# Dependent Care FSA Changes FAQ

On March 11, 2021, President Biden signed the *American Rescue Plan Act (ARPA)*. This far-reaching legislation includes provisions related to Dependent Care FSAs. Below, we answer common questions about these changes and their effect on your (or your client's) plan.

### How does ARPA change the Dependent Care FSA election?

ARPA changes Dependent Care FSAs in an important, but temporary way. Employers are permitted (but not required) to increase the contribution ceiling to $10,500 (from the statutory $5,000) for calendar year 2021. The contribution limit increases from $2,500 to $5,250 for married couples filing taxes separately. Employers can set a maximum contribution below the temporary $10,500 limit. It should still be noted that both employee and employer contributions count towards the limit.

### What happens if my plan runs on a plan year different from January 1 through December 31?

Under this temporary adjustment for 2021, the most that can be contributed to a Dependent Care FSA contributed is up to $10,500. Contributions made for the plan year ending in 2021 and the plan year starting in 2021 will need to be prorated accordingly so that the amount of all contributions made during calendar year 2021 does not exceed the increased limit, if so adopted by the employer.

### What do I have to do if I want to make this change?

Benefit Strategies maintains an online form located **here**.

This form will allow you to update your plan with Benefit Strategies.

### Do I have to offer a special enrollment period for participants to increase their election?

The Internal Revenue Service and Department of Labor has not yet issued guidance on whether this higher election limit itself constitutes as a qualifying event that allows employees to make and election change mid-plan year, or if an employer must offer a special enrollment period. The Consolidated Appropriations Act of 2021 (CAA) provides an employer the ability to temporarily amend their plan to allow employees to make a mid-year prospective election changes during their plan year that ends in 2021. That option provided by the CAA allows for employees to make such changes without needing to have experienced a qualified event applicable for Dependent Care FSAs as defined under the Treasury regulations.

Employers that wish to provide for prospective mid-year changes for employees during their 2021 plan years regarding the increased limit should also amend their plans as provided under the CAA.

Benefit Strategies maintains a form to make such changes located **here**.

### What happens if I do not adopt the increased election limit?

Participants in your plan will not be able to elect more than $5,000.

### How does increasing the limit or offering a special enrollment period affect compliance?

Cafeteria Plan components (such as Dependent Care FSAs, Health FSAs, and Health Savings Account contributions) are subject to nondiscrimination rules. These rules ensure that the plan does not disproportionately benefit company officers and highly compensated employees.

We always recommend that plan sponsors (employers) conduct nondiscrimination testing early in the plan year to ensure that the plan is incompliance. If it is not, the plan sponsor can adjust the maximum election for employees determined to be highly compensated to bring the plan back into compliance.

If you allow a higher election or allow for prospective mid-year election changes, you should test the plan again to ensure that the changes do not cause the plan to fail.

Because Dependent Care FSA dependents must "double pay" at the beginning of each year (absorb the payroll deduction that reduces their take-home pay and pay their care provider) until their first elections are deposited into their accounts, many lower income employees who can't afford those double payments don't participate. A higher election limit increases those payroll deductions, which may disproportionately benefit highly compensated employees. In that case, a higher election amount is more likely to bring the program out of compliance.

### How do I test my plan?

Benefit Strategies provides this service. You provide us with information about each employee and we can run the tests. If a plan fails, we can offer recommendations on how to bring it into compliance.

### When do I test my plan?

You are required to comply with nondiscrimination rules at the end of the plan year. We recommend that you also test the plan at the beginning of the year and when you make substantial changes (such as offering a special election period or absorbing a population of new participants, such as a business acquisition or hiring spree). When you test during the year, you can identify nondiscrimination issues and correct them (typically by limiting the election limit) to bring the plan into compliance.

If you wait until the end of the year to test and the plan fails, participants must include their elections as taxable income, thus negating the tax benefits that a Dependent Care FSA otherwise offers.

## Other Recent Changes to Dependent Care FSAs

### What changes were made to Dependent Care FSAs in 2020?

To help participants whose spending projections were affected by the pandemic, Congress and the Trump Administration temporarily changed some plan rules for 2020 and 2021. The two most important:

- Employers can temporarily allow prospective mid-year election changes by employees, without experiencing a qualifying event.

- Employers can allow an extended grace period to incur claims or a rollover of unused balances into the following plan year.

### How do the prospective mid-year election changes work?

Employers can offer a mid-year period during which all employees can participate in the plan and current participants can opt out or change their elections (up or down). All changes are prospective. This option is currently available for plan years that end in 2021. This is purely optional, and an employer must temporarily amend their plan to allow for it. The sooner in a plan year this is adopted, the more flexibility non-participating employees have with electing to participate.

### What do I need to do to offer prospective mid-year election changes?

Further information, as well as forms to amend your plan accordingly are also available **here**.

### If I offer mid-year election changes for the Dependent Care FSA, do I have to do it for the Health FSA as well?

No. You can choose to offer this for only the Dependent Care FSA.

### How does the extended grace period work?

You can allow employees to extend the period to incur claims to the end of the calendar year following the end of the plan year.

**Example 1**: Your 2021 plan year ends December 31, 2021. You can allow participants to use their 2021 balances to reimburse eligible expenses incurred through December 31, 2022.

**Example 2**: Your 2021 plan year ends June 30, 2021. You can allow participants to use their 2021 balances to reimburse eligible expenses incurred through June 30, 2022.

If you choose this option, you cannot also offer a rollover (described below). And you need to amend your plan document to reflect this change. You must make the change no later than the last day of the plan year following the year that the change applies (e.g., by December 31, 2022, for a calendar-year 2021 plan), though we recommend that you make the change promptly so that employees can adjust their following year's election to reflect their leftover balance from the prior year.

### How does the rollover of unused funds work?

Rollovers of Dependent Care FSA funds are not permitted under tax law. Temporary changes enacted in 2020 allow employer to offer employees the opportunity to roll over up to their full election from the 2020 and 2021 plan years into the following plan year.

If you choose this option, you cannot also offer an extended grace period. It is either one or the other, but not both. You will need to amend your plan document to reflect this change. You must make the change no later than the last day of the plan year following the year that the change applies (e.g., by December 31, 2022, for a calendar-year 2021 plan). We recommend that you make the change promptly so that employees can adjust their following year's election to reflect their leftover balance from the prior year.