Structuring Student Loan Repayment Benefit Programs

by | **Daniel R. Salemi, Michael Gorman** and **Gena Yoo**

Student loan debt is a major strain on the financial health of many Americans and may prevent some from saving adequately for retirement. Employers are finding creative ways to help ease the burden through student loan repayment benefits.

Employers are looking for innovative ways to tailor their total compensation packages as student loan debt emerges as a pressing concern for many employees, particularly Millennials.

According to the Federal Reserve Bank of New York, the total amount of outstanding student loans was estimated at $1.48 trillion in the second quarter of 2019 and was projected to reach $1.6 trillion at the end of the year.[1] As many as 44.7 million Americans have student loan debt.[2] Most borrowers owe between $10,000 and $50,000, with an average monthly student loan payment ranging from $200 to $300. Millennials are most affected by student loan debt, with about 15.1 million borrowers ages 25 to 34 (a large share of the Millennial population) collectively holding approximately $497.6 billion in student loan debt.[3]

Student loan debt is causing a serious strain on many Americans' financial health. For example, the combination of a large student loan balance and repayment obligations can discourage employees from saving for their retirement. This is especially true for those who incurred significant student loan debt but did not receive a degree or did not end up working in the field in which they received the degree.

Many employers believe that a student loan repayment program of some kind is an ideal way to attract and retain employees, while also addressing a need. Only 4% of employers offer student loan repayment benefits according to a 2019 International Foundation of Employee Benefit Plans survey, but 2% were in the process of implementing a program, and 23% of respondents said they were considering implementing one in the future.[4] These benefits may become the norm as employees with student debt become a larger part of the workforce.

This article will discuss some of the options employers may consider when designing student loan assistance programs, including repayment programs offered both within and outside of 401(k) plans.

Offering Student Loan Repayment Programs Within a 401(k) Plan

Plan sponsors looking to offer student loan repayment benefits on a tax-favored basis may consider designing a student loan repayment benefit within a 401(k) plan. This design is supported by a 2018 private letter ruling (PLR) issued by the Internal Revenue Service (IRS).[5]

In the PLR, the plan sponsor explained that it intended to amend its 401(k) plan to offer a student loan repayment benefit program. Prior to the amendment, participants who contributed at least 2% of their eligible compensation to the plan received a matching contribution equal to 5% of their eligible compensation. The match was determined on a pay period basis. Under the proposed student loan repayment benefit program, employees would opt out of the "regular" 5% matching contribution in order to be eligible for a nonelective employer contribution of up to 5% and a true-up matching contribution of up to 5%. Generally, a *true-up matching contribution* is an annual employer contribution equal to the difference between the matching contribution allocated to a participant on a pay period basis and the matching contribution the participant would have received if the matching contribution was allocated on an annual basis.

Here, the true-up matching contribution works a little differently; it provides a pay period matching contribution equal to 5% in pay periods where the participant contributes at least 2% of his or her eligible compensation to the 401(k) plan, provided that the nonelective contribution is not available with respect to such pay period (for example, during pay periods where a student loan payment is not due and pay periods that occurred after the participant finished paying off the student loan). This design allows participants to avoid having to choose between student loan payments and saving for their retirement on a tax-advantaged basis.

Turning to the specifics of the proposed program:

- Participation would be voluntary, and participants could choose to stop participating in the program at any time.
- Once enrolled in the program, participants could still contribute to their 401(k) accounts but would not receive regular matching contributions with respect to those contributions.
- Instead, the employer would make a nonelective contribution equal to 5% of the participant's eligible compensation for that pay period, as long as the participant made a student loan payment equal to at least 2% of his or her eligible compensation during that pay period.
- If the participant contributed at least 2% of his or her eligible compensation to the plan during a pay period in which the participant was not eligible for the nonelective contribution, the participant would be entitled to a catch-up matching contribution equal to 5% of the participant's eligible compensation for that pay period.

The PLR attracted significant attention because the proposed design could be construed as violating the Tax Code's *contingent benefit rule*. This rule prohibits plan sponsors from conditioning "other benefits" on whether or not employees made 401(k) contributions.[6] Plan sponsors were concerned that IRS would conclude that a student loan repayment benefit program of this type would violate the contingent benefit rule. Because IRS concluded that the student loan repayment benefit program did not violate the contingent benefit rule or any other qualification requirement, many plan sponsors view the door to be open for other employers to offer student loan repayment benefit programs through their 401(k) plans. However, given the limited precedential value of a PLR, plan sponsors should work closely with their service providers, including their attorney, when establishing this type of plan design.[7]

While the retirement plan program described in the PLR primarily benefits participants who would not otherwise contribute to the 401(k) plan, the IRS interpretation of the contingent benefit rule appears to permit a variety of program designs. For example, instead of providing a student loan repayment nonelective contribution *in lieu* of the regular matching contribution, a plan may be permitted to provide a student loan repayment nonelective contribution *in addition* to the regular matching contribution.

