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Structuring Student Loan Repayment Benefit Programs: IRS Guidance, Applicable Rules, Key Planning Considerations

CARES Act, Offering Repayment Within 401(k) Plans, and Available Options Outside of Retirement Plans

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Today's faculty features:

Susan E. Bernstein, Special Counsel, **Schulte Roth & Zabel**, New York

Ian L. Levin, Partner, **Schulte Roth & Zabel**, New York

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Structuring Student Loan Repayment Benefit Programs:

IRS Guidance, Applicable Rules, and Key Planning Considerations

Presented by:

Ian L. Levin
ian.levin@srz.com

Susan E. Bernstein
susan.bernstein@srz.com

Schulte Roth & Zabel

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Overview



- Taxation of Education Assistance to Employees
 - Fringe Benefits
 - Qualified Educational Assistance Programs
 - Qualified Scholarships, Grants and Qualified Tuition Reduction Programs
 - Taxable Employer Assistance Programs
- IRS Guidance on Student Loan Repayment in a 401(k) Plan
 - 401(k) contributions made on student loan repayments
- Legislative landscape
 - SECURE ACT – IRA contributions for students
 - CARES ACT – Student loan relief
 - Proposed federal legislation



Education Assistance to Employees

Basic Taxation

Code Section 61



- Gross income means:
 - all income from whatever source derived, including compensation for services, fees, commissions, *fringe benefits*, and similar items

Fringe Benefits

Code Section 61



- In the broadest sense include all benefits provided by an employer to its employees (or others performing services for the employer) other than cash salary or wages for services rendered.
 - Such benefits may include:
 - reimbursements for certain expenses
 - privileges
 - goods
 - services or facilities to employees at a discount or without charge
 - use of property at a discount or without charge

Fringe Benefits

Code Section 61



- Unless an exemption applies:
 - fringe benefits are not excludable from gross income
 - taxable income =
 - fair market value of fringe benefit
minus
 - the amount, if any, the employee paid for the benefit
minus
 - the amount, if any, specifically excluded from gross income under a specific provision of the Code.

Fringe Benefits

Section 132 of the Code



- Certain fringe benefits are excluded from an employee's gross income, including:
 - no additional-cost service
 - qualified employee discount
 - working condition fringe
 - de minimis fringe
 - qualified transportation fringe
 - qualified moving expense reimbursement
 - qualified retirement planning services
 - qualified military base realignment and closure fringe

Educational Assistance

Working Condition Fringe Benefits



- Generally:
 - any property or service
 - provided to an employee of an employer
 - that, if the employee paid for the property or service, the amount paid would be allowable as a deduction as a trade or business expense under Code Section 162

Educational Assistance

Working Condition Fringe Benefits



- Educational expenses would be deductible by employee if the education:
 - maintains or improves skills required by the individual in the individual's employment or other trade or business
 - or
 - meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an *established* employment relationship, status, or rate of compensation

Educational Assistance

Working Condition Fringe Benefits



- "*Maintains or Improves Skills*"
 - Refresher courses or courses dealing with recent developments should be deductible
 - if a teacher who has satisfied the minimum requirements for teaching is required by his or her employer to take an additional college course each year to keep his or her teaching job, then the education assistance is non-taxable even if the teacher eventually receives a master's degree and an increase in salary because of this extra education; or
 - if a computer programmer's employer pays his or her tuition for graduate level computer courses so the computer programmer can keep up with the latest technology, the educational assistance should qualify as a tax-free fringe benefit

Educational Assistance

Working Condition Fringe Benefits



- Will be taxable if the education:
 - is required in order for the individual to meet the minimum educational requirements for qualification for employment or other trade or business
 - or
 - qualifies the employee for new trade or business

Educational Assistance

Working Condition Fringe Benefits



- Example:
 - if a computer programmer's employer provides the computer programmer with educational assistance to attend law school, the educational assistance will be subject to tax because the courses are not directly related to the employee's job as a computer programmer and the education would prepare him or her for a new career as a lawyer

