

IRS Clarifies Taxation for Dependent Care Programs for 2021 and 2022

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06.21.2021

The IRS recently issued Notice 2021-26, which provides guidance related to certain pandemic relief provisions including carry-overs and extended grace periods which impact dependent care assistance programs (DCAPs) provided under a Code Section 125 cafeteria plan in tax years ending in 2021 and 2022. Due to the pandemic, individuals with DCAPs found themselves incapable of using the pre-tax funds they had set aside in those accounts because, for example, daycare centers were closed or parents were home. In response, Congress passed a law allowing DCAPs to carry over unused benefits from a plan year ending in 2020 to a plan year ending in 2021 and from a plan year ending in 2021 to a plan year ending in 2022. Alternatively, a DCAP could extend its 2020 and/or 2021 grace period(s) for up to 12 months following the end of 2020 and/or 2021.

In Notice 2021-26, the IRS clarified that for 2021 and 2022, any amounts in a DCAP resulting from such carryover or extended grace period will remain excludable from gross income of the employee for 2020 or 2021 and will be disregarded for purposes of applying DCAP limits for subsequent tax years. However, note that for non-calendar year DCAPs, the IRS makes clear that for plan years ending in 2022, the increased exclusion will not apply to any reimbursement of expenses incurred during the 2022 portion of the plan year.

Please contact your servicing Laner Muchin attorney or any member of our Employee Benefits and Executive Compensation Team if you have questions about DCAPs or the guidance from the IRS described above.

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