Part I

Section 416.– Special Rules for Top-Heavy Plans

Rev. Rul. 2004-13

ISSUE

In the situations described below, which plans meet the requirements of § 416(g)(4)(H) of the Internal Revenue Code for the 2004 plan year so that they are not subject to the top-heavy rules in § 416?

FACTS

Situation 1. A nongovernmental profit-sharing plan containing a cash or deferred arrangement ("CODA") described in § 401(k) provides for safe harbor matching contributions that are intended to satisfy the requirements of § 401(k)(12)(B) and otherwise satisfies the requirements of § 401(k)(12). The plan also permits the employer to make a nonelective contribution for any plan year at the employer's discretion. The nonelective contribution is subject to 5-year vesting described in § 411(a)(2)(A) and is allocated to participants' accounts in the same ratio that each participant's compensation bears to the compensation of all participants. The plan is a calendar-year plan and covers all employees of the employer (including highly compensated employees as defined in § 414(q)) who have 1 year of service and are age 21 or older. Other than elective contributions and the matching contributions, no other contributions are made to the plan for 2004 and there are no forfeitures.

Situation 2. The facts are the same as in Situation 1, except the employer makes a discretionary nonelective contribution to the plan for 2004.

Situation 3. The facts are the same as in Situation 1, except forfeitures occur in 2004 due to the severance from employment of a participant who was not fully vested in amounts attributable to discretionary nonelective contributions made in a prior year. Pursuant to the terms of the plan, forfeitures are allocated to participants' accounts for 2004 in the same manner as nonelective contributions.

Situation 4. The facts are the same as in Situation 1, except employees are permitted to make elective contributions immediately upon commencement of employment but are not eligible for matching contributions until they have completed 1 year of service with the employer.

LAW AND ANALYSIS

Under § 416, a plan that is a top-heavy plan (as defined in § 416(g)) for a plan year

must satisfy the vesting requirements of § 416(b) and the minimum benefit requirements of § 416(c) for such plan year. Section 416 does not apply to any governmental plan.

Section 416(g)(4)(H) provides that the term "top-heavy plan" does not include a plan that consists solely of (1) a CODA that meets the requirements of § 401(k)(12) and (2) matching contributions that meet the requirements of § 401(m)(11). Section 416(g)(4)(H), which is effective for years beginning after December 31, 2001, was added to the Code by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16.

The determination of whether a plan is a top-heavy plan is made on a year-by-year basis. Thus, a plan that satisfies § 416(g)(4)(H) for one plan year may be subject to the top-heavy requirements the next plan year if it does not satisfy § 416(g)(4)(H) for the next plan year.

Section 401(k)(12) and § 401(m)(11) provide design-based safe harbor methods for satisfying the actual deferral percentage ("ADP") nondiscrimination test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage ("ACP") nondiscrimination test contained in § 401(m)(2). Section 401(k)(12) provides that a CODA is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements. To satisfy the ADP test safe harbor contribution requirement, an employer must make either (1) a nonelective contribution equal to at least 3 percent of each eligible nonhighly compensated employee's compensation ("safe harbor nonelective contribution") or (2) a matching contribution that satisfies certain minimum amount and rate conditions ("safe harbor matching contribution"). Matching contributions do not satisfy § 401(k)(12) or § 401(m)(11) if the rate of matching contributions for a highly compensated employee at any rate of elective contributions is greater than that for a nonhighly compensated employee who is eligible to make elective contributions. Also, a plan does not meet the requirements of § 401(k)(12) if, under the terms of the plan, a nonhighly compensated employee is eligible to make elective contributions but is not eligible to receive either a safe harbor nonelective contribution or a safe harbor matching contribution. Safe harbor nonelective contributions and safe harbor matching contributions must be nonforfeitable when contributed to the plan and subject to withdrawal restrictions.

Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test for matching contributions if the plan meets the requirements of § 401(k)(12) and in addition meets certain limitations on the amount and rate of matching contributions available under the plan.

In Situation 1, although the plan provides for discretionary nonelective contributions, none are made for 2004 and thus only contributions described in § 401(k)(12) or § 401(m)(11) are made to the plan for that year.

In Situation 2, the employer makes a discretionary nonelective contribution for 2004, a type of contribution that is not described in § 401(k)(12) or § 401(m)(11).

In Situation 3, the allocation of forfeitures to participants' accounts does not satisfy

the requirements for safe harbor nonelective contributions under § 401(k)(12).

In Situation 4, under the plan, newly hired nonhighly compensated employees who make elective contributions will not be eligible to receive any matching contributions until they have completed 1 year of service. Since this will result in a greater rate of matching contributions for highly compensated employees than for nonhighly compensated employees, the matching contributions do not satisfy the requirements of § 401(k)(12) (or § 401(m)(11)). Further, since all eligible nonhighly compensated employees under the plan do not receive safe harbor nonelective contributions or safe harbor matching contributions, the matching contributions made under the plan do not satisfy the requirements of § 401(k)(12). However, certain plans that provide for early participation may satisfy the requirements of § 401(k)(12) with respect to the portion of the plan that covers employees who have completed the minimum age and service requirements of § 410(a)(1), while satisfying the ADP test of § 401(k)(3)(A)(ii) for the eligible employees who have not completed the minimum age and service requirements. Unless a plan (within the meaning of § 414(l)) meets the requirements of § 416(g)(4)(H), no portion of the plan will satisfy § 416(g)(4)(H). (See Notice 2000-3, 2000-1 C.B. 413, Q&A-10.)

HOLDINGS

In Situation 1, the plan meets the requirements of § 416(g)(4)(H) and is therefore not subject to the top-heavy rules in § 416 for 2004 because no other contributions are made to the plans other than contributions described in § 401(k)(12) or § 401(m)(11). The plans in Situation 2, Situation 3 and Situation 4 do not meet the requirements of § 416(g)(4)(H) and are therefore subject to the top-heavy rules in § 416 for 2004.

DRAFTING INFORMATION

The principal author of this revenue ruling is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday. Mr. Kuehnle may be reached at 1-202-283-9888 (not a toll-free number).