

# Top Heavy Testing

Compliance Testing that May Result in Minimum Required Contributions



This document provides general information about Top Heavy Testing and the implications to employers when a plan is top heavy. Contribution requirements may differ slightly if the Employer sponsors more than one retirement plan.

## Why is this Test Required?

Laws authorizing retirement plans were enacted by Congress as a system for helping workers save for retirement. Special tax incentives encourage Employers to promote savings by making plan contributions. Top Heavy testing is required to make sure non-owners and non-officers also receive a benefit under the plan.

## How is the Test Calculated?

A plan is top heavy when more than 60% of the plan accounts (or benefits promised) are held for Key Employees as of the Determination Date.

**Key Employees** – Employees that own more than 5% of the Employer (including family members); Certain employees (officers, owners greater than 1%), will be considered key if their compensation exceeds the indexed limit for the year.

**Non-Key Employees** – Employees not meeting one of the conditions above.

**Determination Date** – Last day of the preceding plan year (Dec 31<sup>st</sup> if calendar year). For new plans use the last day of the first plan year.

**Balances to be used** – Actual cash balances are used for 401(k) and Profit Sharing Plans. Accrued balances are used for pension plans (Money Purchase, All types of Defined Benefit Plans).

Unrelated rollovers deposited to the plan are not included in this test. Catch-up contributions are also ignored in the year they are contributed.

## Safe Harbor Plan Exception

If a Safe Harbor plan has no employer contribution or reallocated forfeitures in addition to the safe harbor contribution, the top-heavy minimum is considered satisfied even if the 60% test fails.

*Employers who sponsor a Defined Benefit Plan in addition to the Safe Harbor Plan will not be able to use this exception due to the required employer contributions to the 401(k) Plan.*

## Implications of Being Top Heavy

When a plan is top heavy the Employer is generally required to fund a contribution of 3% of full year compensation to all non-Key employees. The minimum increases to 5% if the Employer also sponsors a type of Defined Benefit Plan.

The Employer is only required to fund a top heavy contribution equal to the highest percentage any Key Employee has received (i.e. 2%, for example). Therefore, the minimum required could be lower than the minimum stated above

Certain employer allocation conditions could be ignored if the Plan is considered top heavy.

The Employer should fund any required contribution by the Employer's tax return due date, including extensions.

## To Avoid Top Heavy Contribution

- Amend to Safe Harbor Plan in future year if no other employer contributions expected or required.
- Avoid Employee/Employer Contributions for Key Employees.

It may not be possible to avoid required top heavy minimums when the Employer sponsors more than one plan.

Please contact JULY at [888.333.5859](tel:888.333.5859) for more information.