IRS APPROVES STUDENT LOAN REPAYMENT FEATURE FOR A 401(K) PLAN

A concern for many workers today is the student loan burden they carry. Many employees, both young and old, are paying off large student loan balances rolled up in pursuing undergraduate and graduate college degrees. As the cost of college education continues to increase at rates that surpass the general inflation rate in the economy, this concern is likely to grow along with student loan balances. A good argument can be made that college education concerns adversely affect the ability of employees to save for retirement. According to one recent study conducted by ORC International, 70 percent of wealthy millennial families put college savings for their children ahead of their own retirement. The IRS has now approved one employer's 401(k) plan design that addresses both these concerns. The employer's plan will permit employees who do not defer their pay but pay off student loans instead to receive an employer contribution equal to the match they forgo by failing to defer.

On August 17, 2018, the IRS National Office released a private letter ruling approving employer contributions to a 401(k) retirement plan tied to employees repaying student loans that do not originate with the employer. The contribution feature approved in the private letter ruling will be structured as a non-elective employer contribution, not a matching contribution dependent upon the employee's 401(k) deferrals, Roth deferrals or after-tax contributions. Under the approach the IRS approved, the employer will make a contribution of 5 percent of the employee's eligible compensation for any payroll period so long as the employee makes a student loan repayment equal to at least 2 percent of the employee's eligible compensation for the payroll period. The employee must also be employed on the last day of the plan year to receive the student loan repayment contribution. The contribution is made after the end of the plan year. The student loan repayment employer non-elective contribution in this case is similar to an employer discretionary or profit sharing contribution contained in many defined contribution retirement plans.

For employees who do not make a student loan repayment equal to at least 2 percent of their eligible compensation for a payroll period but instead make an employee 401(k) deferral, Roth deferral or after-tax contribution of at least 2 percent, the employer will continue to make a matching contribution after the end of the plan year in an amount equal of 5 percent of the employee's eligible compensation for the payroll periods in which they defer or contributed. This contribution is termed a true-up matching contribution. Both the student loan repayment non-elective contribution and the true-up matching contribution are subject to the plan's vesting schedule.

A private letter ruling is a determination promulgated by the IRS National Office, which is only applicable to the taxpayer to whom the letter is addressed. It does not serve as authority upon which any other taxpayer can rely. However, private letter rulings in most cases set out the IRS's then-current thinking on technical topics framed within the context of a real world facts. This is the first ruling by the IRS to involve student loans in determining retirement plan contributions. The anonymous ruling indicates that the employer will amend its existing 401(k) plan to provide for these changes upon IRS approval.

If you have any questions about this ruling or other questions about retirement planning, please contact Bill Roberts at (502) 568-9364 or ebplans@hallrender.com or your regular Hall Render attorney.