Educational Assistance

Working Condition Fringe Benefits



- Once an employee has met the minimum educational requirements in effect when hired, any education requirements later imposed by employer will not be treated as minimum educational requirements
 - Example:
 - An individual hired by an employer as an accountant must later take educational courses to satisfy minimum educational requirements imposed by the employer after being hired
 - the additional courses are not treated as initial minimum requirements
 - the educational assistance for such courses may be non-taxable to employee

Educational Assistance

Working Condition Fringe Benefits



- *New Trade or Business*
 - To be non-taxable, employee's education must not qualify employee for a new trade or business:
 - regardless of whether such education improves job skills or
 - whether the individual actually engages in or desires to engage in the new trade or business
 - Determination is fact-specific, depending on the nature of the employee's position, the course to be taken, etc.
 - no bright-line rule
 - decisions must be done on a case-by-case basis

Employer Provided Educational Assistance

Qualified EAPs



- **Code Section 127** – Qualified Educational Assistance Programs
 - Permits an employer to provide up to \$5,250 of non-taxable educational assistance to an employee
 - Typically in the form of reimbursement to employee
 - Education is not required to be job-related
 - CARES Act amended Code Section 127 for 2020 – addressed later

Educational Assistance

Qualified EAPs



- Educational assistance may be provided for any form of instruction or training that improves or develops the capabilities of an individual
 - Does not cover past or future education – only current education courses
 - Excludes instruction or training involving sports, games or hobbies not related to the business of the employer
 - Can cover:
 - tuition
 - fees
 - books
 - supplies (textbooks) and
 - equipment

Educational Assistance Qualified EAPs



- Must be a separate written plan of the employer
- Must not favor highly compensated employees
- Must be for the exclusive benefit of employer's employees
 - Employer may cover retired, disabled, or laid-off employees, employees on leave (*e.g.*, in the U.S. Armed Forces), and self-employed persons, but may not benefit employees' spouses or dependents
- Eligible employees must be given reasonable notice of the terms and availability of the program
- Shareholders or owners may not receive more than 5% of benefits during the year

Educational Assistance Qualified EAPs



- Cannot:
 - pay for or provide tools or supplies that the employee may retain after completing a course of instruction, other than textbooks
 - pay for meals, lodging or transportation
 - pay for room and board
 - allow a choice between cash or other benefits instead of educational assistance

Educational Assistance Qualified EAPs



- Amounts above \$5,250
 - Could be non-taxable as a working-condition fringe benefit
 - But must meet the requirements

Employee Benefit - Student Loan Repayment Assistance Programs



- **How does this employee benefit currently work?**
 - Some companies provide a monthly or annual cash benefit:
 - For example, an employer contributes \$50 - \$200 per month to aid in the repayment of student loans
 - Some employers provide a lifetime cap (e.g., \$100/month up to lifetime maximum of \$10,000)
 - One financial services company, for instance, offers its employees with student loans up to \$2,000 per year, with a lifetime cap of \$10,000, to aid in the repayment of such loans
 - Benefit is generally taxable (especially for tuition expenses incurred in the past)



**Qualified Scholarships and Grants
and
Qualified Tuition Reduction Programs**

Scholarships, Grants and Tuition Reduction



Qualified Scholarships and Grants and Qualified Tuition Reduction Programs are only available for Qualified Educational Organizations

Qualified Educational Organizations:

- the institution must maintain a faculty and curriculum; and
- the institution must normally have a regularly enrolled student body on site

Qualified Scholarships and Grants

Code Section 117(a)



- Excludable Fringe Benefit
- Gross income does not include any amount received as a qualified scholarship or grant (no dollar limit)
- Qualified Scholarships and Grants are non-taxable if:
 - recipient is a degree candidate at a Qualified Educational Organization; and
 - funds are used for tuition, fees books, supplies and equipment required for instruction at a Qualified Educational Organization

Qualified Tuition Reduction Programs

Code Section 117(d)



- Excludable Fringe Benefit
 - Gross income does not include any Qualified Tuition Reduction whether in the form of tuition remission, tuition waiver or tuition grant
- Qualified Tuition Reduction means tuition provided to an employee (their spouses and dependent children) for education below graduate level
 - The employee is a degree candidate at a Qualified Educational Organization
 - The program cannot discriminate in favor of highly compensated employees
 - Recipients who are graduate students are eligible if they are engaged in teaching or research activities for the Qualified Educational Organization

