

# Day Care Reimbursement Flexible Spending Account

A day care reimbursement flexible spending account is an allowable option of a cafeteria compensation plan.

## How does it work?

At the beginning of each plan year, each participating employee will determine an amount to set aside for the plan year on a non-taxed basis to pay the day care expenses. The employee will then submit vouchers, with receipts from the day care provider, requesting reimbursement for those expenses as they are incurred. The employee will be reimbursed with tax-free dollars.

## Who is eligible to participate?

The employer will determine who is eligible to participate when establishing and qualifying the plan. The tax regulations state the plan must be offered to all employees:

- Who have completed at least one year of service.
- Who work at least 1,000 hours per year.
- Who are at least 21 years of age.

## Is the tax credit or the cafeteria plan better?

Each employee with day care expenses should do a comparison between the cafeteria reimbursement and the tax credit to determine which would be better for him or her.

If an employee chooses to be reimbursed through the cafeteria plan the maximum reimbursement (subject to the plan documents) is \$5,000 per year (\$2,500 if married and filing separately). If an employee chooses to take the tax credit, the maximum eligible expense qualifying for the credit is \$3,000 for one child, and \$6,000 for two or more children.

The following example shows a comparison between the cafeteria plan reimbursement and the income tax credit. Assume that the husband's salary is \$18,000 per year and that the wife's salary is \$18,000 per year. The total adjusted gross income is \$36,000 ( $\$18,000 + \$18,000 = \$36,000$ ). They file jointly, and 28% of salary is withheld for taxes (7.65% Social Security, 15% Federal and 5.35% State). They have one child who goes to a day care center. The cost for the child is \$400 per month.

Through the cafeteria plan, the couple would save \$112 per month in taxes or \$1,344 per year ( $\$400 \text{ per month} \times .28 \times 12 = \$1,344$ ).

With the tax credit, the couple would get a credit of \$750.00 per year ( $\$3,000 \times .25 = \$750.00$ ). Based on their adjusted gross income, the allowable percentage would be 25% of their qualifying expense.

The family in the comparison above would save significantly more money with participation in the cafeteria plan dependent day care reimbursement rather than taking the income tax credit.

## Dependent Day Care Comparison Cafeteria Plan vs. Tax Credit

### Dependent day care cafeteria plan:

If the employee chooses to be reimbursed through the company's cafeteria plan with non-taxed dollars, the maximum reimbursement (subject to the plan document) is \$5,000 per year (\$2,500 if married and filing separately),

Enter the qualifying dependent care expenses \$ \_\_\_\_\_

Enter your total tax percentage (federal, state and FICA) X \_\_\_\_\_

Multiply the expense by the %, enter the result \$ \_\_\_\_\_  
(this is the amount of tax savings)

### Dependent day care tax credit:

If the employee chooses to take the dependent tax credit (Form 2441 of the IRS Form 1040), the maximum eligible expense qualifying for the dependent tax credit is \$3,000 for one child, and \$6,000 for two or more children.

In order to determine the percentage that applies to the adjusted gross income from Form 1040 in figuring the applicable tax credit, multiply the dependent day care expense (up to \$3,000 for one child or up to \$6,000 for two or more) by the allowable percentage indicated for the adjusted gross.

Adjusted Gross	Percentage is:
Over      But not over –	
0-10,000	35%      (.35)
10,000-12,000	34%      (.34)
12,000-14,000	33%      (.33)
14,000-16,000	32%      (.32)
16,000-18,000	31%      (.31)
18,000-20,000	30%      (.30)
20,000-22,000	29%      (.29)
22,000-24,000	28%      (.28)
24,000-26,000	27%      (.27)
26,000-28,000	26%      (.26)
28,000-No Limit	25%      (.25)

Enter the qualified dependent care expenses \$ \_\_\_\_\_

Enter the % that applies to the adjusted gross X \_\_\_\_\_

Multiply the expense by the %, enter the result \$ \_\_\_\_\_  
(this is the amount of tax savings)