be illustrated by the following example:

Example. An employer maintains Plan A and Plan B, each containing a key employee. Plan A's plan year commences July 1 and ends June 30. Plan B's plan year is the calendar year. For Plan A's plan year commencing July 1, 1984, the determination date is June 30, 1984. For Plan B's plan year in 1985, the determination date is December 31, 1984. These plans are required to be aggregated. For each of these plans as of their respective determination dates, the present value of the accrued benefits for key employees and all employees are separately determined. The two determination dates, June 30, 1984, and December 31, 1984, fall within the same calendar year. Accordingly, the present values of accrued benefits as of each of these determination dates are combined for purposes of determining whether the group is top-heavy. If, after combining the two present values, the total results show that the group is top-heavy, Plan A will be top-heavy for the plan year commencing July 1, 1984, and Plan B will be top-heavy for the 1985 calendar year.

T–24 Q. How is the present value of an accrued benefit determined in a defined contribution plan?

A. The present value of accrued benefits as of the determination date for any individual is the sum of (a) the account balance as of the most recent valuation date occurring within a 12-month period ending on the determination date, and (b) an adjustment for contributions due as of the determination date. In the case of a plan not subject to the minimum funding requirements of section 412, the adjustment in (b) is generally the amount of any contributions actually made after the valuation date but on or before the determination date. However, in the first plan year of the plan, the adjustment in (b) should also reflect the amount of any contributions made after the determination date that are allocated as of a date in that first plan year. In the case of a plan that is subject to the minimum funding requirements, the account balance in (a) should include contributions that would be allocated as of a date not later than the determination date, even though those amounts are not yet required to be contributed. Thus, the account balance will include contributions waived in prior years as reflected in the adjusted account balance and contributions not paid that resulted in a funding deficiency. The adjusted account balance is described in Rev. Rul. 78–223, 1978–1 C.B. 125. Also, the adjustment in (b) should reflect the amount of any contribution actually made (or due to be made) after the valuation date but before the expiration of the extended payment period in section 412(c)(10).

T–25. Q. How is the present value of an accrued benefit determined in a defined benefit plan?

A. The present value of an accrued benefit as of a determination date must be determined as of the most recent valuation date which is within a 12-month period ending on the determination date. In the first plan year of a plan, the accrued benefit for a current employee must be determined either (i) as if the individual terminated service as of the determination date or (ii) as if the individual terminated service as of the valuation date, but taking into account the estimated accrued benefit as of the determination date. For the second plan year of a plan, the accrued benefit taken into account for a current participant must not be less than the accrued benefit taken into account for the first plan year unless the difference is attributable to using an estimate of the accrued benefit as of the determination date for the first plan year and using the actual accrued benefit as of the determination date for the second plan year. For any other plan year, the accrued benefit for a current employee must be determined as if the individual terminated service as of such valuation date. For this purpose, the valuation date must be the same valuation date for computing plan costs for minimum funding, regardless of whether a valuation is performed that year.

T–26. Q. What actuarial assumptions are used for determining the present value of accrued benefits for defined benefit plans?

A. (a) There are no specific prescribed actuarial assumptions that must be used for determining the present value of accrued benefits. The assumptions used must be reasonable and need not relate to the actual plan and investment experience. The assumptions need not be the same as those used for

minimum funding purposes or for purposes of determining the actuarial equivalence of optional benefits under the plan. The accrued benefit for each current employee is computed as if the employee voluntarily terminated service as of the valuation date. The present value must be computed using an interest and a post-retirement mortality assumption. Pre-retirement mortality and future increases in cost of living (but not in the maximum dollar amount permitted by section 415) may also be assumed. However, assumptions as to future withdrawals or future salary increases may not be used. In the case of a plan providing a qualified joint and survivor annuity within the meaning of section 401(a)(11) as a normal form of benefit, for purposes of determining the present value of the accrued benefit, the spouse of the participant may be assumed to be the same age as the participant.