Qualified Tuition Reduction Programs

Code Section 117(c) limitation



- Qualified Scholarships under Section 117(a) and Qualified Tuition Reductions under Section 117(d) –
 - If the funds are used for past, present, or future employment services, then the funds are taxable to the employee

Comparing Education Assistance Programs

	Scholarships and Grants Code Section 117(a)	Qualified Tuition Reduction Code Section 117(d)	Education Assistance Programs Code Section 127	Working Condition Fringe Benefits Code Section 132(d)
Plan must be nondiscriminatory	Yes	Yes	Yes	<u>No</u>
Student must be degree candidate	Yes	Yes	No	No
Must be job-related	No	No	No	<u>Yes</u>
Written plan required	No	No	<u>Yes</u>	No
Imposes dollar limit	No	No	<u>Yes (\$5,250)</u>	No

Stacking Educational Assistance Benefits



- More than one IRC section may apply to the same benefit:
 - For example-
 - Education expenses up to \$5,250 may be excluded from tax under IRC Section 127; and
 - Education expenses exceeding \$5,250 may be excluded from tax under IRC Section 132(d)
- For certain employers (educational institutions)
 - Qualified scholarships under 117(a); and
 - Qualified tuition reductions under 117(d)



Recent Legislation:

**Setting Every Community Up for
Retirement Enhancement Act of 2019
("Secure Act")**

and

**Coronavirus Aid, Relief, and Economic Security Act
("CARES Act")**

SECURE Act: IRA Contributions for Graduate Students



- **Graduate and postdoctoral stipends and fellowships are treated as compensation for IRAs**
 - Compensation for purposes of making contributions to an IRA now includes amounts paid to an individual such as non-tuition fellowships and stipends that aid in the pursuit of graduate and postdoctoral studies
 - This change enables students to begin saving for retirement
- **Effective Date:** These changes are effective for taxable years beginning after December 31, 2019

CARES Act: Student Loan Assistance



- Temporarily expands Code Section 127 educational assistance programs
 - Employer may reimburse or pay an employee's student loan payments for period beginning on March 27, 2020 through December 31, 2020
 - Under this exception to Section 127, the student's loans do not have to relate to courses they are currently taking to be tax-free
 - Subject to the annual limit of \$5,250 per employee
 - This is a combined limit taking into account other education assistance payments
 - Employers need to create a written plan, or modify existing plan, to reflect the CARES Act student loan repayment opportunity
 - Employees who benefit are not able to deduct interest with respect to amounts paid or reimbursed by an employer on their 2020 taxes

CARES Act: Student Loan Assistance



- The U.S. Department of Education directed the office of Federal Student Aid to provide the following relief on federal student loans from March 27, 2020 – August 1, 2020 (later extended until December 31, 2020)
 - Suspended loan payments automatically
 - stop collections on defaulted loans
 - set interest rates to 0%
- Emergency Funds
 - CARES Act provided \$7 billion in funds to colleges to be designated for emergency financial aid in the form of grants, loans and scholarships

"Never mind the pension scheme -
I'm just hoping I can pay off my
student loan before I retire!"



Student Loan Repayment Assistance Programs



To appreciate the importance of the next topic it is important to understand the **power of compounding**:

If you start saving \$250/month at age:

- **25:** You'll accumulate \$878,570 by age 65
- **35:** You'll accumulate \$375,073 by age 65
- **45:** You'll accumulate \$148,236 by age 65


The longer you wait to start saving and investing, the more you'll miss out on compound interest. But, how can those saddled with student debt save for retirement?



