

Conference Line

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Top-Heavy Plans

An ftwilliam.com Webinar - Tuesday, January 29, 2013

Your Presenters

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Today's Agenda

- What is a top heavy plan?
- Key employees
- Top heavy ratio
- Top heavy minimum allocation & vesting
- Safe harbor 401(k) plans
- Plan aggregation
- Miscellaneous

Questions during webinar

- If you have any questions during the webinar, please send them in using the Q&A option on your toolbar. We will gather questions and post them with answers on our website in the near future.
- Please also feel free to email support@ftwilliam.com or call 800.596.0714

WHEN IS A PLAN TOP HEAVY?

Definition of Top Heavy Plan(s) (401(a)(10)/416)

- Over 60% of accounts/benefits belongs to key employees on determination date
 - Defined Contribution: Market value of account
 - Defined Benefit: Present value of accrued benefit (“PVAB”)
 - Aggregated Plans: Sum of present value and account balance
- Does not apply to governmental plans or 403(b) plans

Determination Date

- Determination Date is the last day of the prior plan year
 - Last day of current plan year is used for new plans
- Example - first plan year is 1/1/2012 – 12/31/2012; determination date for both 2012 and 2013 plan years is 12/31/2012

WHO ARE THE PLAN'S KEY EMPLOYEES?

Key Employee Defined (416(i)(1))

- Ownership
 - More than 5% owner
 - More than 1% owner with annual compensation greater than \$150,000 no COLA
 - Family attribution rules - Code section 318 – apply
- Officer with annual compensation greater than \$165,000 (2012 and adjusted for COLA)

Compensation

- 415 compensation for the plan year including the determination date
 - As defined by the plan
 - Includes elective deferrals
- Compensation from all related employers is taken into account

Officers

- Officers are counted in year of determination date
 - Limited to 50, or if fewer, the greater of 3 (actual officers) or 10% of employees
Example – a 50-person company with seven officers would only need to count five of them as key employees
- All businesses are considered to have officers, even if not by name e.g., partnerships, sole proprietorships, labor organizations
 - Status as an officer is determined based upon facts and circumstances, not title

Key Employee Defined (416(i)(1))

- Ownership in related business entities not aggregated

Example: Sanjay owns 3% of company A & 4% of company B – related employers. Sanjay is considered a 1% owner

- No transition period for Key determination
 - Conservative approach would be to include a related employer when related for any part of the year

Key Employee Defined

- Former employee (even deceased) included
- Leased employee may be considered a Key employee
- If an employee is Key for part of the year, considered Key for all of the year
- Anyone who is not a Key employee is considered a Non-key employee

Additional Issues to Define Key Employee

- Short plan year
 - Conservative interpretation of compensation would be to prorate compensation limit or annualize actual compensation paid
 - Last day of short plan year = determination date for next year
 - Example – short plan year 1/1/2012 – 6/30/2012 due to switch to fiscal year. Use \$82,500 for officer compensation and \$75,000 for 1% owner compensation

DETERMINING THE PLAN'S TOP HEAVY RATIO

Top Heavy Ratio

- **DEFINED CONTRIBUTION PLANS**
 - Sum of fair market value of key employees' accounts
÷ Sum of fair market value of all employees' accounts
- **DEFINED BENEFIT PLANS**
 - Sum of PVAB of key employees' accounts
÷ Sum of PVAB of all employees' accounts
- Calculated on Determination Date

Top Heavy Ratio Adjustments

- Adjustments to Defined Contribution Plans
 - Pension Plans (Money Purchase/Target Benefit): Include contributions that are due by the determination date, even if they are not made by the determination date
 - Non-Pension Plans: Generally only contributions that are actually made to the plan by the determination date are included in the top heavy ratio
 - Exception for first plan year

Top Heavy Ratio Adjustments

- Adjustments to Defined Contribution Plans
 - What about 401(k) deferrals from compensation that is payable at the end of the plan year, but is not deposited until after the end of the plan year?

Catch-Up Contributions

- Catch-up contributions are not considered in the plan year made, for purposes of determining a top heavy minimum contribution
- Catch-up contributions will be included as part of a key employee's account balance in future years

Top Heavy Ratio Adjustments

- One-Year Distribution Rule
 - Any part of an employee's account balance/PVAB distributed in the one-year period ending on the determination date is generally added back to the top heavy ratio calculation
 - **EXAMPLE:** The determination date is December 31, 2012. Carl terminated employment on September 1, 2012, and immediately took a lump sum distribution of his entire vested account balance. The distribution is added back to the amounts used to calculate the top heavy ratio for the December 31, 2012 determination date.
 - The distribution will NOT be included for the next top heavy determination date on December 31, 2013.

