)-1(a)(2)) or benefits chosen under a cafeteria plan described in 125(d) in lieu of an elective contribution under a qualified cash or deferred arrangement. 26 C.F.R. § 1.401(k)-1(e)(6)(i). The Abbott Laboratories 401(k)-SLR program raised at least the specter of this compliance concern. To address the risk, Abbott Laboratories asked the IRS to rule that the arrangement did not violate the contingent benefit rule.

IRS PLR 201833012: A Model 401(k)-SLR Arrangement

On August 17, 2018, the IRS made public PLR 201833012, providing some comfort to employers seeking guidance regarding the application of the contingent benefit rule to a 401(k)

plan with an SLR feature. The letter responds to an unnamed employer requesting that the IRS rule on whether its proposed 401(k) plan amendment to provide SLR-related contributions on behalf of employees who pay down qualifying student loan debt violated the contingent benefit rule. This unnamed employer was Abbott Laboratories.^[11] In its holding, the IRS clarified that a 401(k) plan tying nonelective employer contributions to qualifying student loan repayments does not violate the contingent benefit rule where such contributions are not contingent on any elective participant contribution.

1. *The Employer's Original 401(k) Plan*

The Abbott Laboratories plan, as described in the PLR, is a defined contribution plan with a 401(k) cash or deferred arrangement feature intended to qualify under Section 401(a). Eligible employees can elect to make pre-tax or Roth 401(k) elective deferrals as well as after-tax employee contributions to the plan. The employer makes a matching contribution (“regular matching contribution”) equal to 5% of the employee’s eligible compensation if that employee contributes at least 2% of his or her eligible compensation during the pay period (the plan’s minimum permitted elective contribution).

2. *The Requested SLR Program Features*

The Abbott Laboratories 401(k)-SLR program included the following key features, as described in the PLR:

1. **Voluntary.** The 401(k)-SLR program is voluntary.
2. **SLR Program Eligibility.** All employees eligible to participate in the 401(k) plan are eligible to participate in the SLR program.
3. **Election/Opt-Out.** The employee must elect to enroll in the program and may opt out any time.
4. **401(k) Elective Deferrals and SLRs.** Employees can make both elective contributions to the 401(k) plan as well as qualifying SLRs.
5. **Alternative Employer Contributions.** Employees who elect to participate in the program are not eligible to receive the 5% regular matching contributions with respect to any elective contributions the employee makes while participating in the program (i.e., employees may not

receive both regular matching contributions and SLR nonelective contributions). Upon opting out of the SLR program, employees resume eligibility for regular matching contributions.

6. **SLR Nonelective Contribution.** The Employer will make a nonelective employer contribution on behalf of an employee equal to 5% of the employee's eligible compensation ("SLR nonelective employer contribution") conditioned on that employee making student loan repayments equal to at least 2% of the employee's eligible compensation for that pay period (i.e., at the same level the employee would have to defer to the 401(k) plan to qualify for regular matching contributions).
 7. **True-Up Matching Contribution.** If an employee that fails to contribute at least 2% of eligible compensation nonetheless makes an elective contribution during the pay period equal to that amount, the employer will make a matching contribution as soon as practicable after the end of the plan year equal to 5% of the employee's eligible compensation for that pay period ("true-up contribution").
 8. **Last Day Allocation Condition.** In order to receive an SLR nonelective employer contribution or true-up matching contribution, the employee must be employed on the last day of the plan year (except in the case of termination due to death or disability).
 9. **Same Vesting as Regular Matching Contributions.** SLR nonelective employer contributions and true-up matching contributions will be subject to the same vesting requirements as regular matching contributions.
 10. **Subject to Plan Qualification Requirements.** SLR nonelective employer contributions are subject to all applicable plan qualification requirements, including contribution limits and coverage and nondiscrimination testing.
 11. **Section 401(m).** Unlike true-up matching contributions, SLR nonelective employer contributions are not treated as matching contributions for Section 401(m)/ACP testing purposes. True-up matching contributions are subject to ACP testing.
 12. **No Employer-Provided Student Loan Debt.** The student loan debt being repaid was all third-party debt. The employer did not extend, and expressed no intention of extending, student loans to employees.
3. *IRS's Holding*

