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Oct. 26, 2018

In a new private letter ruling, the IRS says that employers can provide matching contributions to the 401(k) plan accounts of employees who make student loan payments (PLR 201833012, 8/17/18). It is expected that this new ruling will encourage retirement savings by employees, especially the younger generation.

According to research by the Pew Charitable Trusts, only slight more than half of Millennials –- 52% to be exact — participate in their company retirement plans. At the same time, a staggering $1.4 trillion is owed in student loan debt in this country, even more than auto loan debt or credit card debt.

With a 401(k) plan, employees can salt away money for retirement without any current tax erosion, within generous limits for salary deferrals. For 2018, the contribution limit is $18,500, with an additional $6,000 allowed if you're age 50 or over.

Frequently, an employer will also provide matching contributions, based on the employee's deferral, providing an extra incentive to participate. A common match is 50% percent of the first 6% of the amount contributed. For instance, if your salary is $100,000 and you contribute 6%, or $6,000, to the plan, the employer may provide a matching contribution of $3,000.

But 401(k) plans must meet strict nondiscrimination requirements. To avoid complex testing, an employer may use a "safe harbor plan." In this case, the employer matches each eligible employee's contribution, dollar for dollar, up to 3% of the employee's compensation and 50 cents on the dollar for the employee's contribution exceeding 3% (up to a 5% maximum) of the employee's compensation.

Finally, distributions are taxable, plus a 10% penalty is imposed for payouts made

- Participation is voluntary. If an employee signs up for the student loan repayment program, he or she receives a nonelective contribution for each pay period in which a student loan debt payment is made.
- The employer contribution is equal to the matching contribution the employee would otherwise receive if the employee made contributions to the plan during the same payroll period.
- The student loan repayment benefit effectively replaces the employer matching contribution for an employee who chooses to participate in the program. Thus, the employee is not eligible for other 401(k) matching contributions.
- The student loan repayment benefit is subject to the other rules for 401(k) plans, including contribution limits and nondiscrimination requirements.

Be mindful that a private letter ruling cannot be cited a precedent by taxpayers other than the one requesting the ruling. Nevertheless, it does provide guidance for establishing such a program.

Net result: This approach may provide a unique opportunity to increase participation in 401(k) plans by younger employees. Business clients may want to implement the strategy.

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