Top Heavy Ratio Adjustments

- **Five-Year In-Service Distribution Rule**
 - Distributions made for reasons other than termination, death or disability are added back if the distribution occurred within the five-year period ending on the determination date
 - **EXAMPLE:** On February 1, 2008, Rita took an in-service distribution of \$10,000 from her 401(k) plan. As of December 31, 2011, the fair market value of Rita's account is \$100,000. Since the in-service distribution occurred within the five-year period ending on December 31, 2011, the \$10,000 in-service distribution is added back to Rita's account, which will be valued at \$110,000 for top heavy ratio purposes as of the December 31, 2011 determination date.

Top Heavy Ratio Adjustments

- How are corrective distributions treated for top heavy purposes?
 - Corrective distributions for ADP & ACP test failures?
 - Corrective distributions for excess deferrals?

Rollovers

- Related rollovers are included in determining top-heavy ratio (60% limit)
- Unrelated rollovers are not included

Top Heavy Ratio Adjustments

- Former Employees

- A former employee's account will only be included in a top heavy ratio if he or she performed services during the one-year period ending on the determination date
- **EXAMPLE:** Julia terminates employment on January 15, 2011. Her account balance will be included in the top heavy ratio calculated on the December 31, 2011 determination date. It will NOT be included in the top heavy ratio calculated on the December 31, 2012 determination date.

Top Heavy Ratio Adjustments

- If Rita terminated employment on January 1, 2009, the in-service distribution that she took on February 1, 2008 would be included in the December 31, 2009 top heavy calculation but not in the December 31, 2010 top heavy calculation.

Top Heavy Ratio Adjustments

- **Former Key Employees**
 - A former key employee is an employee who is currently a non-key employee, but who was a key employee during any prior plan year
 - The accrued benefit of a former key employee and any distributions made to that former key employee are completely excluded from the top heavy ratio (both numerator and denominator)
 - If the former key employee becomes a key employee in a later year, then his or her accrued benefit is included in both the numerator and the denominator of the top heavy ratio

Top Heavy Ratio Adjustments

- **Former Key Employees**
 - **EXAMPLE:** Jessica owns 25% Company X, and participates in Company X's calendar year 401(k) plan. She sells her entire share of the company on April 1, 2011.
 - Because Jessica satisfied the 5% owner test during the 2011 plan year, she is treated as a key employee on the December 31, 2011 determination date and is included in the top heavy ratio. She will be treated as a former key employee for the 2012 plan, and will be excluded from the top heavy ratio on the December 31, 2012 determination date.

TOP HEAVY MINIMUM ALLOCATION

Top Heavy Plan Requirements

- Minimum employer contributions are required when a plan is top heavy
- Vesting must be at least as fast as a 3-year cliff or 6-year graded vesting schedule

Top Heavy Allocation

- DEFINED CONTRIBUTION PLAN W/NO DEFINED BENEFIT PLAN: The lesser of 3% of statutory (testing) compensation or the same percentage of allocation as that of the key employee with the highest allocation rate
 - This includes salary deferrals made by a Key employee
 - Earnings are NOT taken into account

Top Heavy Allocation

- Who is eligible for a top heavy allocation in a defined contribution plan?
 - All non-key employees who are participants in the plan
 - Last day requirement is allowed
 - Service requirement is NOT

Top Heavy Allocation

- DEFINED BENEFIT PLAN W/NO DEFINED CONTRIBUTION PLAN: 2% of average compensation times years of service when the plan is top heavy (not more than 10 years)
 - In other words, 20% maximum
- Years in which no key employee or former key employee benefits under the plan are ignored

Top Heavy Allocation

- Who is eligible for a top heavy allocation in a defined benefit plan?
 - Minimum benefits must accrue for any non-key employee who in a plan year is a participant in the plan and is credited with at least 1,000 hours of service
 - The non-key employee does NOT need to be employed on the last day of the plan year

Top Heavy Allocation

- Non-Key Employee Participant in Both Defined Contribution and Defined Benefit Plan:
 - Four “safe harbor” options:
 - Top heavy minimum is provided by defined benefit plan
 - Top heavy minimum of 5% of compensation is provided by the defined contribution plan
 - Floor-offset
 - Demonstrate that combined benefits provided together by the DC and DB plans are comparable to the DB minimum benefit

SAFE HARBOR 401(K) PLANS & THE TOP HEAVY RULES

Safe Harbor 401(k) Issues

- A safe harbor 401(k) plan is deemed to not be top heavy if:
 - The plan only consists of a safe harbor 401(k) arrangement; AND
 - Any matching or nonelective contributions made to the plan satisfy the ACP safe harbor
- Top heavy testing is required if a profit sharing contribution is made

