Mineral MITRATECH

TRINITY BUSINESS PARTNERS

Table of Contents

Cafeteria Plans: Dependent Care Flexible Spending Account (DCFSA) 2

DCAP Nondiscrimination Testing 2

Key Definitions and Examples 2

Employee and Spouse Eligibility 3

Qualifying Person 3

Eligible Expenses 4

Enrollment 5

Contributions 5

Claims and Claim Substantiation 6

Use It or Lose It Rule 8

Grace Period 8

Planning for Expenses 8

Cafeteria Plans: Dependent Care Flexible Spending Account (DCFSA)

A cafeteria plan can offer a variety of benefits. A common and popular benefit is a ***dependent care flexible spending account*** (DCFSA), which is a cafeteria plan option allowing eligible employees to elect pre-tax payroll deductions during the plan year that are directed to a DCFSA. The money in the DCFSA can then pay for or reimburse eligible expenses incurred by the employee for the care of their qualifying dependent (usually a child under age 13). Generally, these deductions are taken in equal installments throughout the plan year.

A DCFSA is also a type of dependent care assistance program (DCAP)—a tax-advantaged Internal Revenue Code § 129 plan. A DCAP is subject to nondiscrimination requirements under I.R.C. § 129, and if offered through a cafeteria plan (typically as a DCFSA), it is also subject to nondiscrimination requirements under I.R.C. § 125. DCAP tests are separate and apart from the § 125 plan tests.

DCAP Nondiscrimination Testing

Nondiscrimination testing is required for a DCAP to maintain its tax-advantaged status by ensuring the plan does not favor highly compensated employees (HCEs) or business owners in eligibility, participation, or benefits. If a DCAP fails any of the required tests, HCEs and owners must include DCAP reimbursements in taxable income.

The IRS requires a DCAP to pass four separate tests:

1. The **eligibility test** reviews participation in the plan. If the number of HCEs outweighs the number of non-HCEs and their dependents, the test may fail. Excluded employee classes must have a legitimate business purpose for their exclusion. Employees under the age of 21 who have not completed one year of service or are covered under collective bargaining agreements are allowable exclusions.
2. The **benefits and contributions test** reviews whether HCEs and non-HCEs are entitled to the same benefit and contribution amounts under the plan. The test may fail when non-HCEs are shown to have different or fewer benefits and contributions.
3. The **owner concentration test** reviews the usage of benefits. The test may fail if owners or shareholders exceed 25% of the total amounts paid or incurred.
4. The **average benefits test** also reviews the usage of benefits. If non-HCEs receive less than 55% of the average benefits provided to HCEs, the test may fail.

Key Definitions and Examples

The following definitions and examples are relative to understanding DCAPs.

This content is owned and provided by Mineral, Inc. “AS IS,” and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warrant that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

A ***dependent*** is an individual under the age of 13 who resides with the employee or an individual over the age of 12 who is mentally or physically incapable of caring for themselves and spends a minimum of eight hours in the employee's residence.

Expenses are reimbursable costs for services such as babysitters, nannies, after-school care, day care facilities, preschool programs, and adult day care for a disabled adult child.

Nondiscrimination relative to DCAPs represents the avoidance of favoring owners and HCEs.

IRS maximum value is the 2026 nontaxable maximum amount of a DCAP, set at $7,500 for a married employee filing jointly or $3,750 for an employee filing as single or filing separately from their spouse, as established by the IRS.

A ***highly compensated employee*** (HCE) is an employee who meets either of these conditions:

- Owns more than 5% of the business at any time during the current or preceding year; or
- Received compensation in the prior year in excess of a certain threshold, which is adjusted annually ($160,000 for 2025 and 2026).

An ***owner or shareholder*** is defined as any person owning more than 5% of the stock, capital, or profits on any day of the plan year. Generally, this includes any ownership of the employee's spouse, parents, children, and grandchildren when determining the employee's ownership percentage.

Employee and Spouse Eligibility

The plan document defines eligibility in accordance with I.R.C. § 129, which includes special rules for married employees. The IRS states that DCFSA expenses qualify only if they are employment-related, meaning the care enables the employee and their spouse to be gainfully employed. For married employees, expenses are considered employment related if the spouse is working, actively searching for employment, a full-time student, or incapable of self-care. Gainful employment traditionally means working for compensation, whether full time, part time, or being self-employed.

Qualifying Person

When claiming child and dependent care expenses, it must be for the care of a qualifying person. A qualifying person can be a:

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

- Dependent child under age 13;
- Spouse who was incapable of self-care and lived with the employee for more than half the year; or
- Person who was incapable of self-care, lived with the employee for more than half the year, and was either the employee's dependent or would have been except for certain income or filing requirements.

IRS Publication 501, *Dependents, Standard Deduction, and Filing Information*, provides detailed information about dependents.

Eligible Expenses

DCFSAs cover the same types of expenses that the IRS recognizes through dependent care tax credits. In general, these are the costs of any caregiver providing services to an employee's child or disabled dependent so that the employee and the employee's spouse can work, look for work, or attend school full time.

