Top-Heavy Explanation

Qualified retirement plans are required to comply with Top-Heavy rules referenced in Internal Revenue Service Code section 416 and regulations. A plan is top-heavy if **60%** or more of the assets belongs to "key employees". Generally, all plans of the employer are aggregated for top-heavy determination.

Key Employee. An employee is a "key" employee if in the prior plan year he was one of the following: (1) an owner of more than 5% of the company; (2) an owner of more than 1% of the company earning more than $150,000; or (3) an officer of the company earning more than $130,000.[(a)] A spouse of a more than 5% owner as well as lineal ascendants and descendants of such an owner are key employees.[(b)] A non-key employee is any employee who is not a key employee. Assets belonging to an employee who did not work at least 1 (one) hour in the prior plan year are ignored.

There is a minimum contribution and vesting requirements that must be fulfilled when a plan becomes top-heavy. In any top-heavy year, a non-key participant in a defined contribution plan must receive an employer contribution equal to the lesser of: (a) 3% of compensation, or (b) the largest percentage of pay for any key employee's contributions (but not more than 3%). The top-heavy contribution is allocated to all non-key participants *regardless* of hours of service, *provided* he is an active employee at year-end.

In any top-heavy year, one of the following *minimum* vesting provisions must be met. After three years of service, an employee is 100% vested in his account balance derived from employer contributions; or an employee has a nonforfeitable right to a percentage of his account balance derived from employer contributions determined under the following table:

Year(s) of Service:	1	2	3	4	5	6
Vested Percentage:	0	20	40	60	80	100

Where the company's objective is to maximize retirement benefits to key employees, it is not unusual for a plan to become top-heavy, especially if the number of participants in a plan is rather small. The top-heavy ratio is calculated every plan year. If a top-heavy plan satisfies the minimum contribution and vesting requirements, the plan continues to enjoy its tax-exempt status.

(a) Officer compensation indexed as follows: 1995 - $60,000; 1996 - $60,000; 1997 - $62,500; 1998 - $65,000; 1999 - $65,000, 2000 - $67,500; 2001 - $70,000; $2002 - $130,000; 2003 - $130,000; 2004 - $130,000; 2005 - $135,000; 2006-$140,000; 2007-$145,000; 2008-$150,000.

(b) Code Section 416 applies the principles of attribution of ownership explained in Code Section 318.

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