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Guidance Issued on Nondiscrimination Testing for DCAPs

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Key Takeaways

- On August 11, 2026, the Department of the Treasury and the Internal Revenue Service issued proposed regulations providing guidance to employers that choose to make contributions to Trump Accounts for employees or their dependents, as well as guidance related to nondiscrimination rules for Dependent Care Assistance Programs (DCAPs) (sometimes referred to as dependent care flexible spending accounts or DCFSAs).
- Of note, the proposed regulations clarify nondiscrimination testing (NDT) requirements for employers offering Trump Account contribution programs and for those employers offering DCAPs.
- The clarifications to the DCAP NDT rules will likely result in employers passing NDT at a greater rate than in the past.
- While these regulations are proposed, employers may implement them for testing for the 2026 plan year.

Overview

Accounts under Section 530A of the Internal Revenue Code (Code), commonly known as “Trump Accounts,” are childhood savings vehicles established under the One Big Beautiful Bill Act. Under this legislation, employer contributions to these accounts are excluded from an employee’s gross income, as long as certain requirements are met, including NDT requirements similar to those required for DCAPs. On August 11, 2026, proposed regulations were issued regarding Trump Account employer contribution program requirements, including these NDT requirements. These proposed regulations provide helpful guidance regarding NDT both for employer contributions to Trump Accounts, as well as for DCAPs. *The focus of this bulletin is on the proposed changes to NDT for DCAPs*.

The proposed regulations provide clarifying guidance on *existing* nondiscrimination requirements for DCAPs. As a reminder, DCAPs allow employees to contribute up to $7,500 per year on a pre-tax basis to be used for qualified dependent expenses. To retain tax-favored status under the Code, DCAPs must satisfy tests governing eligibility and benefits to ensure the program is not discriminating in favor of highly compensated employees (HCEs) and certain owners.

NDT Testing for DCAPs

The proposed regulations (and existing law) require DCAPs to be made available on terms that do not discriminate in favor of HCEs or their dependents. To determine if the program is discriminatory, the following four tests would be required to be met (with details on the proposed changes included below):

(1) **Contributions and Benefits Test**

A DCAP must demonstrate that it does not discriminate in favor of HCEs by ensuring that contributions and benefits are not provided on more favorable terms for HCEs than for other employees. The proposed regulations provide that a program satisfies this requirement if it is designed to provide contributions and benefits on the same terms for all employees who are eligible to participate, even if eligible employees receive different amounts of contributions and benefits as a result of different elections or different utilization under the plan.

(2) **Eligibility Test**

The proposed regulations would require eligibility classifications to be reasonable, based on objective business criteria, and nondiscriminatory under *either* a facts-and-circumstances test or a numerical safe harbor.

> (a) The *facts-and-circumstances test*. The proposed regulations provide that an eligibility classification must be, based on all facts and circumstances, reasonable and established under objective business criteria that identify the category of employees who are eligible under the program. The proposed regulations would clarify that "reasonable classifications" generally include specified job categories, nature of compensation (salaried or hourly), geographic location, and similar bona fide business criteria, but that an enumeration of employees by name, or by criteria having substantially the same effect, is not a reasonable classification. While no one factor would be determinative, relevant considerations include the underlying business reason for the classification, the percentage of the employer's employees who are eligible under the plan, whether the eligible employees under the plan are representative of the employer's workforce across salary ranges, and the extent to which the plan's ratio percentage differs from the employer's safe harbor percentage. In general, the greater the business justification for the classification, the broader the coverage under the plan, the more representative the classification is across salary ranges, and the smaller the difference between the plan's ratio percentage and the employer's safe harbor percentage, the more likely the classification is to be nondiscriminatory.
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> (b) The *numerical safe harbor* would be satisfied if the plan's "ratio percentage" is greater than or equal to the "safe harbor percentage" of the employer. The plan's ratio percentage is determined by dividing the eligibility percentage of non-HCEs by the eligibility percentage of HCEs. The proposed regulations provide additional detail for determining eligibility percentages of HCEs and non-HCEs. The safe harbor percentage could be as high as 90 percent but may be reduced based on the percentage of non-HCEs who are employees. This test is already familiar in the retirement plan world under Code Section 410.

(3) **Average Benefits Test**

The law requires that the average benefits provided to non-HCEs must be at least 55 percent of the average benefits provided to HCEs under "all plans of the employer." The proposed regulations clarify that "all plans of the employer" is limited to all DCAPs of the employer.

Further, the proposed regulations clarify that for purposes of determining whether the average benefits test is met, only employees who actually contribute (or receive contributions) are considered. The average benefits test must be satisfied as of the last day of the plan year, but as a practical matter must be determined at an earlier date to ensure proper correction, if the test is not met.

CPC Comment: *The average benefits test has historically been the most difficult nondiscrimination test for DCAPs to pass; it is expected that passing rates will increase significantly under the proposed regulations once employers use the updated testing methodology.*

(4) **Owner Concentration Test**

This rule requires that not more than 25 percent of the amounts paid or incurred by the employer for DCAPs may be provided for shareholders or owners (including spouses and dependents) who own (including via family members) more than 5 percent of the stock or of the capital or profits interest in the employer on any day of the year. The proposed regulations restate the rule without change.

Excluded Employees

The proposed regulations would exclude from the *eligibility* and average *benefits testing* employees who have not attained age 21 and completed one year of service, as well as certain collectively bargained employees. In addition, for the *average benefits test only*, with respect to benefits provided via salary reduction, any employee whose compensation is less than $25,000 may be excluded (but is *not required* to be excluded).

CPC Comment: *This clarification may allow for more predictability in testing earlier in the plan year.*

Remediation of Certain Testing Failures

Under the proposed regulations, employers can address *average benefit test* failures by including excess benefit amounts in income for HCEs and would generally preserve favorable treatment for non-HCEs. How to determine excess benefit amounts are detailed in the proposed regulations. Current corrections typically involve midyear adjustments to elections and taxation of contributions if completed before the end of the plan year.

Effective Date

The proposed regulations, when made final, would apply to plan years beginning on or after publication of those final regulations in the *Federal Register*. However, the preamble to the proposed regulations makes it clear that employers may rely on them for plan years before the final regulations are issued.

Note: Comments to the proposed regulations are due by September 25, 2026, and a public hearing has been scheduled for October 15, 2026.

Please contact the CPC team with any questions.

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