

American Rescue Plan Act of 2021

Impacts and Key Takeaways

On March 11, President Biden signed a COVID-19 stimulus bill into law—known as ARPA, or the American Rescue Plan Act of 2021. ARPA increases the amount employees can exclude from their 2021 gross taxable income for employer-provided dependent care assistance program (DCAP) benefits (such as MidAmerica’s Dependent Care Account) under Internal Revenue Code Section 129.

Before ARPA was enacted, the amount that could be excluded from taxation for DCAP benefits through a Code Section 125 cafeteria plan was capped at \$5,000, or \$2,500 for married individuals filing separately. With the new law, the 2021 limit has been increased to \$10,500 (or \$5,250 for married individuals filing separately).

This change is helpful for those employees whose DCAPs were amended as a result of the Consolidated Appropriations Act, 2021 (CAA) to allow an additional grace period or carryover of unused funds from 2020 in 2021. With ARPA, those unused funds may be used in 2021 without the participant having to pay additional taxes on amounts over the usual \$5,000 calendar year limit.

Because the maximum allowable non-taxable DCAP limit has increased for 2021, it is also possible to amend the DCAP limit to allow elections to the DCAP to be increased to the new limit for 2021.

ARPA at a Glance



- Increased exclusion limit presents taxation relief for employees who, as a result of the Consolidated Appropriations Act, 2021 (CAA), now have access in 2021 to unused DCA funds from 2020
- Increases the amount that could be excluded for dependent care assistance program (DCAP) benefits through a Code Section 125 cafeteria plan to \$10,500 (or \$5,250 for married individuals filing separately)

MidAmerica’s Stance



After thorough review of ARPA, MidAmerica will not amend plans to allow for elections up to the increased 2021 maximum DCA limit. For a breakdown of the reasons why, see page 2.

This stance does not impact the taxation relief afforded to employees whose DCAPs were amended as a result of the CAA to allow an additional grace period or carryover of unused funds from 2020 in 2021—these individuals may use those 2020 funds in 2021 without paying additional taxes on amounts over the usual \$5,000 calendar year limit.

Four Reasons Behind MidAmerica's Stance

Why MidAmerica will not amend plans to allow for elections up to the increased 2021 maximum DCA limit.

1

The mid-year election changes may be challenging to allow and could impact tax filings.

If an employer allows their employees to increase their DCA elections for 2021, employees must be cognizant of any unused 2020 DCA funds that are available for use in 2021 due to an extended grace period or carryover provision afforded by the CAA and adopted by their employer. Specifically, it's wise not to increase the 2021 DCA election to an amount that will exceed the \$10,500 exclusion limit that ARPA allows, once any unused 2020 funds are factored in. Any amount of DCAP benefits that exceeds the applicable limit that can be excluded from gross income must be reported to the Internal Revenue Service (IRS) as taxable income. This can be especially difficult to monitor for DCAPs that do not have a calendar year plan year, as the ARPA limit applies to the 2021 calendar year, not the 2021 plan year.

2

Nondiscrimination rules could be complicated by the DCA limit increase.

It's important to note that Code Section 129 nondiscrimination requirements have not changed for 2021. These requirements stipulate that DCAPs cannot discriminate in favor of highly compensated employees (HCEs). If a DCAP is deemed discriminatory, any HCEs participating in the DCAP will lose their exclusion from income under Code Section 129, meaning the amount of DCAP benefits the HCE receives for the year will be included in their gross taxable income for that year.

Allowing employees to increase their 2021 DCA elections mid-year up to the new \$10,500 limit may create a discriminatory status for the DCA, causing all participating HCEs to lose their income exclusion under Code Section 129.

3

Unforeseen impacts to 2022 taxable income.

ARPA provides for a higher exclusion limit in 2021 but what happens in 2022? If there is no further legislation to address income exclusion, then any unused DCA funds from 2021 that are available to be used in 2022 will be subject to the previous \$5,000 limit, meaning that any eligible expenses over \$5,000 that are incurred and reimbursed in 2022 would be regarded as taxable income in 2022. This is especially an issue for plans that operate on an off-calendar year plan year, so that elections made in 2021 will extend into the 2022 calendar year when the deduction limit is lowered.

4

The introduction of unplanned employer withholding and FICA obligations.

Code Section 129 provides that amounts contributed to a DCA, up to the prevailing allowable limit, are not subject to federal income tax withholding or FICA taxes. However, if an employer were to allow an employee who has a large DCA amount from 2020 that is available for use in 2021, to increase their 2021 contribution election to the new \$10,500 limit, it is possible that there could be unplanned withholding and FICA obligations if the IRS did not deem these elections as reasonably excludable from income.

Have questions? We're here to help.

If you have questions about the ARPA, its impact to your plan or MidAmerica's stance, don't hesitate to contact our Account Management team at accountmanagement@myMidAmerica.com.