Safe Harbor 401(k) Issues

- Safe harbor 401(k) match or non-elective contributions may be used to satisfy the top heavy minimum
 - Minimum 3% Non-elective will typically cover top heavy minimum if definition of compensation does not exclude compensation prior to entry (first year of eligibility issue)

Safe Harbor 401(k) Issues

- If a safe harbor plan is deemed to not be top heavy, but the employer sponsors another plan that is top heavy, safe harbor contributions MAY be used to satisfy the top heavy minimum in the other plan
- Example – the ABC company sponsors a safe harbor 401(k) plan and a profit sharing plan that is top heavy, the safe harbor contributions made to the first plan may be used to satisfy the top heavy minimum in the second plan

PLAN AGGREGATION

Aggregation Rules

- If more than one plan is sponsored by an employer, then those plans are generally aggregated when calculating the top heavy ratio
- DB & DC plans included

Aggregation Rules

- Test Results:
 - If ratio exceeds 60% for the group, ALL plans are top heavy
 - If ratio is 60% or less, ALL plans are NOT top heavy
 - If a plan is permissively aggregated to a group, but the ratio is still over 60%, only the plans that are required to be aggregated are top heavy

Aggregation Rules

- Plans that must be aggregated consist of:
 - Each employer plan that has at least one key employee participant; and
 - Each employer plan which enables any other plan that has at least one key employee participant to satisfy Code section 401(a)(4) or 410
 - This group includes any safe harbor 401(k) plan that falls under the above categories even if the plan is deemed to satisfy the top heavy requirements

Aggregation Rules

- **EXAMPLE:** Employer X sponsors Plan A and Plan B. The company's key employees participate in Plan A. No key employees participate in Plan B, but in order to pass coverage, Plan A is aggregated with Plan B
- Therefore, Plan A and Plan B must be aggregated for top heavy purposes.

Aggregation Rules

- What is the determination date for aggregated plans?
 - Determine the value of the accrued benefits on each separate plan's respective determination date that falls within the same calendar year. Then add those values together to calculate the top heavy ratio
 - Example – Plan A's year ends on 9/30. Plan B's year ends on 12/31. Plan A and Plan B are aggregated. For 2013, you would use the PYE 9/30/12 & 12/31/12 balances or PVABs

Aggregation Rules

- Permissive Aggregation:
 - Plans not required to be aggregated may be aggregated, if the group of plans together satisfy Code sections 401(a)(4) and 410

Additional Aggregation Issues

- Simplified Employee Pension Plan (“SEP”) under Code section 408(k) is subject to Code section 416 top heavy rules and aggregation with qualified plans (416(i)(6))
- SIMPLE IRA under 408(p) (SIMPLE Retirement Account) is not aggregated with other plans for top heavy purposes
- If safe harbor 401(k) plan is part of required aggregation group that is top heavy, but the safe harbor 401(k) plan on its own is not top heavy, the employer contributions made under the safe harbor plan may still be used to satisfy the top heavy requirements of the aggregated group

MISCELLANEOUS ISSUES

Multiple Employer Plans

- Each employer (including controlled group within the multiple employer plan) is tested separately
- Noncompliance with minimum contribution (or vesting) by one employer disqualifies total plan

Collectively Bargained Employees

- Employees covered by a collective bargaining agreement may be excluded
- Collectively bargained plan that includes at least one key employee must be aggregated

Plan Design Considerations

- Integrated profit sharing formula when plan is top heavy
 - Plan document will generally require that top heavy minimum contributions are met before any contributions based on excess are paid

401(k) Design Issues

- Forfeitures
- Disaggregation of otherwise excludable employees
- First plan year, typically small employer with Key employee deferring and no employer contributions

Top Heavy Testing with the ftwilliam.com Administration Software

- Software separates testing & transactions
 - Need to have transaction batches added to run top heavy testing
 - Can just add ending balances batch, or use all transactions
- See troubleshooting link in the Admin User Guide for help with top heavy testing

ftwilliam.com Administration Software

- Calculates eligibility & entry dates
- Identifies HCEs & key employees
- Offers multi-tiered contribution allocations
- Self-employed calculations
- Transactions can be imported from 16 vendors
- Balance forward accounting/participant statements
- Integrated with other software modules

In Closing

- There are still issues for which we do not have complete guidance
- Generally not an issue for large plans
- In smaller plans, best to build top heavy minimums into regular plan design so as not to surprise plan sponsor after plan year end with required contributions

Thank you for attending

Don't hesitate to contact us with any questions.



HAVE A WONDERFUL DAY!