

IMPORTANT RETIREMENT PLAN DEFINITIONS

HIGHLY COMPENSATED EMPLOYEE (HCE): An HCE is an employee who: (a) owns more than 5% of the employer, or (b) earned more than \$120,000 from the employer during the preceding plan fiscal year. Parents, spouses, and children of more than 5% owners are also treated as HCEs by family attribution rules in all cases.

INCLUDIBLE COMPENSATION: Under any type of qualified retirement plan, the maximum includible compensation which may be taken into account is \$280,000 per year.

KEY EMPLOYEE: A key employee is an employee who: (a) owns more than 5% of the employer, or (b) owns more than 1% of the employer and earns more than \$150,000 per year or (c) is an officer of the employer and earns more than \$180,000 per year. The number of officers treated as key employees is limited to a number which is 10% of all employees (but no more than 50 officers or less than 3 officers). Parents, spouses, and children of key employees with ownership interests in the employer are also treated as key employees by family attribution rules in most cases.

REGULAR NONDISCRIMINATION TESTS: *PLAN COVERAGE TEST:* After application of certain minimum age and service rules, the percentage of NHCEs eligible for plan coverage must be at least 70% of the percentage of HCEs eligible for plan coverage. *EMPLOYEE 401(k) SALARY DEFERRAL TEST:* The average employee 401(k) salary deferral (as a % of pay) by HCEs for a year cannot exceed the average employee 401(k) salary deferral by NHCEs for the year by 2% or 2 times, if less. *EMPLOYER MATCHING CONTRIBUTION TEST:* The average employer matching contribution (as a % of pay) for HCEs for a year cannot exceed the average employer matching contribution for NHCEs for the year by 2% or 2 times, if less. *EMPLOYER DISCRETIONARY CONTRIBUTION TEST:* The employer discretionary contribution test is satisfied if the employer contribution for each HCE and NHCE is the same uniform percentage of pay (called the “prorata” method) OR if the employer contribution for each HCE and NHCE is X% of includible compensation plus X% (or 5.7%, if less) of the portion of includible compensation above the social security wage base (called the “permitted disparity” method).

SPECIAL NONDISCRIMINATION TEST: An alternative employer discretionary contribution test (referred to as “Cross Testing”) may be used to demonstrate that employer contributions do not discriminate in favor of HCEs by converting employer contributions to benefits and then testing such converted benefits under nondiscrimination rules applicable to employer-provided benefits. Cross testing may be used when an employer wants to have different levels or amounts of contributions for different groups of participants. For example, an employer may want to contribute more for its owners, partners, or shareholders (i.e., the HCE group) than for its other employees (i.e., the NHCE group). Cross testing often produces a substantial contribution bias in favor of the HCE group because these individuals are usually in the upper half of the age profile for the employer’s entire workforce. In other words, because the HCE group will have smaller converted benefits at age 65 than the converted benefits for the NHCE group, current contributions for the HCE group can be much larger than current contributions for the NHCE group to “even things out” under the nondiscrimination rules.

TOP HEAVY PLAN: If key employees have more than 60% of total accumulated plan assets (excluding rollover account balances) as of the last day of a plan fiscal year, a plan is treated as a top heavy plan for the following plan fiscal year. Distributions during the preceding plan fiscal year are also taken into account. Under a top heavy plan, the employer contribution (including any employer matching contribution) for each non-key employee must be at least 3% of pay or, if less, the highest rate of employer contribution for any key employee. **A key employee’s own voluntary 401(k) salary deferral contribution is treated as an employer contribution in the determination of the amount of top heavy minimum contribution for each non-key employee.**