

Dependent Care Flexible Spending Accounts

Dependent Care Flexible Spending Accounts Offer Tax Savings

With the costs of child and eldercare rising, managing quality care for loved ones can be a daunting task. If your employer offers a dependent care flexible spending account (FSA), you should consider the tax savings it offers.

A dependent care FSA allows you to direct part of your pre-tax earnings into a special reimbursement account. Because the money goes into your dependent care account before federal income or Social Security taxes are withheld, you pay less in taxes. During the year, you use these funds to reimburse yourself for dependent care expenses.

Eligible dependents

Eligible dependents include dependent children under age 13 who are claimed as dependents on your tax return, and your spouse or other adult dependent, such as a parent, who is physically or mentally incapable of self-care and for which you maintain a household.

Types of reimbursable expenses

Payments to nursery schools and day care centers qualify for reimbursement, as do payments for before- and after-school care and summer day camp (but not overnight camp) for children up to age 13. If the dependent is not your child, the expense of care outside your home qualifies only if the dependent regularly spends at least eight hours per day in your home.

Payments made to an individual or to a relative who cares for your dependents are also eligible, provided that this relative is not a person who you claim as a dependent.

Maximum deposit

The IRS limits the amount of a tax-free reimbursement to \$5,000 for couples filing jointly or individuals who are single and head of household. If you are married filing separately, you can set aside \$2,500.

Careful estimates required

It is important to carefully estimate the amount to deposit in your account because, under IRS regulations, any money left after you have submitted all your claims will be forfeited. There is a grace period, generally until April 15 of the following year, to submit reimbursement claims for expenses incurred in the previous year. If your yearly expenses exceed the amount in your FSA, the remainder must be paid with after-tax dollars.

Changing the amount specified

Once you have designated a contribution amount for a given year, you may not discontinue contributions to your account. The only way the amount can be changed is if you have a change in family status, such as marriage, divorce or legal separation, birth or adoption of a child, or the death of a spouse or dependent. You can also change your contribution amount if there has been a significant change in your spouse's coverage due to a change in his or her employment.

Dependent care tax credit

You cannot use the Dependent Care FSA and the federal dependent care tax credit for the same expenses. You will need to determine which approach would be more advantageous. Lower income families may be better off claiming the child-care credit than using a FSA, but it's best to check with a CPA.

Leaving your job

Your deposits will stop, but you can continue to submit claims for expenses incurred prior to termination through the end of the plan year or until your balance is used up.