

Benefit Fact Sheet

What is it?

A dependent care assistance program is a type of Cafeteria Plan which allows participants to contribute pre-tax income to pay for eligible dependent care expenses. Employees estimate their dependent care expenses prior to the start of the plan year and elect an amount to be deducted from their paycheck over the course of the plan year.

The maximum annual contribution allowed by the Internal Revenue Service (IRS) is \$5,000 per household, or \$2,500 if married and filing separate income tax returns. The key statutory provisions governing DCAPs are IRS Code Sections 125, 129, and 21.

The IRS relaxed the “use it or lose it” rule by allowing a “grace period” for employees to use DCAP balances that remain at the end of the plan year. Expenses incurred during the 2 ½ months following the end of the plan year can be paid with unused contributions carried over from the prior year. Employers may choose to not offer the grace period extension.

Why offer it?

- Assists employees with a wide range of dependent care needs and employees may perceive this as a “family friendly benefit.”
- Plan administration costs are relatively minimal and tax-deductible to the employer.
- Reduces employees’ taxable income.

What types of employers offer it?

Employers that offer flexible savings accounts.

What size employers offer it?

Any size employer may offer a DCAP; however, smaller employers may have difficulty passing required non-discrimination testing. DCAP plans are typically offered by employers of 50 or more employees.

What are the critical underwriting or participation requirements?

- Administration fees are based on the size of the group and plan participation.
- The plan must meet non-discrimination requirements set by the IRS in order to obtain favorable tax treatment. To meet this requirement, the plan must not discriminate in favor of highly compensated employees or key employees with respect to eligibility, contributions and benefits. Plans must perform annual testing to determine non-discrimination, the results of which are subject to audit by the IRS.
- Participants may only make plan elections during the annual enrollment period or when qualified status changes occur (e.g. birth or adoption).

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How much does it cost?

Most employers elect to outsource plan administration. Costs are often combined with the fees for Health Care Spending Accounts. General fee ranges are:

- Set up/Renewal fees: \$500-\$3,000
- Monthly per participant fees: \$3 to \$6
- Other services such as: Discrimination testing and preparation of plan documents, summary plan descriptions and Form 5500s may be included in set up/renewal fees or charged on a per service basis.

Employer costs are fully or partially offset through savings from payroll reductions leading to lower FICA and FUTA taxes, as well as workers compensation premiums in some states.

Informational link(s)

- [Flexible Spending Accounts](#) (FlexAmerica)
- [Flexible Spending Account Eligible Expenses](#) (AFA Company)
- [Child and Dependent Care Credit](#) (IRS)

Pros and cons

Pros

- Enhances benefit program at minimal cost to employer. Plan administration fees are tax deductible to employer.
- Reduces employee's taxable income.
- Outsourcing administration provides employer ease of administration.

Cons

- Strict participation/enrollment rules can create employee relations issues if not communicated properly.
- Employee contributions are "use it or lose it," whereby funds remaining in a DCAP at the end of the plan year must be forfeited.
- Employees need to assess whether they should participate in an employer sponsored DCAP or claim the dependent care tax credit (outlined in IRC Section 21). Generally, if an employee's income tax bracket is 15% or less, it may be advantageous to claim the dependent care tax credit versus participating in a DCAP.

Notes

- Examples of eligible expenses are: In home care, day care, elder care, pre school, and after school programs.

This Fact Sheet is designed to provide a general overview of the benefit program, service, or regulatory act it describes. The information included in this document is not a substitute for legal or professional opinion relative to a plan sponsor's particular fact pattern. Your ArlenGroup consultant can answer more specific questions relative to its application for your organization. A menu of additional topics is available online at: www.arlengroup.com/facts.