The IRS held that the SLR nonelective employer contributions did not violate the contingent benefit rule because those contributions are conditioned on the employee making SLRs during the pay period—not elective contributions under a cash or deferred arrangement. Moreover, because employees who make SLRs (and thereby receive SLR nonelective employer contributions) are still able to make elective contributions, the SLR nonelective employer contribution is not conditioned on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The IRS made clear that, in accordance with Internal Revenue Code Section 6110(k)(3), the ruling may not be used or cited as precedent and it applies only to the requesting employer.

Practical Considerations of a 401(k)-SLR Program

With the rise of student loan debt and its growing impact on the lives of the American workforce, it is inevitable that plan sponsors will have to consider how they can offer SLR benefits to employees. Incorporating an SLR benefit into a 401(k) plan similar to that approved in PLR 201833012 is one viable option, but plan sponsors should carefully consider the benefits and risks.

Again, PLRs are only binding with respect to the requesting employer. Although practitioners often view PLR holdings as an indication of the IRS's position on a certain issues, plan sponsors seeking to rely on PLR 201833012 to support a similar arrangement must do so based on their own specific facts. Plan sponsors in need of additional assurances about adding an SLR feature to their 401(k) plan may want to apply for their own PLR—a process that can be time-consuming and expensive.[\[12\]](#)

While PLR 201833012 addresses the specific concern regarding the contingent benefit rule, there are a number of other practical considerations unaddressed in the PLR that employers should weigh in considering whether to incorporate an SLR program into a 401(k) plan:

1. *Costs/Benefits of an SLR Program*

Incorporating an SLR programs into an existing 401(k) plan will provide employers a means to reward employees for paying down their student debt without significantly increasing costs, because the SLR nonelective employer contribution or true-up matching contribution is provided

in lieu of (or offset by) any employer matching contributions. Additional costs, however, may include increased administration and utilization costs,[\[13\]](#) some of which are described below.

For employees who cannot afford to repay their student loans and make elective retirement contributions, the SLR feature approved in PLR 201833012 will allow employees to reduce their student loan debt while growing their 401(k) account balances at the same level as regular matching contributions under the plan. However, when making an SLR, employees will sacrifice more take-home pay than if they made a 401(k) deferral, because loan repayments are made with after-tax funds. The SLR nonelective employer contributions made to the 401(k) plan, however, are not taxable to the employee until paid and are tax deductible for the employer when contributed.

2. *Unclear Impact on Other Plan Requirements*

One major drawback of PLR 201833012 is that apart from the contingent benefit rule it fails to address how the SLR benefit may interact with other 401(k) requirements, including those related to annual coverage and nondiscrimination testing.

For example, while participant student loan repayments would not be considered in annual deferral percentage (“ADP”) testing, if fewer non-highly compensated employees make elective deferrals to the 401(k) plan as a result of the SLR feature, there could be a negative impact on ADP testing as well as ACP testing, potentially reducing the amount of permissible contributions by or for highly compensated employees.[\[14\]](#)

It is also unclear whether the feature could be offered through a 401(k) plan that uses a safe harbor contribution design.

3. *Loan Substantiation and Repayment Monitoring*

Although PLR 201833012 is silent on the need for participants to substantiate student debt amounts, employers will presumably need to collect some verification of debt amounts from the employee’s lenders. Additionally, there are sure to be some additional administrative costs associated with monitoring employee loan repayments, which is necessary to ensure employees are paying off the qualifying loans in accordance with the plan. Many plan sponsors and

recordkeepers, however, are likely ill-equipped to monitor such loan repayments, as they occur outside of the retirement plan. Thus, the plan may need to hire a third party to provide SLR monitoring services. The plan sponsor may also have to provide the third-party provider employee payroll data to ensure employee loan repayments satisfy the plan's contribution requirements (e.g., 2% of eligible compensation).

4. *Tracking Opt-Outs*

Plan sponsors will need to track employees who opt-out of the SLR program. This likely can be tracked by a plan recordkeeper.

