

## Dependent Care Assistance Plan Q & A

IRS permits you to exclude from your gross income a certain amount of the dependent care expenses that you pay in order to work (or look for work), and has provided two methods for you to do this. Under § 21, you can deduct your expenses as a Dependent Care Tax Credit when filing your income tax return. IRC § 129 allows you to participate in a Dependent Care Assistance Plan (DCAP) through your cafeteria plan.

- How do I know whether to use the DCAP under the cafeteria plan or the Dependent Care Tax Credit when filing my income tax return?

Generally, if your income tax bracket is 15% or less, you will probably come out ahead by filing for a tax credit on your income tax return. However, this varies depending on your filing status and how many dependents you have. For more information, see the IRS Publication 503, Child and Dependent Care Expenses.

- Must my spouse work also?

Your spouse must also be gainfully employed, in active search of gainful employment, be physically incapable of self-care, or be a full-time student. Unpaid volunteer work is not considered gainful employment.

If you divorce and remarry, your spouse must also be gainfully employed even if she has no legal connection with the children.

- What is a "qualified individual"?

There are two types of qualified individuals:

- Dependent 12 or younger. This is your dependent living with you (usually your child) for whom you are eligible to claim a dependency exemption on your income tax return.
- Disabled spouse or dependent. If your spouse (or dependent) is physically or mentally incapable of self-care, that person is a qualified individual. It is not necessary for you to be eligible to claim a dependency exemption on your income tax return for that person.

- What expenses can I claim under a DCAP?

You can only claim expenses that are "employment-related expenses" or expenses which pass both of the following tests:

- The dependent care is necessary for you (and your spouse) to be gainfully employed (or to actively search for gainful employment), and
- The dependent care (and incidental household services) is for one or more qualifying individuals.

The expenses are determined on a daily basis. This means that the dependent care for each day must be necessary for you (and a spouse, if any) to work. If you work Monday through Friday and your spouse works Thursday through Sunday, only the dependent care for Thursday and Friday are eligible since those are only the two days both of you work.

Expenses for incidental household services are eligible may be claimed if they are "paid for the performance in and about the taxpayer's home of ordinary and usual services necessary to the maintenance of the household" and are "attributable in part to the care of the qualifying individual."

The following expenses are **not** reimbursable:

- Overnight Camp (not even if the charges for day and night are split out)
- Care where the provider is your child that is under 19 years old
- Care provided by a day care center that does not comply with state or local law
- Payment to someone that you or your spouse could claim as a dependent for federal income tax purposes
- Services provided outside your household for dependent incapable of self-care unless that person spends at least eight hours a day in your household
- Educational expenses for kindergarten and above

- How much can I claim?

The most you can claim in a calendar year is the smallest of the following amounts:

\$5,000 if you are married and filing a joint return or you are single (\$2,500 if you are married, but filing separately),

Your earned income, or

If you are married at the end of the taxable year, your spouse's earned income.

If your wife is physically incapable of self-care or is a full-time student, your wife will be considered to have an imputed earned income of \$200 for one child or \$400 per month for two or more children.

- How do I get reimbursed?

To be reimbursed, you must file a claim form with your employer according to the claim instructions which include the following rules:

1. The expenses must be incurred within the Plan Year. You will be given a grace period after the end of the Plan Year to submit all your expenses.
2. The claim must be for expenses already incurred.

If the balance in your DCAP account (contributions to date minus previous payments) is not sufficient to pay your expenses, you will be paid the amount in your account. After you contribute more money to the account, you will automatically be reimbursed for the difference.

- What happens if I change day care providers or the provider changes rates?

IRS has realized the difficulties these issues raise for employees, and has become very liberal in allowing changes for day care. You can change your election if your day care provider changes rates unless the day care provider is a relative. If you switch day care providers, you can change your election accordingly.

- What happens if I do not have enough expenses to be reimbursed for the whole amount that I have contributed?

The regulations for cafeteria plans do not allow any unused contributions to be carried forward to the next plan year or to be refunded to you. Be careful estimating your expenses.