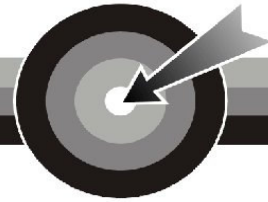


# The Pension Specialists, Ltd.

Retirement Plan Third Party Administrator



Summer, 2004

## Plan Trustee News

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Specialists, Ltd.

The Pension Specialists, Ltd.

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## Understanding "Top-Heavy" Plans

### What is a "top-heavy" plan?

A retirement plan is top-heavy for a plan year when, as of the last day of the preceding plan year, more than 60% of the plan assets are in the accounts of "key employees".

### Who is a "key employee"?

A key employee is:

- An owner of more than 5% of the plan sponsor, OR
- An owner of more than 1% of the plan sponsor with compensation of more than \$150,000 OR
- An officer of the plan sponsor with compensation over \$130,000 (as adjusted for inflation).

"Key employees" no longer need to be included in top-heavy calculation if they terminated or retired within the previous four years as required prior to 2002.

### Why is "top heavy" status important?

If your plan becomes top-heavy, a minimum employer contribution must be provided to all participants who are non-key employees. These contributions are also subject to a special top-heavy vesting schedule. The minimum contribution is the lesser of 3% of participant's gross compensation, or the highest deferral rate of any key employee. For example, if the highest salary deferral by any key employee is 2% of compensation, the plan sponsor would have to contribute 2% to non-key

employees as their top-heavy contribution.

### Vesting of "top-heavy" contributions

The top-heavy contributions may have a different vesting schedule from other company contributions. These contributions must vest according to one of the following schedules, or more rapidly: 1) 100% after 3 years of participation or, 2) 100% over 6 years, where participant is 20% vested after 2 years and 20% per year thereafter.

### New "Top-Heavy" Exemption

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) added IRC section 416(g)(4)(H) which exempts top-heavy regulations from certain safe harbor plans. This exemption applies if, in any year that the plan is considered "top-heavy", the contributions made to the plan in that year are exclusively:

- 401(k) contributions and
- Matching contributions on the 401(k) contributions.

Revenue Ruling 2004-13 recently gave guidance on this exemption. Four examples help clarify how this top-heavy exemption applies to 401(k) plans. The plan, in all examples, has safe harbor matching contributions, and allows for discretionary employer non-elective contributions subject to 5-year vesting, and covers all employees who are age 21 and have 1 year of service

- Example 1: Employer does not make a discretionary profit sharing contribution and the plan does not allocate any forfeitures. The top-heavy exemption applies.

- Example 2: Employer makes a discretionary profit sharing contribution for the plan. Plan is not eligible for the top-heavy exemption.
- Example 3: Plan does not make contributions, but has forfeitures which are allocated and they are allocated in the same method as profit sharing contributions. Plan is not eligible for the top-heavy exemption.

- Example 4: Plan allows immediate eligibility to make elective contributions, but 1 year eligibility for matching contributions. Plan is not eligible for the top-heavy exemption.

Your plan's top-heavy test is included each year in your annual administrative reports. Plan sponsors should carefully review their top-heavy status each year so that they can plan for top-heavy

contributions if necessary. If you have any questions about your plan's top-heavy status or this exemption, please contact us by calling 815.394.5500 or 800.963.5501. You may also reach us by email at [info@pensioninsider.com](mailto:info@pensioninsider.com).



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## About The Pension Specialists, Ltd.

The Pension Specialists, Ltd. is an independent retirement plan administrator. Our mission is to provide the highest quality services to assist clients in reaching their objectives.

Formed in 1987, we have grown to service over 800 employer retirement plans, with services covering over 25,000 plan participants with over \$350 million of retirement plan assets. We consult with clients to implement plans.

We proactively service our clients to maintain interactive communication, maximize benefits and solve problems. Our in-house staff performs all plan administration.

The Pension Specialists, Ltd. provides services to many well known companies, which include Broker Dealers, Investment Firms, CPA Firms, Law Firms, Medical Groups, Hospitals, Engineers and Retail Businesses.

For more information about The Pension Specialists, Ltd., contact us at 815.394.5500 or 800.963-5501 or by email at [info@pensioninsider.com](mailto:info@pensioninsider.com).

