

# DEPENDENT CARE FLEXIBLE SPENDING ACCOUNT

## A TAX BREAK ON DEPENDENT CARE EXPENSES

---

Any employee with young children in daycare knows that a sizable amount of the family's take-home pay is earmarked for this expense. The same is true for those who must provide daycare for a disabled spouse or parent. Because we're aware of this financial burden on employees, we're pleased to present some good news for employees with dependents in day-care.

The good news is that now there's a way to get a tax break on your daycare expenses — the dependent care flexible spending account. When you sign up for a flexible spending account, you're taking advantage of an IRS-approved way of handling dependent daycare expenses — a way that lets you pay for them with tax-free dollars.

## HERE'S HOW IT WORKS

---

- First, you estimate how much money you'll spend in the coming year for **eligible dependent care expenses**. These are expenses you incur for care of your dependents **during your working hours**. Be sure to read the Dependent Care Flexible Spending Account Information Sheet included in your kit before estimating how much you'll need.
- Once you've calculated the yearly amount, the flexible spending account allows you to set aside a portion of it from your salary each payday
- The amount you allocate to your flexible spending account is taken out of your pay **before** your taxes are calculated and withheld. This means that the part of your pay that goes to your flexible spending account is tax-free.
- When you pay for eligible dependent care expenses during the year, you get reimbursed for them with the money you've set aside in your flexible spending account. Since that money was set aside on a tax-free basis, **you've saved the tax dollars you would have paid on earnings spent for dependent care expenses**.

## HERE'S AN EXAMPLE THAT SHOWS HOW YOU CAN SAVE

---

In this example, the **family income** of a married employee with one child is \$35,000 per year. The employee has estimated that he will spend at least \$300 per month for dependent daycare (tax calculations assume employee is married filing a joint return and has two federal exemptions.) Compare the results when the employee pays for these expenses through his flexible spending account (FSA) rather than the traditional way:

	<u>Traditional Method</u>	<u>FSA Method</u>
<b>Employee's Family Monthly Gross Pay</b>	\$2,916.67	\$2,916.67
Dependent care FSA deduction	- 0.00	- 300.00
<b>Taxable Income</b>	2,916.67	2,616.67
Estimated federal and state taxes	427.85	365.60
Estimated Social Security (FICA) taxes (7.65%)	<u>223.13</u>	<u>200.18</u>
<b>Net Pay</b>	2,265.69	2,050.89
Reimbursement from FSA	+ 0.00	+300.00
<b>Spendable Income</b>	<b>\$2,265.69</b>	<b>\$2,350.89</b>

# IMPORTANT INFORMATION ABOUT YOUR DEPENDENT CARE FSA

## YOUR SAVINGS DEPEND ON YOUR CIRCUMSTANCES

---

The employee in our example saved \$85.20 per month — \$1,022.40 for the year — by using his flexible spending account (FSA). Your own savings will depend on your particular circumstances — your family income, tax status, dependent care expenses and the amount you decide to allocate to your account — but the FSA provides employees the opportunity to **save money on dependent care expenses** by paying for them with tax-free dollars.

## TAX LAWS

---

Because of the tax advantages of the dependent care FSA, there are rules and regulations about:

- the amount you are allowed to contribute to your FSA;
- the types of expenses eligible for reimbursement;
- taking a dependent care tax credit on your personal tax return if you are contributing to an FSA; and
- when you are allowed to cancel or change the amount you are contributing to your FSA each payday

Please read the Dependent Care Flexible Spending Account Information Sheet included in this kit for complete explanations of these rules.

## USING YOUR FSA

---

We will give you Request for Reimbursement forms to use after you incur eligible expenses. When you file a Request for Reimbursement, IRS regulations require you to submit a statement from your dependent care provider showing the amount of your expenses and the dates they were incurred. You will also be asked to provide the taxpayer identification number of your dependent care provider.

You may file a Request for Reimbursement anytime you've incurred eligible expenses. You will be reimbursed from your FSA periodically, according to a schedule we've established. Your reimbursement checks will be mailed directly to you, along with a statement showing the balance of your account.

Your FSA can only be used to reimburse expenses incurred **during our FSA plan year**. We will tell you when the plan year begins and ends before you sign up. Time will be allowed after the end of the plan year for you to file for expenses you incurred during the last part of the year.