Recent IRS Guidance: Private Letter Ruling

Student Loan Repayment Assistance

Private Letter Ruling 201833012

- 
- Issued by IRS in May 2018
 - Facts
 - Employer sponsors a 401(k) Plan; employees can elect to make 401(k) or Roth 401(k) contributions
 - Employer makes a regular matching contribution equal to 5% of employee's eligible pay if employee deferred at least 2% of pay for that pay period
 - Many employees could not make both 401(k) contributions/Roth 401(k) contributions **AND** pay their student loan debts

Student Loan Repayment Assistance

Private Letter Ruling 201833012

- Student loan repayment (SLR) program (separate from employer's 401(k) Plan)
 - Employer would make a non-elective contribution (SLR Contribution) at the end of the year to 401(k) Plan equal to 5% of an employee's eligible pay if employee:
 - voluntarily enrolled in SLR program
 - made student loan repayments of at least 2% of eligible pay
 - was employed on last day of the year
 - Employee entitled to 5% non-elective contribution or company match-not both
 - Importantly, an employee could still make 401(k) contributions or Roth 401(k) Contributions

Student Loan Repayment Assistance

Private Letter Ruling 201833012

- Issue:

- Code Section 401(k)(4)(A):

- Commonly referred to as the "contingent benefit" prohibition

A cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election.

Except for matching contributions, no other benefit can be conditioned (directly or indirectly) on an employee electing to make 401(k) contributions or Roth 401(k) contributions

- Employer concerned that its SLR program design could violate contingent benefit prohibition because employee could only receive SLR contribution or matching contribution

Student Loan Repayment Assistance

Private Letter Ruling 201833012

- SLR Contributions subject to all applicable plan qualification requirements, including:
 - eligibility
 - vesting
 - distribution and contribution limits
- Non-discrimination requirements still apply!
 - Both SLR Contributions and matching contributions must be tested for non-discrimination
 - SLR Contributions cannot be treated as a Matching Contribution for purposes of ACP Test


Student Loan Repayment Assistance

Private Letter Ruling 201833012

- IRS Ruling: SLR program did not violate "contingent benefit" prohibition
 - SLR contribution, itself, not conditioned (directly or indirectly) on the employee making elective contributions to the plan
 - Because the employee is still permitted to make elective contributions in addition to student loan repayments, non-elective contribution is not conditioned (directly or indirectly) on the employee electing to make or not to make contributions in lieu of receiving cash

Student Loan Repayment Assistance

Private Letter Ruling 201833012

- 
- IRS has indicated that it is currently developing general guidance regarding issue
 - As a result, the IRS has indicated that new rulings regarding similar facts will not be issued
 - What should other employers do?



Recent Legislative Proposals

Legislative Landscape

Student Loan Repayments



Various proposed bills pending in Congress that would increase the tax-favorable alternatives for employer provided student loan repayments

Legislative Landscape

Student Loan Repayments



- The Student Loan Repayment Assistance Act of 2019 (H.R. 655)
 - Would provide a business-related tax credit of 10% for employers that provide student loan repayment assistance for employees (up to cap of \$500/month)
 - The bill would require [like Section 127]:
 - A separate written plan of the employer
 - Plan must not favor highly compensated employees
 - Must be for the exclusive benefit of employer's employees
 - Eligible employees must be given reasonable notice of the terms and availability of the program

Legislative Landscape

Student Loan Repayments



- Securing a Strong Retirement Act of 2020 ("SECURE Act 2.0")
- Retirement Parity for Student Loans Act (S.1428 & H.R. 6276)
 - Would permit matching contributions in 401(k), 403(b) and 457(b) plans on account of an employee's qualified student loan payments
 - Qualified student loan payments are defined as payments made by an employee in repayment of a qualified education loan incurred to pay higher education expenses of the employee

Legislative Landscape

Student Loan Repayments



- The Student Loan Repayment Acceleration Act (S.2347)
 - Would exclude employer contributions for student loan repayments from income and payroll taxes, up to \$10,000 per year

Legislative Landscape

Student Loan Repayments



- COVID-19 Graduate Relief Act (H.R. 6502 & S.3556)
 - Would allow borrowers a payment deferment for up to three years following the COVID-19 pandemic and the enactment of this bill

Legislative Landscape

Student Loan Repayments



- Economic and Student Loan Debt Relief (H.R. 7114)
 - Would further amend Section 127 (and thereby extend the CARES Act student loan provisions providing a pause and interest waiver on repayment) from Sept. 30, 2020 through December 31, 2020
 - Would amend Section 127 to make the CARES Act exclusion from income for 2020 a permanent tax exclusion for employer-paid student loan repayment assistance

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