(b) Except in the case where the plan provides for a nonproportional subsidy, the present value should reflect a benefit payable commencing at normal retirement age (or attained age, if later). Thus, benefits not relating to retirement benefits, such as pre-retirement death and disability benefits and post-retirement medical benefits, must not be taken into account. Further, subsidized early retirement benefits and subsidized benefit options must not be taken into account unless they are nonproportional subsidies. See Question and Answer

T–27.

(c) Where the plan provides for a nonproportional subsidy, the benefit should be assumed to commence at the age at which the benefit is most valuable. In the case of two or more defined benefit plans which are being tested for determining whether an aggregation group is top-heavy, the actuarial assumptions used for all plans within the group must be the same. Any assumptions which reflect a reasonable mortality experience and an interest rate not less than five percent or greater than six percent will be considered as reasonable. Plans, however, are not required to use an interest rate in this range.

T–27 Q. In determining the present value of accrued benefits in a defined benefit plan, what standards are applied toward determining whether a subsidy is nonproportional?

A. A subsidy is nonproportional unless the subsidy applies to a group of employees that would independently satisfy the requirements of section 410(b). If two or more plans are considered as a unit for comparability purposes under §1.410(b)–1(d)(3), subsidies may be necessary in both plans or else the subsidy may be nonproportional. Thus, for example, in the case of a plan which provides an early retirement benefit after age 55 and 20 years of service equal to the normal retirement benefit without actuarial reduction and if the employees who may conceivably reach age 55 with 20 years of service would, as a group, satisfy the requirements of section 410(b), that subidy is proportional. However, in contrast, consider a plan that provides an early retirement benefit that is the actuarial equivalent of the normal retirement benefit. In determining the early retirement benefit, the plan imposes the section 415 limits only on the early retirement benefit (not on the normal retirement benefit before applying the early retirement reduction factors). In such a plan, a participant with a normal retirement benefit (before limitation by section 415) in excess of the section 415 limits will receive a subsidized early retirement benefit, whereas a participant with a lower normal retirement benefit will not. Thus, such a benefit would be a nonproportional subsidy if the group of individuals who are limited by the limitations under section 415 do not, by themselves, constitute a cross section of employees that could satisfy section 410(b).

T–28 Q. For purposes of determining the present value of accrued benefits in either a defined benefit or defined contribution plan, are the accrued benefits attributable to employee contributions considered to be part of the accrued benefits?

A. The accrued benefits attributable to employee contributions are considered to be part of the accrued benefits without regard to whether such contributions are mandatory or voluntary. However, the amounts attributable to deductible employee contributions (as

defined in section 72(o)(5)(A)) are not considered to be part of the accrued benefits.

T–29 Q. How are plans described in section 401(k) treated for purposes of the top-heavy rules?

A. No special top-heavy rules are provided for plans described in section 401(k), except a transitional rule. For plan years beginning after December 31, 1984, amounts which an employee elects to defer are treated as employer contributions for purposes of determining minimum required contributions under section 416(c)(2). However, for plan years beginning prior to January 1, 1985, amounts which an employee elects to have contributed to a plan described in section 401(k) are not treated as employer contributions for these purposes. A plan described in section 401(k) which is top-heavy must provide minimum contributions by the employer and limit the amount of compensation which can be taken into account in providing benefits under the plan.

T–30 Q. What distributions are added to the present value of accrued benefits in determining whether a plan is top-heavy for a particular plan year?

A. Under section 416(g)(3)(A), distributions made within the plan year that includes the determination date and within the four preceding plan years are added to the present value of accrued benefits of key employees and non-key employees in testing for top-heaviness. However, in the case of distributions made after the valuation date and prior to the determination date, such distributions are not included as distributions in section 416(g)(3)(A) to the extent that such distributions are included in the present value of the accrued benefits as of the valuation date. In the case of the distribution of an annuity contract, the amount of such distribution is deemed to be the current actuarial value of the contract, determined on the date of the distribution. Certain distributions that are rolled over by the employee are not included as distributions. See Question and Answer T–32. A distribution will not fail to be considered in determining the present value of accrued benefits merely because it was made before the effective date of section 416. For purposes of this question and answer, distributions mean all distributions made by a plan, including all distributions of employee contributions made during and before the plan year.

