DEPENDENT CARE FSA INCREASE TO $7,500

FREQUENTLY ASKED QUESTIONS

Overview Questions

What is changing with the Dependent Care FSA in 2026?

- Effective the start of your new plan year beginning on or after January 1, 2026, the annual contribution limit for Dependent Care Flexible Spending Accounts (DCFSAs) will increase from $5,000 to $7,500 for single individuals and married couples filing jointly. For married individuals filing separately, the limit increases from $2,500 to $3,750.

What law created this change?

- The One Big Beautiful Bill Act (OBBB Act), signed into law by President Trump on July 4, 2025, established this increase. This is the first permanent increase to the DCFSA limit since it was set at $5,000 in 1986.

Is this increase automatic for all plans?

- No. Statutorily employers are not required to adopt the increased limit. Each employer must decide whether to implement the new $7,500 limit and amend their plan documents accordingly. Alerus is implementing an automatic amendment acceptance process with respect to the Dependent Care FSA election limit increase. In accordance with our Service Agreement, if you do not refute this plan update with Alerus in writing to health_benefits_client_support@alerus.com by October 31, 2025, it will be understood as your acceptance and execution of this amendment, and your Dependent Care FSA plan election limit will be adjusted to $7,500 effective the start of your new plan year beginning on or after January 1, 2026 (and your plan will automatically align with any future increases to the maximum election limit as permitted under the Code). You retain the option to elect a lower plan election limit by submitting a refute within the response period.

Is this new limit a calendar year limit or a plan year limit?

- The new $7,500 limit for the Dependent Care FSA is a calendar year limit under the Code that applies to each employer's specific plan year. For most employers with calendar year plans, this effectively means the limit is on a calendar year basis starting January 1, 2026. If an employer's plan year is different (e.g., begins on a different date than January 1), then the $7,500 limit applies to the new plan year starting on the first of the plan year beginning after January 1, 2026.

Can my organization opt-out of this election limit increase or adopt a lower election limit than $7,500 but still greater than $5,000?

- Yes. To opt-out of the increase to the maximum amount as permitted under the Code, you will need to refute this Amendment with Alerus in writing to **health_benefits_client_support@alerus.com** by October 31, 2025.

Implementation and Administrative Questions

What steps do you need to take to implement the increase?

- To implement the increase, you will need to:
    - Complete your Dependent Care FSA Contribution Limit Amendment.
    - Modify open enrollment communications and materials.
    - Distribute the Summary of Material Modifications (SMM) to your participants to notify them of this update.
    - Alerus will update your system limits.

When do we need to make our decision about adopting the increase?

- Amendments need to be completed by October 31, 2025.

Is there a cost to amend our plan?

- Yes, an amendment fee of $90 applies to this amendment. This will be billed on your January 2026 invoice with Alerus (unless you opt out of the amendment by the end of the amendment submission period (October 31, 2025).

Will future increases be automatic?

- While no further election limit increases are announced at this time, this plan amendment will both increase your limit to $7,500 effective the start of your new plan year beginning on or after January 1, 2026, and align your plan with the maximum statutory limit as permitted under the Code should this amount be increased in the future.

Nondiscrimination Testing Concerns

How does the increased limit affect nondiscrimination testing?

- The higher contribution limit may make it more difficult to pass the required 55% Average Benefits Test. This test requires that the average DCFSA benefit for non-highly compensated employees (non-HCEs) equal at least 55% of the average benefit for highly compensated employees (HCEs). Since HCEs are more likely to contribute the full $7,500, while non-HCEs may contribute less or opt out entirely, the plan could fail this test.

What happens if our plan fails nondiscrimination testing?

- If the 55% Average Benefits Test is failed, HCEs lose the tax-free treatment of their DCFSA contributions, meaning their contributions would be added back to their taxable income. This eliminates the tax advantage for those employees.

How can we minimize the risk of failing nondiscrimination testing?

- Best practices include:
    - Educating all employees about the benefit to encourage broader participation.
    - Conducting early testing early in the plan year based on projected benefit amounts for the rest of the plan year.
    - Consider using the "top-paid group" election (limiting HCE status to the top 20% of earners).
    - Potentially setting a lower contribution limit for HCEs if testing shows failure risk.
    - Monitoring participation throughout the year and adjusting if necessary.

Employee Education and Communication

How should we communicate this change to employees?

- Your communication should include:
  - Clear explanation of the new $7,500 limit (if you're adopting it).
  - Reminder of eligible expenses and requirements.
  - Information about the enhanced Child and Dependent Care Tax Credit also taking effect in 2026.
  - Recommendation that employees consult with tax advisors to determine the best strategy for their situation.
  - Emphasis that the same expenses cannot be used for both the DCFSA and tax credit.

