**Dependent Care Assistance Programs (DCAPs) and COVID-19 and a Reminder on Health FSAs**

In the wake of the COVID-19 pandemic, many employers are dealing with how to handle Dependent Care Assistance Programs (DCAPs) when employees are no longer working and not in need of childcare, or alternatively, an employee’s childcare program/center/provider has closed due to the pandemic.

DCAPs, sometimes referred to as “dependent flex spending accounts", are an employer sponsored plan to provide the exclusive benefit of dependent care assistance. Under the Internal Revenue Code (IRC), employees can exclude up to $5000 annually from the gross income for dependent care. DCAPs are subject to flexible spending arrangement rules under the IRC.

**General Principles**

Because of their tax favored status, DCAPs are subject to many regulations. Any common law employee can participate in a DCAP. In order to have dependent care expenses reimbursed by the program the following general requirements must be met:

• The expense must enable the employee (and their spouse) to be gainfully employed

• The expense must be for a qualifying individual (a child under the age of 13)

• The expense must be for care, not education (daycare is acceptable, private school tuition is not)

• The expense must be incurred in the coverage period (the plan year)

• The expense must be substantiated

**Exclusion from Income**

An employee's exclusion from income for payments under a DCAP in a calendar year is limited to the smallest of the following amounts:

• $5,000 if the employee is married and filing a joint return or if the employee is a single parent ($2,500 if the employee is married but filing separately);

• The employee's “earned income” for the year; or

• If the employee is married at the end of the taxable year, the spouse's earned income

The spouse of a married employee is deemed to be gainfully employed and to have an earned income of not less than $250 per month if there is one qualifying individual, or $500 per month if there are two or more qualifying individuals in each month during which they are a full-time student; or is incapable of self-care and has the same principal place of abode as the employee for more than half the year.

**Leave of Absence**

If an employee takes a leave of absence they may no longer be considered “gainfully employed” and eligible for dependent care reimbursements during their leave. In general, this is determined on a daily basis, however there is an exception to the “daily basis” rule for certain short, temporary absences (e.g. Emergency Paid Sick Leave) and part-time employment.

This exception is based on the IRS regulations establishing a “safe harbor” under which an absence of up to two consecutive calendar weeks is treated as a short, temporary absence. However, whether an absence for longer than 2 weeks qualifies as short and temporary is determined on the basis of facts and circumstances.

Likewise, when it comes to FMLA, the IRS does not agree that one’s entire absence under FMLA (which guarantees eligible employees up to 12 weeks of unpaid leave for certain purposes) is appropriate as a temporary absence safe harbor, noting that an absence of 12 weeks “is not a short, temporary absence” within the meaning of the regulations.

**Reimbursements**

Reimbursements are subject to the same rules as flexible spending arrangements (FSAs). The period of coverage must be 12 months unless there is a short plan year. DCAPs that are underspent lead to forfeited money, unused contributions cannot carry over from year to year. DCAPs are not subject to COBRA and the participant has no right to coverage after their plan participation terminates. Employers can provide for a spend-down provision in their plan documents to allow former employees to receive reimbursement through the end of the plan year in which they terminated employment and coverage. If the plan document does not provide for this spend down, the funds are forfeited.

**Reimbursements During Leave of Absence**

Although the employee may not be eligible to reimburse dependent care expenses while on leave, an employee on LOA may be able to continue to participate in (and make contributions to) a DCAP but any reimbursements from the DCAP will still be subject to the gainfully employed rule and would have to fall within the exception for short, temporary absences.

**Changes to Elections**

Under the cafeteria plan regulations, elections are irrevocable unless a permitted event occurs. For DCAPs this is:

* A change in status
* A change in cost and coverage
* FMLA (employees taking FMLA leave can revoke elections of non-health benefits and reinstate their benefits upon return from leave)

**REMINDER:** Although IRS rules govern dependent care assistance programs (DCAPs) also known as dependent care FSAs, including the requirement that elections are irrevocable except in the case of a “change event”, an employer is not required to recognize all the IRS permitted election changes when designing their FSA plan. Therefore, if an employee requests to change their dependent care FSA election, employers need to be mindful of:

• FSA plan document language – must explicitly permit changes to elections due to a change in cost. If it does not, an employer may want to consider prospectively amending their plan to include this change event.

