StatonWalsh

Financial Clarity Through Transparency

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Top-Heavy Plans

While large qualified retirement plans are rarely top heavy, most small plans are. In fact, the smaller the plan, the more likely it is to be top heavy.

When Is a Qualified Retirement Plan Top Heavy?[1]

- If the total present value of the accrued benefits for key participants in a defined benefit plan exceeds 60% of the present value of all benefits in the plan, the plan is top heavy.
- If the total account values for key employees in a defined contribution plan exceed 60% of the total value of all accounts, the plan is top heavy.

Key Participants

Key participants are any participants and participants' beneficiaries who, during the determination year:[2]

- are or were an officer of the sponsoring employer and earning more than $215,000[3];
- owned more than 5%[4] of the employer; or
- owned more than 1%[4] of the employer and received more than $150,000 of compensation from the employer.

Special Requirements for Top-Heavy Plans

- Vesting must either provide that a participant is fully vested after three years of service[5] or the vesting schedule must provide for graded vesting over six years of service[5] (0-20-40-60-80-100). More rapid vesting is permitted.
- For defined contribution plans, the employer must contribute and allocate to non-key participants the lesser of 3%[6] of compensation or the highest contribution percent of

[1] If there are multiple plans, they are generally aggregated together for determination purposes. Money rolled out or transferred is generally added back to the distributing plan as a key or non-key account for a period of five years (reduced to one year in 2002) and ignored by the receiving plan. In the case of mergers, the opposite is true.

[2] In-service distributions are subject to a five-year look-back period.

[3] This value applies to 2023.

[4] The family attribution rules of IRC Sec. 318 apply. Any participant is deemed to have the same ownership share as his or her spouse, children, parents and grandparents. In community property states spousal attribution may apply.

[5] In some instances, participation may be substituted for service.

[6] This may be higher in some circumstances.

any key employee. Elective deferrals by a key employee under a 401(k) plan are considered to be an employer contribution.[1] The plan may require that a participant be employed at the end of the plan year; it may not require that the participant work a minimum number of hours.

- For defined benefit plans, the employer must contribute and provide for a minimum benefit accrual of 2%[2] of average compensation for a maximum of ten years of participation. The plan may not require that a participant be employed at the end of the plan year; it may require that the participant perform 1,000 (or less) hours of service during the plan year.
- If the employer maintains multiple plans, top-heavy minimum contributions requirements do not have to be satisfied in all plans; special rules apply.
- If a plan is in the process of termination, top-heavy requirements continue to apply. Typically, this will apply only to plans that are not otherwise “frozen” at the time the plan is terminated.
- However, if a defined benefit plan is “frozen”, the plan does not need to provide ongoing top-heavy benefit accruals.
- Depending on the plan document, the plan may or may not have to provide top-heavy contributions or benefits to key participants.
- Failure to provide the proper top-heavy benefit accruals or contributions will result in the plan being disqualified.
- If a plan has dual eligibility for different plan contributions, eligibility for any benefit makes a non-key employee eligible to receive a top-heavy benefit, if applicable.[3] Example: A 401(k) plan has no service requirement for employee deferrals but requires one year of service for employer discretionary allocations. A 3% or more deferral by a key employee participant will trigger a 3% top-heavy contribution for all participants including those eligible for employee deferrals only.

[1] Matching contributions are credited to meeting the top-heavy minimum contribution requirement.
[2] This percentage may be higher in some circumstances.
[3] Effective January 1, 2024, part-time employees working at least 500 hours per year for three years must be allowed to make 401(k) deferrals. If these employees are not otherwise eligible for the plan, they do not need to receive the top-heavy minimum benefit or be included in employer contributions.

Important Notice

This report is intended to serve as a basis for further discussion with your other professional advisors. Although great effort has been taken to provide accurate numbers and explanations, the information in this report should not be relied upon for preparing tax returns or making investment decisions.

Assumed rates of return are not in any way to be taken as guaranteed projections of actual returns from any recommended investment opportunity. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney.

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