Should we advise employees whether to use the DCFSA or the tax credit?

- No. Employers should not provide specific tax advice to individual employees. Instead, provide general information about both options and recommend employees consult with qualified tax professionals to determine the best approach for their individual circumstances.

Eligible Expenses and Usage

Are there any changes to what expenses are eligible for reimbursement?

- No, eligible expenses remain the same. Examples of qualifying expenses include:
  - Licensed daycare and childcare centers.
  - Nursery school and preschool programs.
  - Before and after-school programs.
  - Summer day camps (day camps only, not overnight).
  - In-home care providers (nannies, babysitters while parents work).
  - Adult daycare for qualifying dependents.
  - Care for disabled dependents.

What expenses are NOT eligible?

- Examples of ineligible expenses include:
  - Educational expenses (kindergarten tuition, tutoring).
  - Overnight camps.
  - Activities and lessons (sports, music).
  - Meals and clothing.
  - Transportation to/from care providers.
  - Care provided by your child under age 19 or other dependents.
  - Late payment fees.

Can employees use both the DCFSA and claim the dependent care tax credit?

- Yes, but employees cannot use the same expenses for both benefits. For example, if an employee has $8,000 in qualifying expenses, they could potentially use $7,500 from their DCFSA and claim the remaining $500 (up to the tax credit limits) for the dependent care tax credit.

Tax Credit Comparison

How does the enhanced dependent care tax credit work starting in 2026?

- The Child and Dependent Care Tax Credit is also being enhanced in 2026:
  - Maximum credit percentage increases to 50% (from 35%).
  - Credit applies to up to $3,000 in expenses for one child, $6,000 for two or more.
  - Credit percentage phases down based on income levels.

- For families with income up to $15,000: 50% credit.
- For married filing jointly with income $45,000-$150,000: 35% credit.
- For married filing jointly with income over $210,000: 20% credit.

Which is generally better - the DCFSA or the tax credit?

- For most employees, the DCFSA provides greater tax savings because:
    - It reduces federal, state, and payroll taxes (FICA).
    - Tax savings are realized immediately through each paycheck.
    - No income phase-out limitations (unlike the tax credit).
    - Higher contribution limit ($7,500 vs. $6,000 max expenses for tax credit).
    - However, the optimal choice depends on individual circumstances including income level, tax bracket, and total dependent care expenses.

Special Considerations

How does this affect employees with multiple jobs or spouses with DCFSAs?

- The $7,500 limit applies per household, not per employer. If both spouses have access to DCFSAs through their respective employers, their combined contributions cannot exceed $7,500 (or cannot exceed $3,750 individually if married filing separately).

What about employees who are highly compensated?

- Highly compensated employees (generally those earning over $155,000 in 2024) are subject to the nondiscrimination testing results. If the plan fails testing, their DCFSA benefits become taxable. Some employers may choose to limit HCE contributions to ensure the plan passes testing.

Can we implement the increase mid plan-year?

- Generally, no. Plan changes like this $7,500 election limit increase should generally be implemented at the beginning of your plan year (Earliest effective date is for new plan years beginning on or after January 1, 2026).

Compliance and Legal Considerations

Are there any other compliance requirements we should be aware of?

- Yes, you should ensure:
    - Updated Summary Plan Descriptions (SPDs) reflect the new limits.
    - Open enrollment materials are revised.
    - Your FSA administrator's systems are updated **(Alerus will complete)**.
    - Nondiscrimination testing procedures are in place.
    - Employee communications comply with ERISA disclosure requirements.

What if we decide not to adopt the increase now but want to later?

- You will need to refute this Amendment with Alerus in writing to health_benefits_client_support@alerus.com by October 31, 2025. You can then choose to complete the amendment and adopt the increase in future years, but you'll need to complete the amendment process again in the future and implement this change at the beginning of a plan year. The amendment cannot be retroactive.

Does this change affect our cafeteria plan's other benefits?

- The DCFSA increase itself doesn't directly affect other benefits, but the nondiscrimination testing applies to the entire cafeteria plan. Failure of the DCFSA testing could potentially impact the tax treatment of other pre-tax benefits for highly compensated employees.

Disclaimer: This information is for general guidance only and does not represent legal advice. Specific implementation details may vary based on your plan design and administrative procedures. We recommend consulting with your legal counsel and tax advisors for advice specific to your organization's situation.