



Benefits Administration Letter

Number: 03-803

Date: June 3, 2003

Subject: Dependent Care Flexible Spending Accounts and other Child Care Subsidies

Since we published BALs 03-306 and 03-801 we've heard from a number of human resource and payroll administration staff asking questions and expressing concerns about agency responsibilities for employees who are eligible for an agency's child care subsidy program and who also make an election to participate in a dependent care flexible spending account (DCFSA). This BAL provides additional background and guidance on this issue.

Public Law 107-67, Treasury and General Government Appropriations Act, 2002, Section 630, Title VI—General Provisions Departments, Agencies and Corporations, authorized permanent legislation enabling Executive Agencies to implement child care subsidy programs for their qualified Federal employees. With the new Federal FSA Program being implemented July 1, agencies may find that they have employees who are receiving a child care subsidy as well as participating in the DCFSA.

In accordance with Section 129 of the Internal Revenue Code, an employee can generally exclude from gross income up to \$5,000 of benefits received under a dependent care assistance program each year. The limit is reduced to \$2,500 for married employees filing separate returns. The exclusion cannot be more than the earned income of either the employee or the employee's spouse. The total dependent care benefits the employer paid to the employee or incurred on the employee's behalf (including amounts from a Flexible Spending Account, Section 125 plan) should be reported in Box 10 of Form W-2. Any amount over \$5,000 should be included in Boxes 1, 3, and 5, as "wages," "social security wages" and "Medicare wages."

Therefore, if an agency has a tracking mechanism that allows them to monitor the aggregate amount an employee is receiving through a Dependent Care Flexible Spending Account and a child care subsidy, that agency is responsible for deducting appropriate employee taxes and remitting both the employee taxes and the employer share of FICA once the \$5,000 (or \$2,500) is reached.

If for some reason the agency does not realize the employee has exceeded the \$5,000 limit on dependent care and therefore did not remit employee taxes, the employee will reconcile that with the IRS at the time they complete and submit their taxes while filing their taxes for the prior tax year.

Here are a few examples that describe this situation:

Example #1 Federal Employee married to Non-Federal Employee

Mary Johnson is a federal employee, married to Rick who works for ABC Company. They have two children, aged 8 and 4. Mary's agency participates in the child care subsidy, and based on income, receives an annual subsidy of \$1,500. Although they do not have a cafeteria plan Rick's employer, ABC Company, also assists its employees with child care expenses. Under the ABC program, Rick receives \$1,000 per year.

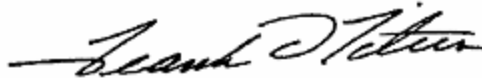
During the initial Open Season, Mary elects to allot \$3,000 into a DCFSA. With their combined child care assistance and FSA election, Mary and Rick exceed the \$5,000 annual maximum by \$500. Since this information could not be known by each employer, Mary and Rick will reconcile any additional taxes owed when they complete and file a tax return on or before the next April 15th.

Example #2 Federal Employee Transfers Between Two Agencies that Offer Subsidies

Marlene works for Agency #1 which participates in the child care subsidy program. She receives \$3,000 per year. In May 2003, she elects to allot \$2,000 into a DCFSA beginning July 1st. Marlene transfers to Agency #2 in September, covered under the Federal FSA Program. That agency also offers a child care subsidy program, and Marlene is eligible for \$2,000.

While the DCFSA would transfer with Marlene, the subsidies are individual to each agency. Marlene's new agency would have no information about any subsidies she had received at Agency #1. Again, Marlene will reconcile any additional taxes owed when she files her tax return on or before the next April 15th.

We hope this information is helpful. If you have any questions, please contact Jennifer Hirschmann. She can be reached at 202-606-1413, or by email at jxhirsch@opm.gov.



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