The cost of care provided outside the home must be for a dependent child under age 13 or any other qualifying person who regularly spends at least eight hours each day in the employee's home.

Eligible expenses typically include the following:

- Day care or preschool for a child under age 13
- Before- and after-school caregivers
- Elder care for dependent parents, including elder day care
- Care for a disabled spouse or a dependent incapable of self-care
- Care-related services (such as a visiting nurse)
- Summer day camps

IRS Publication 503, *Child and Dependent Care Expenses*, provides information and examples about the types of dependent care expenses that may be eligible for DCFSA reimbursement.

Note: Employees who participate in a DCFSA may also be eligible to claim the dependent care tax credit in certain circumstances. However, the same dependent care expenses cannot be used for both benefits. Employees must allocate expenses between the DCFSA and the tax credit and should evaluate which approach is more advantageous based on their individual tax situation.

For example, an employee may receive the maximum nontaxable DCFSA benefit and still qualify for a partial dependent care tax credit if:

- Their total dependent care expenses exceed the applicable statutory limit; and
- They have one or more qualifying individuals (with higher limits applying if there are two or more qualifying individuals).

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

In these situations, the tax credit may apply to eligible expenses in excess of the amount reimbursed through the DCFSA, up to the applicable limits. The credit is calculated as a percentage of those remaining expenses, with the applicable percentage based on the employee's income.

Because the interaction between a DCFSA and the dependent care tax credit can be complex, employees should consult a tax advisor to determine the most beneficial approach for their circumstances.

Enrollment

Employees may enroll in a DCFSA during the employer's annual open enrollment period for participation in the upcoming plan year. For companies that operate on a calendar year, this period generally occurs in the fall for an effective date of January 1.

Once an employee elects to participate and authorizes a dollar amount to be contributed each pay period, the employer will take regular deductions out of the employee's pay, on a pre-tax basis, and set aside those amounts to be used for the employee's DCFSA.

The employee's election amount, or choice not to enroll, applies throughout the 12-month plan year. Elections cannot be changed during the year unless the employee experiences a permitted election change event, such as a change in marital status, birth or adoption of a child, or certain employment changes. For details, see Comprehensive Guide to Midyear Benefit Election Changes.

Contributions

The IRS limits the amount employees may contribute to a DCFSA each calendar year, regardless of the employer's plan year. The limit applies per household, and married spouses filing separately are subject to half that amount.

For calendar year 2025, the IRS limit is $5,000 (or $2,500 each if married filing separately). Under the One Big Beautiful Bill Act (signed July 4, 2025), the annual DCFSA/DCAP limit increases to $7,500 per household ($3,750 if married filing separately) for tax years beginning after December 31, 2025. Employers may choose—but are not required—to adopt the higher limit. Plans must be amended and payroll systems updated if the new limit is implemented.

If either the employee or their spouse has earned income below the applicable limit, the maximum contribution is limited to the lesser of the two spouses' earned income. For example, an employee's plan allows contributions up to the applicable IRS limit. However, the employee's spouse earns $2,000 during the year. The employee's maximum DCFSA election is limited to $2,000.

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warrant that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

When both an employee and their spouse are eligible to participate in a DCFSA through their respective employers, their combined contributions cannot exceed the applicable IRS household limit for the year. For example, an employee and their spouse each enroll in a DCFSA through their respective employers. Even if each employer allows contributions up to the applicable IRS limit, the couple's combined contributions may not exceed the household maximum for that year (i.e., spouses with their own DCFSA may not each contribute the maximum annual amount). Contributions in excess of the limit may result in taxable income.

It is important to know that the annual limit is a universal limit during a calendar year across all employers. The applicable limit refers to the statutory IRS maximum in effect for the year, regardless of whether an individual employer adopts the higher limit. If an employee contributed to a DCFSA with their employer and then changed jobs, they can still only contribute up to the calendar year maximum for both accounts combined. For example, Pat contributed $1,250 to their DCFSA with ABC Company from January 1, 2026, through March 31, 2026. On April 1, 2026, Pat left ABC Company to work for XYZ Company. XYZ Company offers a DCFSA plan at the maximum IRS annual limit, and Pat is eligible to contribute beginning May 1, 2026. Pat may only contribute $6,250 for the remainder of 2026.

The IRS does not require a prorated limit for short plan years like with a health flexible spending account (HFSA). However, employers can choose to prorate for short plan years so contributions do not exceed the maximum allowable calendar year limit.

The exception to the maximum allowable calendar year limit occurs when an employer provides a direct pay dependent care assistance program and provides a DCFSA. However, any amount over the maximum limit is taxable.

The employer may design its DCFSA plan with a lower limit, although most plans use the federal limit. The limit is typically not adjusted for inflation each year.

An employee whose spouse is on a qualifying leave of absence covered under the Family and Medical Leave Act (FMLA) may choose to continue contributions to their DCFSA to plan for expenses once the spouse returns from their FMLA leave or to change their current election amount.

Claims and Claim Substantiation

To receive reimbursement from a DCFSA for eligible expenses, employees must submit a claim to the DCFSA administrator with supporting documentation. The employer's plan may set time limits for claiming reimbursements, such as 90 days from the date the expense is incurred.