Although the PLR is a promising indicator for employers seeking to attract or retain talent by incorporating a student loan repayment benefit program into their retirement plans, it cannot be relied upon as precedent because it applies only to the specific plan sponsor that requested it. As a result, any in-plan student loan repayment benefit program (and any taxable student loan repayment benefit that is offered in addition to an in-plan program) should be reviewed with counsel before implementation. The authors have observed that many plan sponsors are waiting for additional IRS guidance before settling on a design.

takeaways

- As many as 44.7 million Americans have student loan debt. Millennials are most affected by student loan debt, with about 15.1 million borrowers ages 25 to 34 collectively holding approximately $497.6 billion in student loan debt.
- Plan sponsors looking to offer student loan repayment benefits on a tax-favored basis may consider designing a student loan repayment benefit within a 401(k) plan.
- Options for designing a student loan repayment benefit outside of a 401(k) plan include providing additional compensation based on the amount of debt being paid off, directly paying a loan service provider on behalf of employees, providing debt counseling or offering signing bonuses that can be used toward paying student loans.
- Most student loan repayment benefit programs offered outside of a qualified plan would result in additional taxable compensation to the employee, but such programs have greater design flexibility.

Offering Student Loan Repayment Programs Within a Multiemployer 401(k) Plan

Nothing expressly prohibits a multiemployer 401(k) plan from offering a student loan repayment benefit. In fact, depending on the industry, participating employers and unions may benefit significantly from bargaining a student loan repayment benefit into an already established multiemployer 401(k) plan. This benefit could allow participating employers to attract and retain talented employees in a tight labor market.

There are, however, practical hurdles that may discourage trustees and bargaining parties from providing student loan repayment benefits through a multiemployer 401(k) plan. For example, such a benefit could be unduly cumbersome to administer if the plan has a large number of participating employers. Either each participating employer offering this benefit would need to independently verify student loan payments and remit corresponding nonelective contributions, or the recordkeeper (or third-party administrator) would need to verify student loan payments and confirm the participating employer's proper remittance of nonelective contributions.

Regardless of the approach taken, the recordkeeper may need to develop new infrastructure that allows it to accurately track verified student loan payments and corresponding nonelective contributions. The expense associated with developing this infrastructure may effectively reduce the relative value of a student loan repayment benefit program.

Designing Student Loan Repayment Benefit Programs Outside of a 401(k) Plan

Employers might also want to explore student loan repayment benefit programs outside of a qualified retirement plan. For example, employers could provide additional compensation based on the amount of debt being paid off, directly pay a loan service provider on behalf of employees, provide debt counseling or offer signing bonuses that can be used toward paying student loans.

Student loan repayment benefit programs offered by employers outside of the qualified plan context do not have the same tax advantages for employees. The nonelective 401(k) contributions described above are not included in a participant's compensation until distributed, and the employer may deduct these contributions for the year to which they apply. Outside of the qualified plan context, most student loan repayment benefit programs would result in additional taxable compensation to the employee. For example, employer payments to employees' loan service provider are taxable to the employee and are not much different from an increase in compensation. Thus, tax consequences (to both the employer and the employee) should be considered when an employer is determining whether to offer a student loan repayment benefit program and whether the plan should be tied to a qualified retirement plan.

Employers have greater design flexibility with student loan repayment benefit programs that are not tied to qualified plans. For example, an employer could combine a student loan repayment benefit program with performance-based awards, such that employees receive additional compensation in the form of direct payments toward student loans if certain performance goals are met. Alternatively, an employer could make a direct payment toward the student loan equal to the value of unused paid time off (PTO) forfeited by the employee at the end of the prior year.

As the design of student loan repayment benefit programs becomes more complicated, the employer should be wary of the tax doctrine of *constructive receipt* and issues related to the deferral of compensation under Tax Code Section 409A. Generally speaking, an amount is taxable to an employee when the employee has a legally binding right to payment, and the amount is made available. Physical possession of the payment is not required. However, the rules regarding timing of income inclusion are complicated, and employers should take care when designing student loan repayment benefit programs that may implicate these rules.

Effect on Retention

Employee retention is one factor to consider when deciding whether to offer a student loan repayment benefit program. Fidelity recently conducted a case study analyzing, among other things, the impact of its direct student debt benefit program on retention. The program allows enrolled employers to make a loan payment directly to loan service providers on behalf of their employees.[8] The study analyzed whether and to what extent employers were able to attract and retain employees by offering the program. Based on a review of 13 employers with nearly 35,000 participants, the study identified an 80% reduction in turnover among newly hired employees and a 22% reduction in overall turnover. In addition, 50% of new hires surveyed reported that the student debt program was a major factor in their decision to join the company.