T–31 Q. Are benefits paid on account of death treated as distributions for purposes of section 416(g)(3)?

A. Benefits paid on account of death are treated as distributions for purposes of section 416(g)(3) to the extent such benefits do not exceed the present value of accrued benefits existing immediately prior to death; benefits paid on account of death are not treated as distributions for purposes of section 416(g)(3) to the extent such benefits exceed the present value of accrued benefits existing immediately prior to death. The distribution from a defined contribution plan (including the cash value of life insurance policies) of a participant's account balance on account of death will be treated as a distribution for purposes of section 416(g)(3).

T–32 Q. How are rollovers and plan-to-plan transfers treated in testing whether a plan is top-heavy?

A. The rules for handling rollovers and transfers depend upon whether they are unrelated (both initiated by the employee and made from a plan maintained by one employer to a plan maintained by another employer) or related (a rollover or transfer either not initiated by the employee or made to a plan maintained by the same employer). Generally, a rollover or transfer made incident to a merger or consolidation of two or more plans or the division of a single plan into two or more plans will not be treated as being initiated by the employee. The fact that the employer initiated the distribution does not mean that the rollover was not initiated by the employee. For purposes of determining whether two employers are to be treated as the same employer, all employers aggregated under section 414(b), (c) or (m) are treated as the same employer. In the case of unrelated rollovers and transfers, (1) the plan making the distribution or transfer is to count the distribution as a distribution under section 416(g)(3), and (2) the plan accepting the rollover or transfer is not to consider the rollover or transfer as

part of the accrued benefit if such rollover or transfer was accepted after December 31, 1983, but is to consider it as part of the accrued benefit if such rollover or transfer was accepted prior to January 1, 1984. In the case of related rollovers and transfers, the plan making the distribution or transfer is not to count the distribution or transfer under section 416(g)(3) and the plan accepting the rollover or transfer counts the rollover or transfer in the present value of the accrued benefits. Rules for related rollovers and transfers do not depend on whether the rollover or transfer was accepted prior to January 1, 1984.

T–33 Q. How are the aggregate defined benefit and defined contribution limits under section 415(e) affected by the top-heavy rules?

A. Section 416(h) modifies the aggregate limits in section 415(e) for super top-heavy plans and for top-heavy plans that are not super top-heavy but do not provide for an additional minimum contribution or benefit. A plan is a super top-heavy plan if the present value of accrued benefits for key employees exceeds 90% of the present value of the accrued benefits for all employees. In the case of a top-heavy aggregation group, the test is applied to all plans in the group as a whole. These present values are computed using the same rules as are used for determining whether the plan is top-heavy. In the case of a super top-heavy plan, in computing the denominators of the defined benefit and defined contribution fractions under section 415(e), a factor of 1.0 is used instead of 1.25 for all employees. In the case of a top-heavy plan that is not super top-heavy, the same rule applies unless each non-key employee who is entitled to a minimum contribution or benefit receives an additional minimum contribution or benefit. In the case of a defined benefit plan, the additional minimum benefit is one percentage point (up to a maximum of ten percentage points) for each year of service described in Question and Answer M–2 of the participant's average compensation for the years described in Question and Answer M–2. In the case of a defined contribution plan, the additional minimum contribution is one percent of the participant's compensation. If a plan does not provide the applicable additional one percent minimum or if a plan is super top-heavy, the factor of 1.25 may be used for an individual only if there are both no further accruals for that individual under any defined benefit plan and no further annual additions for that individual under any defined contribution plan until the combined fraction satisfies the rules of section 415(e) using the 1.0 factor for that individual. The rules contained in this Question and Answer apply for each limitation year that contains any portion of a plan year for which the plan is top-heavy. This Question and Answer may be illustrated by the following example:

