

Top Heavy

A "Top Heavy" Defined Contribution Plan is a plan that on the annual determination date, the total accounts of all key employees exceeds 60 percent of the total accounts of all employees. A "Top Heavy" Defined Benefit Plan is a plan where on the annual determination date, the present value of the accrued benefits of all key employees exceeds 60 percent of the present value of the accrued benefits of all employees. The determination date for assessing whether a plan is "Top Heavy" or not may change whether it is a newly created plan, or whether it is an existing plan. For a new plan, the determination date of the assessment is the last day of the first plan year. However, with respect to an existing plan, the determination date is the last day of the preceding plan year.

Another integral piece to the "Top Heavy" analysis is determining which employees are considered key employees, which directly impacts the determination of whether a plan is "Top Heavy." A key employee is an employee who at any time during the plan year is:

1. An officer having annual compensation greater than \$165,000;
2. A five percent owner;
3. A one percent owner whose annual compensation exceeds \$150,000

The IRC defines a non key employee as any employee who is not a key employee. When determining whether an employee is an officer of the company, all of the facts and circumstances must be examined, including the employee's duties, term of position, and extent of his or her authority. Interestingly, an employee who does not have the title of an officer, but has the same authority as an officer, is considered an officer for the key employee test.

What Occurs After A Plan Is Determined To Be "Top Heavy?"

If a plan or aggregated group of plans is determined to be "Top Heavy" under the IRC, it is in violation of the law, unless the plan takes certain measures to ensure compliance with the IRC. If the plan fails to satisfy the "Top Heavy" requirements of the IRC it will lose its status as a qualified trust.

In order for the "Top Heavy" plan to maintain its qualified status for the plan year it must meet the "Top Heavy" requirements of the IRC, by satisfying:

1. The Internal Revenue Code's "Top Heavy" vesting requirement; and
2. The Internal Revenue Code's "Top Heavy" minimum benefit or contribution requirement.

Vesting

If a plan is considered "Top Heavy," the employer must adopt one of two vesting options established by the IRC. Specifically, the plan must allow for a three year vesting term or a six year graded vesting schedule. Within the three year vesting schedule, an employee who completes at least three years of service must be 100 percent vested. Pursuant to the six year graded vesting schedule, an employee must become vested consistent with the table below:

<u>Completed Years of Service</u>	<u>Vested Percentage</u>
2	20%
3	40%
4	60%
5	80%
6	100%

The purpose of the IRC's vesting requirements for "Top Heavy" plans is to accelerate the accrued benefits of an employee.

When a plan ceases to be "Top Heavy," the employer may change the vesting schedule to its previous schedule, or to a schedule that would otherwise be permissible under the law. However, this change cannot be to the detriment of the employee, as the employee cannot be required to forfeit any benefits accrued during the time period that the plan was "Top Heavy." Moreover, any employee with three or more years of service must be given the option of remaining under the "Top Heavy" vesting schedule.

Minimum Benefit Or Contribution

In addition to complying with the "Top Heavy" vesting requirement, the employer must also provide certain minimum benefits or contributions to comply with the "Top Heavy" requirements,

If a Defined Contribution Plan is determined to be "Top Heavy," then the employer's required contribution for each non key employee must not be less than three percent (3%) of the employee's compensation. However, the IRC has carved out a special exception where the highest contribution rate for any key employee does not exceed three percent. In this instance, the required minimum contribution rate is the equivalent of the highest contribution rate of any key employee. This minimum contribution must be made for any non key employee who is a participant in the plan and has not separated from service at the end of the plan year, regardless of whether they have completed 1,000 hours of service.

If a Defined Benefit Plan is determined to be "Top Heavy," then the required accrued benefit, when expressed as an annual retirement benefit of a non key employee, must not be less than the employee's average compensation multiplied by the lesser of: (1) two percent times the number of years of service; or (2) 20 percent. The term "annual retirement benefit" under the IRC means a benefit attributable to employer contributions payable in the form of a single life annuity beginning at the retirement plan's normal retirement age. If the employee does not retire at the normal retirement age, then the amount of the benefit must at least be the actuarial equivalent of the minimum single life annuity benefit of normal retirement age. The benefit may be more or less depending upon whether the benefit commences before or after the normal retirement age. This minimum benefit must be provided to any non key employee who is a participant in the plan and who has at least 1,000 hours of service during the plan year.