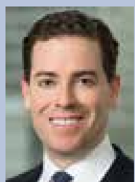
Most 401(k) plans are designed so that employer contributions vest over as many as six years, which encourages employees to stay with the employer until the employer contributions vest. Thus, student loan repayment benefit programs that make nonelective contributions to an employer's 401(k) plan may tie employees to their employers for a period consistent with the 401(k) plan's vesting schedule. While student loan repayment benefit programs that are not tied to qualified plans could be designed to promote employee retention through the use of a clawback provision, these program designs may not be optimal. The payments would generally be taxable to the participant when the student loan payment is actually or constructively received.

Student Loans Are a Top Priority for Regulators and Politicians

IRS has made clear that student loan repayment benefit programs are a high priority. In October 2019, the agency listed guidance on student loan payments and retirement plans as one of its top priorities in its 2019-2020 Priority Guidance Plan. Thus, additional IRS guidance may be forthcoming, and any such guidance would likely apply to taxpayers generally.

The legislative landscape is also changing to better address student loans. The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted on December 20, 2019, expanded the definition of *qualified higher education expenses* that can be withdrawn tax-free from a 529 savings plan to include amounts paid as principal or interest on qualified education loans. Such withdrawals have a lifetime limit of $10,000 per beneficiary. This may increase the popularity of student loan repayment benefit programs that provide employer contributions directly to a 529 plan established for the benefit of an employee or that provide employer nonelective contributions into a 401(k) plan when the employee contributes to a 529 plan. However, employers should proceed with caution because the SECURE Act changes only federal law, and not all state laws have been revised to treat student loan repayments as qualified distributions from 529 plans. This means that certain states may disallow any state income tax deduction or credit the employee would receive with respect to the contribution to the 529 plan if the amount is subsequently used to make a student loan payment.

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act amends Tax Code Section 127 to allow employers to reimburse employees up to $5,250 tax-free for qualified student loan payments incurred by the employee (i.e., not for student loans of the employee's spouse or child). This benefit is available only through December 31, 2020. The $5,250 cap applies to the aggregate of student loan payments and bios



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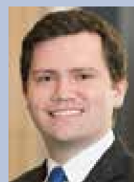

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traditional educational assistance benefits provided under a Section 127 plan (e.g., tuition, books, supplies, and other education-related expenses). When designing or amending a Section 127 plan, employers should make sure to avoid offering employees the choice between taxable compensation and a tax-free benefit.

In addition, through September 30, 2020, the interest rate for all federal student loans has been set to 0%, all payment obligations have been automatically suspended (unless the individual with the student loan elects otherwise), and all involuntary collections of federal student loan debt (e.g., wage garnishment) have been suspended.

Prior to the COVID-19 crisis, many politicians had proposed solutions to tackle the student loan issue. For example, the Higher Education Loan Payment and Enhanced Retirement (HELPER) Act introduced by Senator Rand Paul in December 2019 would allow individuals to withdraw up to $5,250 each year from a 401(k) plan or individual retirement account (IRA), tax- and penalty-free, to make student loan payments.[9] This bill may further incentivize retirement plan participation since the elective deferrals would be tax-deductible, and the distribution would not be subject to tax or an early withdrawal penalty. This proposal has been met with widespread skepticism, primarily because it may provide a disincentive to long-term retirement savings.

Conclusion

Student loans are top of mind for regulators, lawmakers and, most of all, individuals who are struggling to make their monthly loan payments. Employers that want to help lighten the burden of student loans on their employees have many options for program designs. In a tight labor market, these programs may help attract and retain employees.

Endnotes

1. Federal Reserve Bank of New York, *Household Debt and Credit* quarterly report (2019:Q2), available at www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2019q2.pdf. See also: www.federalreserve.gov/releases/g19/current/default.htm.
2. NBC News, "These five charts show how bad the student loan debt situation is," available at www.nbcnews.com/news/us-news/student-loan-statistics-2019-n997836.
3. *Forbes,* "A Look at Millennial Student Debt," available at www.forbes.com/sites/wesleywhistle/2019/10/03/a-look-at-millennial-student-debt/#6fef15482437.
4. International Foundation of Employee Benefit Plans, *Education Benefits: 2019 Survey Results.*
5. Internal Revenue Service (IRS) Private Letter Ruling 201833012 (August 17, 2018).
6. Internal Revenue Code Section 401(k)(4)(A) and Treasury Regulation Section 1.401(k)-1(e)(6).
7. IRS further noted that, to be compliant with the regulations, employers cannot extend student loans to their employees.
8. Fidelity, Case Study: Student Debt Direct[sm] Benefit, available at https://sponsor.fidelity.com/bin-public/06_PSW_Website/documents/Case%20_Study_StudentDebt.pdf.
9. Full text of the bill is available at www.paul.senate.gov/news/dr-rand-paul-introduces-helper-act-reduce-student-loan-debt-and-increase-retirement-savings.

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