

INFORMATION NEEDED FOR 55% AVERAGE BENEFITS TEST FOR DEPENDENT DAYCARE

The 55% test is a utilization test. Under this plan, the average dependent daycare pre-tax benefits provided to the non-highly compensated employees must be **at least** 55% of the average pre-tax benefits provided to the highly compensated employees (HCE). The test will fail if HCEs utilize the dependent daycare plan more than the non-highly compensated employees.

The HCEs' contributions can be reduced to prevent discrimination violations. The HCEs would have to include in gross income any amounts received as dependent care assistance if the plan is found to be discriminatory.

Who is a "**Highly Compensated Employee**" as defined in Code § 414(q)?

- An officer whose principal duties include supervising other employees' work at any time during the current or preceding year
- A shareholder owning more than 5% of the voting power or the total employer stock class value at any time during the current or preceding year, applying the attribution rules of Code § 318 (in general, these rules count any stock ownership of the employee's spouse, parents, children, and grandchildren when determining the employee's ownership percentage)
- A highly compensated employee based on compensation level, defined by Code § 414(q) for the preceding plan year, who had compensation of \$160,000 or more for 2025, and, if elected by the employer, also in the top 20% of employees based on compensation.

Employees that can be excluded from the HCE group:

- Employees who have not completed six months of service
- Employees who usually work less than 17.5 hours per week
- Employees who typically do not work more than six months during any year
- Employees under age 21
- Employees who are covered under a collective bargaining agreement (if a collective bargaining agreement covers at least 90% of all employees)

Employees whose annual compensation is less than \$25,000 may be disregarded if the pre-tax benefit is funded through a salary reduction agreement. However, if employees earning less than \$25,000 also participate in the dependent daycare, including them in this test increases the chances of passing it.

If the dependent care plan is determined to be discriminatory under the 55% average benefits test, dependent care pre-tax benefits provided to highly compensated participants become taxable.

2025
IRC SECTION 129 DEPENDENT CARE
55% AVERAGE BENEFITS TEST

STEP 1

Dependent care benefits elected by HCEs \$ _____ (A)

Number of HCEs (including those who do
not participate) _____ (B)

Average dependent care benefits - highly compensated employees (A/B) \$ _____ (C)

STEP 2

Dependent care benefits elected by non-highly compensated employees \$ _____ (D)

Number of non-highly compensated employees (including those who do
not participate) _____ (E)

Average dependent care benefits - non-highly compensated employees
\$ _____ (F)

STEP 3

Divide (F) by (C)

Average Benefits Percentage _____ %

If the Average Benefits Percentage is less than 55%, the plan fails, and all amounts of salary reduced by HCEs as dependent care are taxable and must be included in gross income.

Date

Signature