

## 20% Top Paid Group HCE Determination

**Employers may determine who a highly compensated employee (HCE) is by using the 20% Top Paid Group Rules. Using this HCE determination method may help an Employer to pass their Non-Discrimination Assessment by reducing the number of individuals in the highly compensated group.**

When Employers choose to apply the 20% Top Paid Group Rules, the HCE determination must be applied consistently with respect to all plan years beginning in the same calendar year for all benefit plan Non-Discrimination Assessments and testing (retirement and non-retirement plans).

If your plan document includes a specific HCE definition, the Plan must be amended to show the HCE 20% Top Paid Group Rules have been elected.

The TASC plan document is silent on the HCE definition thus an amendment to the TASC cafeteria plan document is not required when changing the HCE determination method. Be sure to review all of your benefit plan documents, such as a 401(k) plan, to determine if an amendment is required for those plan documents.

Following, is a three-step process describing how to determine your HCEs using the 20% Top Paid Group Rules. Please note, once the active employee list is determined, there are two more separate processes (Steps 2 and 3) with different exclusions allowed for each.

Step 1 determines the beginning pool of employees to use for Steps 2 and 3. In Step 2, the number of employees to include in your top paid group is determined. Step 3 determines the list of employees that received the most compensation for the year and which employees to include in the top paid group.

All three steps use data from the look-back year, also called the determination year. The look-back year is generally the prior calendar year. However, if your Plan is an off-calendar plan year, refer to the Non-Discrimination Assessment Instructions for the applicable determination year for your Plan.

### **Step 1. Determine which employees must be included.**

- A. Make a list of the employees from your look-back year.
  1. Include all employees, even if they were not eligible for the plan.

### **POINTS TO REMEMBER**

- ❖ The 20% Top Paid Group Rules may be applied as an option for determining who is a highly compensated employee for the Non-Discrimination Assessment.
- ❖ The 20% Top Paid Group Rules must be applied consistently to all plan years beginning in the same calendar year for all benefit plans (retirement and non-retirement).
- ❖ More-than-5% owners are still reported as HCEs even if they do not fall within the top paid group.

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2. Remove the following employees from the list.
  - Non-resident aliens with no U.S. sourced income
  - Employees who performed no services during the year.
  - Former employees
- B. Enter the number of employees remaining on the list for your Step 1 result. This is the list of employees to start with for each step below.

Step 1 Result: \_\_\_\_\_

## **Step 2. Determine the number of employees for your top paid group (top 20%).**

- A. Remove the following employees from the list compiled in Step 1 (even those participating in the plan)\*:
  1. Employees who have not completed six months of service by the end of the year.
    - Includes an employee's service from prior year and look-back year.
  2. Employees who normally work less than 17.5 hours per week.
  3. Employees who normally work 6 months or less during any year.
    - Determination is made on customary experience in prior years.
    - An employee that works one day is deemed to have worked in that month.
  4. Employees who have not attained age 21 by the end of the year.
  5. Union employees (remove only if the following applies):
    - 90% of all employees are covered by a collective bargaining agreement and the union employees are excluded from participating in the Plan.

\*An Employer may choose to include these employees, however removing them is usually more beneficial.

- B. Remove all applicable exclusions and then multiply the remaining number of employees by 20%. Enter this number for your Step 2 Result.

Step 2 Result: \_\_\_\_\_

## **Step 3. Identify the employees who received the most compensation and the HCEs to report.**

- A. Go back to Step 1 and use the list of employees determined for the Step 1 Result. (The exclusions from Step 2 may not be used for this Step 3 determination.)
- B. Remove Union employees, only if the following is applicable:
  - 90% of all employees are covered by a collective bargaining agreement and the Union employees are excluded from participating in the Plan.
- C. Sort the remaining employees in order by compensation (highest to lowest).
- D. Starting at the top of the list (highest paid employee), count down the list of employees and stop when you get to the number shown in the Step 2 Result. This is your top paid group list.
  - If there are employees at the bottom of the top paid group list and the top of the remaining employees list at the same compensation level, an Employer may apply tie-breaking rules to determine which employees to include in the top paid group. The rules applied must be reasonable, non-discriminatory, uniformly and consistently applied.

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- E. Find the HCE defined compensation limit for your Plan's look-back year. (Refer to the Non-Discrimination Assessment instructions for details.)
- F. From your top paid group listing (Step 3D), remove all employee's with compensation less than your Plan's HCE defined compensation limit (Step 3E). These employees are not HCEs.
- G. Add all more-than-5% owners back to your top paid group list, if they had been removed by the Step 2 or Step 3 process. (Refer to the Non-Discrimination Assessment instructions for the definition of a more-than-5% owner.)

The list of employees remaining in the top paid group list, after Step 3G, are your HCEs to report on the Assessment.

### Example:

Employer X has 200 employees in the look-back year.  
2 employees are terminated.  
73 employees work less than 17.5 hours per week.  
5 employees earn more than \$120,000 annually.  
1 employee is a more-than-5% owner and earns \$60,000 annually.

Step 1            200 employees  
                  -   2 terminated employees  
                  198 employees

Step 2            198 employees  
                  -  73 employees working less than 17.5 hrs/week  
                  125 employees  
                  x  20%  
                  25 employees

Step 3            198 employees  
List the employees by compensation.  
Remove all employees except for the highest paid 25 employees.  
The HCE defined limit is \$120,000 for your look-back year.  
Remove all employees that make \$120,000 or less.  
Add back in the more-than-5% owner that earns \$60,000 annually.  
HCEs in your top paid group to report on the Assessment = 6 employees.