

Proposed Regulations Offer Clarity on Dependent Care Assistance Program Nondiscrimination Rules

September 30, 2026

As part of the proposed regulations governing employer contributions to Trump Accounts that were published on August 20, 2026 (See: [Third Set is a Charm? Proposed Regulations Regarding Employer Contributions to Trump Accounts](#)), the IRS provided a bonus—proposed nondiscrimination rules for dependent care assistance programs (“DCAPs”), which largely mirror those for employers’ Trump Account Contribution Programs.

The IRS issued these proposed regulations because Internal Revenue Code (“Code”) Section 128, governing Trump Accounts, incorporates the provisions of Code Section 129(d)(2), (3), (6), (7), and (8) by reference. These proposed regulations contain definitions and the nondiscrimination rules applicable to DCAPs. The proposed regulations will apply to plan years beginning on or after the date final regulations are published, but employers may rely on them prior to that date.

Overview DCAP Nondiscrimination Tests

DCAPs allow an employee to exclude up to \$7,500 per year (\$3,750 for a married individual filing separately) of dependent care assistance from their taxable income. This includes pre-tax salary reductions under a cafeteria plan. A DCAP must satisfy four nondiscrimination tests:

- **Average benefits test:** The average benefits provided to non-highly compensated employees (“NHCEs”) under all DCAPs maintained by the employer must be at least 55% of the average benefits provided to highly compensated employees (“HCEs”). The proposed regulations clarify that eligible employees who do not elect to participate do not have to be counted in the average benefits test as receiving \$0. Instead, the average benefit test only counts employees who receive a benefit greater than \$0.
- **Contributions and benefits test:** Contributions and benefits may not discriminate in favor of HCEs or their dependents. The proposed regulations confirm that a plan offering the same benefits to all employees will pass this test, even if employee utilization is different between HCEs and NHCEs.
- **Eligibility test:** The DCAP must benefit employees in a classification that does not discriminate in favor of HCEs or their dependents. The proposed regulations establish criteria for reasonable classifications of employees and numerical safe-harbor and facts-and-circumstances tests, which are similar to the nondiscriminatory classification coverage tests under Code Section 410(b) for qualified retirement plans.
- **25% Owner concentration test:** No more than 25% of the dependent care assistance provided through the DCAP during the year may be provided to individuals who own more than 5% of the employer (including any ownership through their spouses and dependents).

Corrections Now Available for Certain Tests

DCAP nondiscrimination testing should be performed annually as of the last day of each plan year. The consequence of failing one of the required tests is generally that HCEs must include the DCAP benefit in taxable income. Testing failures do not affect NHCEs. The proposed regulations update these rules by

allowing employers to correct failures of the 55% average benefits test and the 25% owner concentration test after the end of the plan year by including the excess amount in the affected HCEs' or owners' income and reporting it timely on Form W-2 (generally due by January 31). The proposed regulations do not, however, provide a similar correction mechanism for the contributions and benefits test or eligibility test.

Other Updates to DCAP Nondiscrimination Testing

The proposed regulations also clarify other testing rules, including:

- Categories of employees who can be excluded from the testing group for the eligibility and average benefits tests:
 - Employees under age 21 who have not completed a year of service, and
 - Collectively bargained employees who do not participate and whose benefits were the subject of good-faith collective bargaining.
- The Code Section 414 related employer rules would apply in determining the employer's employee population and benefits (See: [Addressing the Risks of Related Employer Status for Benefit Plan Purposes](#)).
- Self-employed individuals are treated as employees for purposes of the tests.

If you have questions about the DCAP nondiscrimination rules, please contact a Boutwell Fay attorney.