Example. A Corporation maintains a profit-sharing plan and a defined benefit plan, and these plans constitute a required aggregation group. Both plans use the calendar year for the plan year and the limitation year under section 415. The plans were determined to be top-heavy for plan year 1986. The plans use the 1.25 factor under section 415(e), and non-key employees covered by both the profit-sharing and the defined benefit plan accrue, under the defined benefit plan, 3% of compensation for each year of service (up to a maximum of 30%). The plans become super top-heavy for the 1990 plan year. In order to satisfy section 415, no further accruals and no further annual additions may take place for any employee covered by both plans until the combined defined benefit-defined contribution fraction for such employee is less than 1.0, using the 1.0 factor in place of 1.25.

T–34 Q. May plans be permissively aggregated to avoid being super top-heavy?

A. Yes, plans may be permissively aggregated to avoid being super top-heavy.

T–35 Q. What provisions must be contained in a plan to comply with the top-heavy requirements?

A. Section 401(a)(10)(B) provides that a plan will qualify only if it contains provisions which will take effect if the plan becomes top-heavy and which meet the requirements of section 416. See Questions and Answers T–39 and T–40 for rules on what provisions must be included. Under section 401(a)(10)(B)(ii), regulations may waive this requirement for some plans. See Question and Answer T–38 for a description of plans that need not include such provisions.

T–36 Q. For an employer who has no employee who has participated or is eligible to participate in both a defined benefit and defined contribution plan (or a simplified employee pension, ''SEP'') of that employer, what provisions must be in the plan(s) to comply with the top-heavy requirements?

A. (a) If the defined benefit plan has no participants who are or could be participants in a defined contribution plan of the employer (or vice versa), the defined benefit plan (or defined contribution plan) need not include provisions describing the defined benefit or defined contribution fractions for purposes of section 415 and, thus, the plan need not contain provisions to determine whether the plan is super top-heavy or to change any plan provisions if the plan becomes super top-heavy. Furthermore, if the plan contains a single benefit structure that satisfies the requirements of section 416 (b), (c), and (d) for each plan year without regard to whether the plan is top-heavy for such year, the plan need not include separate provisions to determine whether the plan is top-heavy or that apply if the plan is top-heavy. If the plan's single benefit structure does not assure that section 416 (b), (c), and (d) will be satisfied in all cases, then the plan must include three types of provisions.

(b) First, the plan must contain provisions describing how to determine whether the plan is top-heavy. These provisions must include (1) the criteria for determining which employees are key employees (or non-key employees), (2) in the case of a defined benefit plan, the actuarial assumptions and benefits considered to determine the present value of accrued benefits, (3) a description of how the top-heavy ratio is computed, (4) a description of what plans (or types of plans) will be aggregated in testing whether the plan is top-heavy, and (5) a definition of the determination date and the valuation date applicable to the determination date. These determinations must be based on standards that are uniformly and consistently applied and that satisfy the rules set forth in section 416 and these Questions and Answers. The provisions in (1) and (3) above may be incorporated in the plan by reference to the applicable sections of the Internal Revenue Code without adversely affecting the qualification of the plan. However, the plan must state the definition of compensation for purposes of determining who is a key employee.

(c) Second, the plan must specifically contain the following provisions that will become effective if the plan becomes top-heavy: vesting that satisfies the minimum vesting requirements of section 416(b), benefits that will not be less than the minimum benefits set forth in section 416(c), and the compensation limitation described in section 416(d). The compensation limitation described in section 416(d) may be incorporated by reference. If a plan always meets the requirements of either section 416(b), (c) or (d), the plan need not include additional provisions to meet any such requirements.

(d) Third, the plan must include provisions insuring that any change in the plan's benefit structure (including vesting schedules) resulting from a change in the plan's top-heavy status will not violate section 411(a)(10). Thus, if a plan ceases being top-heavy, certain restrictions apply with respect to the change in the applicable vesting schedule.

