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Temporary Relief for Dependent Care Assistance Programs

The shutdown of worksites and childcare facilities in 2020 presented many challenges for both employers and employees. The closure of schools and daycare options also impacted dependent care expenses incurred by employees and the use of amounts under dependent care assistance accounts based on employee elections made prior to the onset of the pandemic.

In an effort to address any adverse consequences associated with reduced dependent care expenses in 2020, Congress enacted legislation in 2020 that allows individuals to carry over unused amounts in their dependent care assistance accounts from 2020 to be used in 2021 and unused amounts in 2021 to be used in 2022. Alternatively, employers may allow individuals an extended period for incurring dependent care expenses (i.e., a 12-month grace period) that extends after the end of the 2020 and 2021 plan years. So, for example, an individual who elected to contribute the maximum of $5,000 to their dependent care flexible spending account for 2020, but who only incurred $1,500 of eligible dependent care expenses in 2020, may carry over the unused $3,500 to be used in 2021 assuming the individual's employer amends the plan document to allow the carryover.

The American Rescue Plan Act of 2021 (the "Act") increased the annual limit for pre-tax benefits in 2021 from $5,000 ($2,500 for married individuals filing separately) to $10,500 ($5,250 for married individuals filing separately). If an employer wants to allow the higher limit, the dependent care assistance program (which is usually part of a cafeteria plan) must be amended. The Act allows the plan to be amended retroactively to increase the annual limit for 2021 if (i) the amendment is adopted no later than the last day of the plan year in which the amendment is effective and (ii) the plan operates in a way that is consistent with the amendment during the plan year. In Notice 2021-26, the IRS provides guidance as to how plans should administer the carryover of unused benefits into 2021 and 2022, the extended claims period, and the increased annual

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limit for 2021. The Notice also provides helpful examples to guide employers in the application of this temporary relief, especially for cafeteria plans that do not use a calendar year as the plan year.

A couple of issues to note:

- The increase in the annual limit is only for 2021. For 2022, the annual limit will again be $5,000 unless future legislation raises the limit.
- Dependent care flexible spending accounts must satisfy certain nondiscrimination testing with respect to the average benefits provided to highly compensated employees vs. non-highly compensated employees. If highly compensated employees utilize the higher limit in 2021 to a greater degree than non-highly compensated employees, this could cause the dependent care flexible spending account program to fail the average benefit test and require that highly compensated employees include the benefits they receive in 2021 as income. Therefore, employers who permit use of the higher annual limit may want to monitor the program during 2021 to address any issues with the average benefit test.

Should you have any questions with respect to how this temporary relief affects your dependent care assistance program, please contact Deborah Holland Tudor or any member of Frost Brown Todd's Employee Benefits & ERISA Group.

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