• Following their plan’s rules to avoid plan disqualification

• Refunds for dependent care FSA contributions already taken from an employee’s paycheck are not permissible.

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| **Dependent Care Change in Status, or Cost & Coverage Events** | **DCAP Election Change** |
| A new childcare provider is available at a different cost than current provider. Includes someone (e.g. parent, older sibling) agreeing/able to watch the child for free. | Employee may increase or decrease election amount consistent with change in qualified dependent care expenses. Employee may cancel the election if child is now being cared for at no cost. |
| Enrolling child at a childcare provider closer to home or new work location. | Employee may increase or decrease election amount consistent with change in cost. |
| An employee or their spouse has a new work schedule (including to or from part-time status), and a different number of hours of childcare are required. | Employee may increase or decrease election amount consistent with change in cost. |
| A child who wasn’t previously enrolled in childcare, now needs a childcare provider due to schools being closed. | Employee may enroll in dependent care FSA. Or increase their election if they are enrolling an additional child not previously enrolled in childcare. |
| Child’s day care closed | Employee may decrease or cancel their election. |

It is likely that many of the reasons an employee no longer needs childcare as the result of the COVID-19 pandemic would allow them to change their DCAP contributions, potentially reducing them to zero dollars, particularly if their child has been pulled from care (change in cost and coverage), or they are taking FMLA leave (including newly created FMLA leave under the new Families First Coronavirus Response Act).

Therefore, employers should be lenient and allow employees to change their DCAP contributions within the above scenarios. Employers with employees who are laid off (not expected to return to work) should consult with counsel to see if their plan documents allow for a spend down, or if that change can be made mid-plan year.

**Health FSA Reminder**

Similar to DCAPs, health FSA elections generally are irrevocable, and the IRS only permits mid-year changes when an IRS approved qualifying status change has occurred. Any change in employment status of the employee, spouse or dependent **that affects eligibility** for the health FSA is a qualified status change and the change in the election must be on account of the qualified status change.

A health care FSA may (but is not required) to permit an employee to change their health FSA election for IRS permitted qualifying change in status events. Employers should refer to their FSA plan documents to determine which events their plan recognizes.

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| **Change in Status Events** | **Health FSA Election Change** |
| Spouse (or dependent) loses health insurance coverage | Employee may increase election amount |
| Employee changes from FT to PT | Employee may revoke election if the change affects eligibility for the health FSA (Note: Employee may lose coverage automatically when hours change to PT.) COBRA paperwork may need to be provided if the account is underspent. (The health FSA balance is equal to or more than the amount of FSA premiums charged for the remainder of the plan year.) |
| Employee is on layoff or furlough | If the employee stops getting paid, the FSA technically ends. COBRA should be offered to continue the FSA. The employer may keep the FSA active by providing contributions for the employee, having the employee send payments into the employer, or catching up the contributions upon return. |
| Employee is on an unpaid, unprotected leave of absence (e.g. not FMLA) | If eligibility is lost, employee may revoke election. COBRA paperwork may need to be provided if the account is underspent. |
| Employee is on FMLA | Employee may revoke election for the period of coverage provided for under FMLA (or the employer may allow the employee to continue coverage but discontinue contributions during the leave period.) |
| Termination of employment - employee | Employee’s coverage ends. COBRA paperwork may need to be provided if the account is underspent. |
| Termination of employment for spouse, dependent who had health insurance or health FSA. | Employee may enroll or increase election |
| Termination and Rehire Within 30 Days | Employee’s elections in effect at termination are reinstated unless another event has occurred that allows a change. |
| Termination and Rehire After 30 Days | Depending on the FSA plan design, the employee may reinstate elections in effect at termination or make a new election under the plan. It is possible, though for the FSA plan to prohibit an employee from re-enrolling in the plan during that plan year. |

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