T–37 Q. For an employer who maintains or has maintained both a defined benefit and a defined contribution plan (or a simplified employee pension, ''SEP'') and some participants do or could participate in both types of plan, what provisions must be in the plans to comply with the top-heavy requirements?

A. If an employer maintains (or has maintained) both a defined benefit plan and a defined contribution plan (or SEP), and the plans have or could have participants who participate in both types of plans, then the plans must contain more provisions than those described in Question and Answer T-36. First, the plans may exclude rules to determine whether the plan is top-heavy (or to apply when the plan is top-heavy) only if both plans contain a single benefit structure that satisfies sections 416 (b), (c), and (d) without regard to whether the plans are top-heavy. Second, unless the plans always satisfy the requirements of section 415(e) using the 1.0 factor in the defined

benefit and defined contribution fractions as described in section 416(h)(i), the plans must include provisions similar to those in Question and Answer T–36 (for top-heavy) to determine whether the plan is super top-heavy and to satisfy section 416(h) if it is.

T–38 Q. Are any plans exempted from including top-heavy provisions?

A. Section 401(a)(10)(B) exempts governmental plans (as defined in section 414(d)) from the top-heavy requirements and provides that regulations may exempt certain plans from including the top-heavy provisions. A plan need not include any top-heavy provisions if the plan: (1) is not top-heavy, and (2) covers only employees who are included in a unit of employees covered by a collective-bargaining agreement (if retirement benefits were the subject of good faith bargaining) or employees of employee representatives. The requirement set forth in section 7701(a)(46) must be met before an agreement will be considered a collective-bargaining agreement after March 31, 1984.

T–39 Q. Must ratios be computed each year to determine whether a plan is top-heavy?

A. No. In order to administer the plan, the plan administrator must know whether the plan is top-heavy. However, precise top-heavy ratios need not be computed every year. If, on examination, the Internal Revenue Service requests a demonstration as to whether the plan is top-heavy (or super top-heavy; see Question and Answer T–33) the employer must demonstrate to the Service's satisfaction that the plan is not operating in violation of section 401(a)(10)(B). For purposes of any demonstration, the employer may use computations that are not precisely in accordance with this section but which mathematically prove that the plan is not top-heavy. For example, if the employer determined the present value of accrued benefits for key employees in a simplified manner which overstated that value, determined the present value for non-key employees in a simplified manner which understated that value, and the ratio of the key employee present value divided by the sum of the present values was less than 60 percent, the plan would not be considered top-heavy. This would be a sufficient demonstration because the simplified fraction could be shown to be greater than the exact fraction and, thus, the exact fraction must also be less than 60 percent.

Several methods that may be used to simplify the determinations are indicated below.

(1) If the top-heavy ratio, computed considering all the key employees and only some of the non-key employees, is less than 60 percent, then it is not necessary to accumulate employee data on the remaining non-key employees. Inclusion of additional non-key employees would only further decrease the ratio.

(2) If the number of key employees is known but the identity of the key employees is not known (i.e. if the only key employees are officers and the limit on officers is applicable), the numerator may be determined by using a hypothetical ''worst case'' basis. Thus, in the case of a defined benefit plan, if the numerator of the top-heavy ratio were determined assuming each key employee's present value of accrued benefits were equal to the maximum section 415 benefits at the age that would maximize such present value, that assumption would only overstate the present value of accrued benefits for key employees. Thus, if that ratio is less than 60 percent, the plan is not top-heavy and accurate data on the key employees need not be collected.

(3) If the employer has available present value of accrued benefit computations for key and non-key employees in a defined benefit plan, and these values differ from those that would be produced under Question and Answer T–25 only by inclusion of a withdrawal assumption, the present value for the key employees (but not the non-key employees) may be adjusted to a ''worst case'' value by dividing by the lowest possible probability of not withdrawing from plan participation before normal retirement age. If the top-heavy ratio based on this inflated key employee value is less than 60 percent, the present value need not be recomputed without the withdrawal assumption. The methods set forth in this answer may also be used to determine whether a plan is super top-heavy by