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

The DCFSA administrator typically provides a form for the employee's use when submitting claims. Along with the claim form, employees need to submit proof that they made a payment and that the expense was of the type that the DCFSA covers. Documentation requirements vary depending on the DCFSA administrator, although all plans require a receipt that shows all of the following:

- Date of service;
- Cost of service;
- Provider name, address, and Social Security number or Taxpayer Identification Number; and
- Description of the service.

The IRS requires all claims to be substantiated for DCFSA reimbursement. A memorandum from the IRS Office of the Chief Counsel provides an explanation of the substantiation requirements as follows:

- Full substantiation is required for every reimbursement (including debit card usage);
- Reimbursements that are not fully substantiated must be included in an employee's gross income;
- Cafeteria plans must require substantiating documents from an independent third party (i.e., statement or invoice from the dependent care provider); and
- Participants are required to provide certifications or documents providing that reimbursements have not been covered by other plans, or that they will not seek reimbursement for the same expense from other plans.

Guidance contained in the memorandum is advice based on counsel interpretation of the law. Proposed regulation § 1.125-6(a)(4) provides that reimbursements of DCFSA expenses may not be reimbursed before the expenses are incurred. Expenses are incurred when the care has been provided. The expense is not incurred if an employee is billed in advance of care.

Claims may only be reimbursed up to the amount in the employee's DCFSA account at the time of the request. For example, Jane has elected to contribute $2,600 for the plan year, so $50 is being deducted from each weekly paycheck. Jane paid $1,000 for childcare services received in January, which is more than the amount of Jane's contributions so far this year. The DCFSA reimbursement is limited to Jane's account balance ($100) at that time. The remainder will be reimbursed when additional funds become available.

When an employee's spouse cannot work due to a disability and is receiving disability benefits, day care expenses generally cannot be claimed except when the spouse is incapable of self-care standards due to a physical or mental defect. Self-care standards are defined by the IRS as the inability of a person to dress, clean, or feed themselves. Although a new birth may qualify as a disability, under state disability laws, state leave laws, short-term disability policies, and the FMLA, it does not meet the IRS self-care standard.

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

Use It or Lose It Rule

A critical element of a DCFSA is the “use it or lose it” rule. Traditionally, money set aside in a DCFSA could only be used for expenses incurred within the specific plan year. If the entire amount an employee elected to set aside in a DCFSA was not spent to reimburse eligible expenses incurred during that plan year, the employee forfeited any unspent funds. Federal rules have been changed to allow the below exception, at the employer’s option, from the standard use it or lose it rule.

Grace Period

The employer’s DCFSA may be designed to provide a grace period of up to 2½ months after the plan’s year-end date during which unused contributions can be used to reimburse eligible expenses incurred during the grace period.

If the plan includes a grace period, the grace period must apply to all participants in the plan. Expenses incurred during the grace period must be paid or reimbursed from benefits that remain unused at the end of the preceding plan year. For example, Pat elected to withhold $3,000 during the 2026 (calendar year) plan year. At the end of the plan year, Pat had $500 remaining in the DCFSA account.

Because the plan includes a 30-day grace period, Pat can use the remaining balance during January 2027 for expenses incurred during that month. Employers may not permit unused benefits or contributions to be cashed out or used to pay or reimburse expenses that are not eligible. Any benefits unused after a 2½-month grace period cannot be carried forward to any subsequent period and are forfeited under the use it or lose it rule.

Unlike HFSAs, DCFSAs are not governed by the Employee Retirement Income Security Act (ERISA). As a result, the employer’s management of DCFSA forfeitures is only subject to IRS regulations. Based on the language in the plan document, forfeited DCFSA funds may be handled as follows:

- Returned to employees on a reasonable and uniform (not individualized based on contribution or forfeiture by individual) basis as taxable income;
- Used to defray expenses to administer the plan;
- Used to reduce salary reduction amounts for the following plan year on a reasonable and uniform basis; or
- Retained in the employer’s general assets to use for any purpose if not prohibited by state law.

The methods used must be listed in the plan documents.

Planning for Expenses

This content is owned and provided by Mineral, Inc. “AS IS,” and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.

Most employees who incur dependent care expenses elect to contribute the maximum amount in a DCFSA. Since the cost of dependent care is generally fixed and predictable, employees assume they will incur that expense for a definite period of time.

Circumstances can change, however, so employees need to consider carefully before choosing to enroll and deciding on an annual election amount. Because midyear election changes are limited and generally apply only on a prospective basis, employees may not be able to adjust contributions to account for earlier over- or under-estimations.

This content is owned and provided by Mineral, Inc. "AS IS," and is intended for informational purposes only. It does not constitute legal, accounting, or tax advice, nor does it create an attorney-client relationship. Because laws are constantly changing, we do not represent or warranty that the content is comprehensive of all applicable laws and regulations, and/or accurate as of the date of use. You are solely responsible for complying with all applicable laws and regulations. Mineral expressly disclaims any liability associated with your use of the content, and/or your noncompliance with applicable laws and regulations.