You should **estimate your expenses carefully**, so that your FSA amount will cover most of your expenses, but will not exceed your total eligible expenses. The IRS regulations governing FSAs do not allow us to return unused amounts to you at the end of the plan year.

We are pleased to offer you the opportunity to participate in the FSA program — and to enjoy a tax break on dependent care expenses — this year.

## DEPENDENT CARE FLEXIBLE SPENDING ACCOUNT INFORMATION SHEET

Because of the tax advantages of the dependent care flexible spending account (FSA), there are tax laws and IRS regulations governing how it may operate. Please read this information sheet closely to be sure you understand these rules before you make your election.

### ELIGIBLE EXPENSES

---

Your dependent care FSA can be used for expenses for dependent care which allows you to work. If you are married, your spouse must be:

- employed also; or
- a full-time student for at least 5 months during the year; or
- disabled and unable to provide his or her own care.

The care must be for your:

- dependent children under age 13;
- disabled children;
- disabled spouse who is incapable of self-care; or
- disabled dependent parent(s) who is incapable of self-care.



Dependent care may be provided by:

- a nursery school;
- a private kindergarten if the child's education is merely incidental to the care provided;
- a daycare center; or
- an individual who is not one of your dependents.

### CHANGING YOUR ELECTION

---

You can change your FSA election once each year during the open enrollment period. If you choose to participate in the program now, you can change your decision during the next annual enrollment period. Similarly, if you choose not to participate now, you can join the plan at that time.

It is important to know that federal law places restrictions on changing your election at other times during the year. For this reason, if you participate in the program, you are generally not allowed to cancel or change the amount you allocate to your FSA until the next annual enrollment period. Nevertheless, you may do so at any time if certain events occur which have an impact on your dependent care needs. The only requirement is that the change you make must be consistent with the particular event that has occurred.

(changing your election, continued)

The events that might permit you to make a change are:

- Family status changes, including your marriage or divorce, the birth or adoption of a child, or the death of your spouse or dependent.
- Employment status changes, including a change in your spouse's employment status, a change in full-time vs. part-time employment status of either you or your spouse, or an unpaid leave of absence taken by either you or your spouse.

## TAX CONSIDERATIONS

---

Another way to get a tax break on dependent care expenses is by taking a dependent care credit when you file your yearly tax return. If you do this, the maximum amount of dependent care expenses you are allowed to consider in calculating your tax credit is:

- \$2,400 for care of one child; or
- \$4,800 for care of two or more children.

You cannot take a tax credit on expenses that were reimbursed from your FSA. For this reason, you must decide whether the tax credit method or the FSA method is better for you. *In general*, the FSA is better if your family's taxable income for the year is more than \$24,000.

In some situations, you may use both your FSA and the tax credit. If you set aside tax-free money in an FSA to pay for only a portion of your yearly dependent care expenses, you may take a tax credit based on some or all of the remaining amount. In this situation, the maximum amount of expenses you can consider in calculating your tax credit is reduced dollar-for-dollar by the amount you put in your FSA. For example, if you set aside \$4,000 in an FSA for care of your two children, but actually incurred expenses of \$4,800 for the year, you may take a tax credit based on the remaining \$800.

NOTE: Federal tax law requires that you report the name, address and taxpayer identification number (or Social Security number, for individuals) of your dependent care provider on your tax return. Failure to do so will result in a denial of your FSA exclusion and/or your tax credit.

## ACCOUNT CONTRIBUTION LIMITS

---

Whether you use your FSA alone or in combination with a tax credit, the maximum amount of dependent care expenses you are allowed to consider in total is limited to:

- \$5,000 if you are single or if you are married and file a joint tax return.
- \$2,500 per parent who is eligible to participate in an FSA, if you are married and file separate tax returns.

If you are married, your FSA contribution is limited to the lower of the annual income of you or your spouse, up to the maximums shown above. If your spouse is a student or disabled and incapable of self-care, his or her monthly income is assumed to be \$200 per month, if care is provided for one dependent, or \$400 per month, if care is provided for two or more dependents. Your spouse's annual income is based on the actual number of months during which he or she is a student or disabled and incapable of self-care during the year.