



# Top Heavy FAQs for DC Plans

## What are the top heavy rules?

In general, a defined contribution plan (i.e. 401(k), profit sharing, money purchase, etc.) is considered to be top heavy when more than 60% of plan assets are attributable to “key employees” as of the “determination date”. Top heavy plans are subject to certain minimum contribution and vesting requirements.

## Who are key employees?

A key employee is an employee who at any time during the plan year:

- Owned more than 5% of the company\*;
- Owned more than 1% of the company\* and had compensation in excess of \$150,000; or
- Was an officer of the company and had compensation in excess of a specific dollar amount that is indexed annually (\$170,000 for 2014)

\* Stock attribution rules under IRC §318 apply

## What is the determination date?

For the first plan year, the determination date is the last day of the plan year. For subsequent years, the determination date is the last day of the prior plan year.

## How is top heavy status calculated?

In general, the top heavy ratio and is calculated by comparing the account balances of key employees to the account balances of non-key employees, after making adjustments.

## What adjustments are made?

First, certain participant balances are excluded.

Rollover account balances

Account balances of terminated participants who did not work for the employer during the plan year

Account balances of former key employees (this means participants who are no longer considered to be key employees, but were in a prior plan year)

Second, certain participant distributions are added-back or included.

- Distributions made on account of termination, death or retirement if the participant worked for the employer during plan year (this is known as the “1-year rule”)
- In-service distributions made within the 5-year period ending on the determination date (this is known as the “5-year rule”)

## After a plan becomes top heavy, is it always top heavy?

No. Top heavy status must be determined annually and may change from year to year. A new plan will be considered top heavy if the top heavy ratio is greater than 60% as of the last day of the first plan year. An existing plan will be considered top heavy if the top heavy ratio is greater than 60% as of the last day of the prior plan year.

## What are the minimum contribution requirements for top heavy plans?

Generally, the employer must make a contribution on behalf of non-key employees equal to the lesser of 3%, or the highest contribution rate of any key employee.

All non-key employees who were eligible to participant in the plan and who were employed on the last day of the plan year are entitled to receive a top heavy minimum, even if the plan otherwise imposes an allocation condition in order to share in employer contributions (ex. 1,000 hour requirement).

In addition, top heavy minimums are determined by considering the participant’s compensation for the entire plan year, even if the plan otherwise excludes compensation paid prior to the participant’s plan entry date.

**Caution:** *Top heavy plans that allow for immediate entry for 401(k) but have a longer eligibility period for employer contributions are still required to make top heavy minimums for non-key participants who were only eligible for the 401(k) portion of the plan.*



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## How is the highest contribution rate for key employees determined?

All contributions (other than rollover contributions) are considered when calculating the contribution rates for key employees. This means that 401(k) deferrals and Roth contributions are included.

For example, if an employer does not make any employer contributions to a top heavy plan for a given plan year but key employees still make 401(k) deferrals, the employer would be required to make a top heavy minimum contribution equal to the lesser of 3%, or the highest deferral rate of any key employee on behalf of non-key employees.

## What contributions count towards top heavy minimums?

All of the following contributions count towards satisfying top heavy minimum contributions:

- Employer matching contributions
- Employer profit sharing contributions
- Forfeiture allocations
- Safe harbor matching contributions
- Safe harbor nonelective contributions
- Qualified Nonelective Contributions (QNECs)
- Qualified Matching Contributions (QMACs)

If an active non-key participant received contributions sufficient to satisfy the top heavy minimum, no additional contributions must be made on their behalf.

## What are the minimum vesting requirements?

Top heavy plans must use either a 3-year cliff or 6-year graded vesting schedule. This requirement has little impact since most plans use vesting schedules that meet or exceed these standards.

## What happens if the employer sponsors more than one plan?

In general, all qualified plans sponsored by the employer must be combined for top heavy purposes including (1) each plan that covers at least one key employee, and (2) any other plans that are aggregated in order to satisfy coverage testing or nondiscrimination testing.

**Note:** *If the employer sponsors a defined contribution and defined benefit plan, both plans must be considered. Defined benefit plans are subject to different rules than those discussed in this FAQ and include higher top heavy minimum contributions.*

## What about controlled groups?

Companies that are members of a controlled group or an affiliated service group are treated as a single employer for top heavy purposes. If more than one employer sponsors a plan, the plans must be combined as described above.

## Are safe harbor 401(k) plans exempt?

In general, safe harbor plans are not required to make top heavy minimums if the employer makes no contributions to the plan other than (1) safe harbor matching contributions, (2) additional matching contributions that satisfy the safe harbor rules, or (3) safe harbor nonelective contributions.

**Caution:** *Forfeiture allocations can trigger top heavy minimums in safe harbor plans!*

## What happens if the employer doesn't fund top heavy minimums?

Failure to make top heavy minimum contributions is an operational failure that will jeopardize the qualified status of the plan. As a result, the contributions must be funded, along with related earnings, in accordance with the principles set forth under the IRS Employee Plans Compliance Resolution System (EPCRS). For additional information on how to make plan corrections, please contact us.