BENEFITS & COMPENSATION

>>ALERT

STUDENT LOAN REPAYMENT BENEFIT UNDER A 401(k) PLAN: AN IMPORTANT NEW BENEFIT THAT EMPLOYERS CAN OFFER RIGHT NOW

Americans owe roughly $1.5 billion in student loan debt, spread out among approximately 44 million borrowers. In an effort to address rising default levels, the IRS recently issued a private letter ruling enabling employers to provide a new student loan repayment benefit utilizing their 401(k) plans.

THE BOTTOM LINE

Employers who wish to attract and retain a young and educated workforce should consider amending their 401(k) plans to provide this benefit. Employers interested in providing this student loan repayment benefit should consult with ERISA counsel prior to implementation.

The new benefit involves linking employer contributions made to a 401(k) plan to student loan repayments made outside of the plan. For example, if a plan normally provides a match on pre-tax or after-tax (Roth) contributions, the plan could be amended to provide a similar match on student loan repayments made outside the plan. In essence the employer would be treating its employees' student loan repayments as if they were pre-tax or after-tax (Roth) contributions made to the plan. The employees would not be required to make actual employee contributions to the plan in order to receive the benefit.

The 401(k) plan that was the subject of the private letter ruling provided for a matching contribution of 5 percent of a participant's compensation if the participant made pre-tax contributions of at least 2 percent of compensation. Instead of this "regular match," employees could elect to participate in the "student loan repayment program" under which they would receive an annual "SLR non-elective contribution" equal to 5 percent of their compensation for each payroll period they made a student loan repayment equal to at least 2 percent of their compensation.

The private letter ruling makes clear that the match on student loan repayments would not be treated as a matching contribution for purposes of testing under Section 401(m) of the Internal Revenue Code. However, these matching contributions would be subject to all other plan qualification requirements, including, but not limited to, eligibility, vesting and distribution rules, contribution limits and coverage and other nondiscrimination testing.

Moreover, employers interested in offering this student loan repayment benefit would need to develop procedures under which they could verify their employees' student loans and document repayments. Accordingly, employers should consult with their ERISA counsel prior to implementing a student loan repayment benefit.

The new student loan repayment benefit allows employees to pay off their student debt while simultaneously creating retirement savings. Too often employees who are laden with student debt forgo contributing to their 401(k) plan and miss out on the employer contribution. In addition, employers may find a student loan repayment benefit more cost-effective than traditional means of student loan repayment assistance, such as paying bonuses.

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Historically, some plan sponsors have toyed with the idea of linking employer contributions to student loan repayments, but they have not done so because they were unsure whether this benefit would be permissible under IRS rules. The private letter ruling provides confirmation that such a benefit is permissible under appropriate circumstances.

A private letter ruling may only be relied upon by the party to whom it is issued, although generally it reflects IRS policy and ruling inclinations for similar fact patterns.

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