Employer Next Steps

Employers may want to consider a 401(k)-SLR design alternative similar to the one covered by the PLR. As a new design alternative, broader adoption may be slow, but as long as student debt remains a pressing economic issue, more employers may move in this direction. There are some companies in the marketplace now marketing administration for similar programs. But because the holding of the PLR cannot be relied on by anyone other than the recipient of the ruling, and given the various facts and circumstances and other compliance considerations (such as nondiscrimination testing) implicated by the design, employers considering a 401(k)-SLR feature should consult with their legal counsel.

Notes

[1] Z. Friedman, *How to Win a Slice of \$1 Million to Pay Off Your Student Loans* (Jan. 15, 2019) (<https://www.forbes.com/sites/zackfriedman/2019/01/15/student-loans-pay-off-debt-contest/#5f5a7f4c713a>).

[2] *Id.*

[3] See The Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2017 – May 2018* (2018) (<https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-student-loans.htm>).

[4] L. Irby, *Breakdown of Student Loan Debt in the U.S.* (Jan. 9, 2019) (<https://www.thebalance.com/2018-student-loan-debt-statistics-4173224>); *see also* C. Maldonado, *IRS Ruling Allows Company to Match Employees' Student Loan Payment into Their 401(k)* (Aug. 28, 2018) (<https://www.forbes.com/sites/camilomaldonado/2018/08/29/irs-ruling-allows-company-to-match-employees-student-loan-payments-into-401k/#614616fb2861>) (noting a Pew research report found that only 52% of millennials elect to participate in their employer sponsored retirement plans).

[5] *See e.g.*, M. Berman-Gorvine, *Employer Help with Student Loans Improves Retention*, Bloomberg Law News (Mar. 8, 2017) (noting a recent Student Loan Hero survey finding that 46% of those with student loans would rather have student loan repayment assistance than a 401(k) plan match); Pension & Benefits Update, *IRS Rules that 401(k) Plan's Student Loan Repayment Feature Would Not Violate Contingent Benefit Rule* (Aug. 29, 2018) (noting a 2016 Plan Sponsor Counsel of America Report indicating low millennial participation rates in employer defined contribution plans was, in part, due to high levels of student loan debt).

[6] M. Alder, *IRS Clears Path for Student Loan Repayment Tied to 401(k)*, Bloomberg Law News (Jan. 17, 2019) (noting that in 2017 an American Student Assistance Survey of those between ages of 22 and 33 found that 86% of young workers would stay with an employer who helped pay off their student loans for five years); *see also* M. Berman-Gorvine, *infra*, *Employer Help with Student Loans Improves Retention* (“Younger and older employees burdened with student debt are likely to stay longer with employers that offer them help with repayment[.]”).

[7] M. Berman-Gorvine, *infra*, *Employer Help with Student Loans Improves Retention*.

[8] M. Alder, *infra*, *IRS Clears Path for Student Loan Repayment Tied to 401(k)*.

[9] *See* Abbott Laboratories press release, *Tackling Student Debt for Our Employees* (June 26, 2018) (<https://www.abbott.com/corpnewsroom/leadership/tackling-student-debt-for-our-employees.html>).

[10] *See* IRC § 401(k)(4)(A); 26 C.F.R. § 1.401(k)-1(e)(6).

[11] A. Elejalde-Ruiz, *Abbott 401(k) Program to Help Employees Who Have Student Debt Could Become National Model*, Chicago Tribune (Aug. 31, 2018) (<https://www.chicagotribune.com/business/ct-biz-irs-student-loan-perk-0902-story.html>).

[12] The process for applying for a PLR is published each calendar year, in the first issued revenue procedure. For 2019's procedures, see Rev. Proc. 2019-1.

[13] EBIA Weekly, *IRS Rules Favorably on 401(k) Contributions That Reward Student Loan Payments* (Aug. 30, 2018).

[14] S. Miller, *infra*, *IRS Allows 401(k) Match for Student Loan Repayments*; M. Webb, *The Good and Bad News Regarding the Recent PLR on Student Loan Repayment Assistance Programs*, Compensation Planning Journal (Oct. 5, 2018).