

## e-Alert

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# COVID Relief Bills Offer Dependent Care FSA Flexibility

## Background

Two recent pieces of pandemic relief legislation intended to provide employees with financial relief from the effects of COVID-19 offer employers additional flexibility to make changes to dependent care FSAs. Employers should decide whether and to what extent they wish to amend their plans to incorporate these changes and communicate the new options to employees quickly to allow employees to realize the greatest benefit.

## Summary

### Changes Under the Consolidated Appropriations Act

Recently, the Consolidated Appropriations Act, which was signed on December 27, 2020, added a few optional special rules for Dependent Care FSAs (DCFSA), including permitting employers to:

- Extend the grace period for plan years ending in 2020 to 12 months after the end of the plan year OR Carryover unused amounts from the 2020 plan year to the 2021 plan year (these options do not apply to plans ending in 2020 that were previously finalized);
- Extend the grace period for plan years ending in 2021 to 12 months after the end

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of the plan year OR Carryover unused amounts from the 2021 plan year to the 2022 plan year;

- Allow prospective election changes without regard to a change in status **for plan years ending in 2021**.

For TASC clients, these changes will be automatically applied to your plan. If you wish to opt out, please contact HR Knowledge.

For employers utilizing another third-party administrator, your provider may require you to opt-in to these changes before your plan year ends. Please contact your administrator or HR Knowledge for information on how these changes will be handled.

### **Changes Under the American Rescue Plan Act**

#### **Dependent Care FSA Contribution Limit Increases Under the American Rescue Plan Act**

The American Rescue Plan Act (ARPA) temporarily increases the maximum dependent care FSA contribution from \$5,000 to \$10,500 (from \$2,500 to \$5,250 for married individuals filing separately) for the 2021 tax year. The change to temporarily increase the maximum allowed contribution **is not mandatory**, allowing employers to determine whether to permit the higher limits. It appears that any discretionary carryover allowed under the CAA for dependent care FSAs would not be included in the maximum dollar limit for 2021.

There are a number of issues an employer may consider when deciding whether to adopt the increased ARPA contribution limit. Please see the considerations below.

#### Considerations for all employers:

- Nondiscrimination Compliance - The 55% Average Benefits Test is the DCFSA test that fails the most often for DCFSA plans. This test requires that non highly compensated employees make up at least 55% of the DCA benefits. Consider who is participating in your DCFSA plan and who is likely to increase their election. To ensure compliance with Section 125 requirements, you should have full Nondiscrimination Testing completed for the DCFSA plan if you choose to make this change. Testing would be completed after employees have made their changes to ensure the plan does not favor highly compensated employees. The cost for this service can range from \$1,000 - \$2,500 depending on employer size and plans to be tested.
- To ensure that employees can take advantage of the increased contribution limit, you should ensure your plan has been amended to include the CAA provision permitting prospective mid-year election changes; otherwise, only those employees who have a mid-year status change event would be able to

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take advantage of the increased contribution limit.

- If an employer is adopting both the carryover provisions of the CAA for 2020 and 2021 plan years, as well as the increased ARPA limit, it could result in some employees having very large DCFSA balances in 2022. For example, if an employee carries over \$5,000 from 2020 to 2021, contributes \$10,500 in 2021 and has no expenses, and then carries over the full \$15,500 to 2022 and contributes another \$5,000 in 2022 (when the limit is supposed to return to its normal amount), the employee could end up with an account balance of \$20,500 in 2022.
- Employees will be required to request mid-year changes by reporting the qualifying life event, contacting HR or HR Knowledge.
  - If you have ADP Workforce Now or Employee Navigator the participant will need to report the event or initiate the election change.
  - If you administer benefits outside of these platforms, employees would need to complete a revised election/change form.

Considerations for employers with non-calendar year plan years:

- For plan years ending in 2021, CAA provisions permit employers to allow prospective election changes without regard to a change in status (qualifying life event).
  - For plan years that have already ended in 2021 (i.e., 4/1/20 – 3/31/21), DCFSA election changes will require a qualifying life event.
  - For plan years that are still active, but will end in 2021 (i.e., 7/1/20 – 6/30/21), DCFSA election changes are only permitted through the last day of your 2021 plan year.
- This change only applies for the 2021 tax year (calendar year), ending on 12/31/2021. Plans that follow an off-calendar year cycle will run the risk of participants over-contributing. Participants will have to closely watch their contributions.
  - If you administer benefits through ADP Workforce Now or Employee Navigator, an additional plan will need to be built to accommodate the additional \$5,500 contribution amount. This plan will run on a short plan year starting with your 2021 renewal date and ending on 12/31/21. This will help to mitigate the risk of participants over-contributing to the plan.
  - If you administer benefits outside of these platforms, your employee contributions will need to be manually monitored.
- There is a one-time administrative fee of \$1,800 to set up the short plan year and administer the ARPA dependent care FSA limit increase.

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This temporary increase **will not be automatically applied**. Employers should contact [HR Knowledge](#), if you wish to allow for this change.

### **Dependent Care Tax Credit**

ARPA also made several modifications to the child and dependent care tax credit. Like the changes to dependent care FSAs, changes to the child and dependent care credit are effective for tax year 2021 only. ARPA raises the dollar limit on employment-related child and dependent care expenses from \$3,000 to \$8,000 for one qualifying child and from \$6,000 to \$16,000 for two or more qualifying children. In addition, the maximum reimbursement percentage is increased from 35% to 50%. Consequently, the maximum allowable credit has been increased to \$4,000 for one child and \$8,000 for two or more children.

The percentage phases down for taxpayers earning between \$125,000 and \$400,000 in gross income.

The tax benefits available under a DCFSA and the child and dependent care tax credit can be combined, but not used for the same expense. The decision whether to contribute to a DCFSA and/or claim the child and dependent care tax credit is a personal tax matter that employees should discuss with their tax advisor.

## **Employer Next Steps**

- Review the COVID Relief Bills summary of changes above.
- Contact our [Benefits Team](#) with any questions, or if you wish to adopt the ARPA DCFSA contribution limit increase.

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