

# THE ADVANTAGE OF *Choice*

  
**COLONIAL**  
SUPPLEMENTAL INSURANCE

*for what happens next*®

## Dependent Care Flexible Spending Account

### A plan that enhances your benefits

If you're one of the many people who spends money on the care of dependents, a dependent care flexible spending account can make these expenses more affordable. This valuable option is available through your employer's flexible benefits plan and is a qualified benefit under Code Section 125 of the IRS. Code Section 125 was created by the United States Congress to make benefits more affordable for you.

### How it works

If you participate, you will elect to have a specified amount of pretaxed money deducted from your paycheck each pay period. These dollars are set aside in a flexible spending account and subtracted from your gross earnings before any taxes are taken out. After you submit a receipt for a qualifying dependent care expense, you will be reimbursed from this account.

### How it benefits you

The advantage to participating is that when you contribute pretax dollars to a reimbursement account, you lower your taxable income; therefore, you pay less in taxes and increase your spendable income!



For example...

### Mary's status:

**Married**

**three fed./state exemptions**

**Weekly salary: \$500**

**Eligible expenses:**

**dep. care/\$50**

Mary has one child.

She pays \$216 per month  
(\$50 per week) for day care.

Here's how a dependent care  
plan can help her.

Mary chooses to have \$50 each pay period deducted from her gross salary. When she incurs qualifying dependent care expenses, she simply files a claim and is reimbursed from the account. Because her taxable income is now lower, her taxes are less.

After Mary is reimbursed from her account, her total spendable income increases by \$14.47 each week.

	Before Dep. Care FSA reim.	After Dep. Care FSA reim.
Gross pay	\$500.00	\$500.00
Pretax dep. care reduction	-0-	- 50.00
Taxable gross	500.00	450.00
FICA, fed. & state taxes	- 71.42	- 59.45
Net pay	428.58	380.55
Dep. care reimbursement		+50.00
<b>Spendable income</b>	<b>\$428.58</b>	<b>440.55</b>

## How much can I contribute?

The U.S. Congress has set these maximum allowable contributions for a dependent care flexible spending account:

- ◆ \$5,000 for a married couple filing jointly.
- ◆ \$5,000 for a single parent.
- ◆ \$2,500 for a married person filing separately.

## Eligible expenses

You may use the plan for expenses that meet the following qualifications:

- ◆ The dependent care must enable you and your spouse to be employed.
- ◆ The amount to be reimbursed must not be greater than your spouse's income or one-half of your income, whichever is less.
- ◆ The child must be under 13 years old and must be your dependent under federal tax rules. Note: If your child turns 13 during the plan year, reimbursements must stop. Your contributions, however, must continue throughout the plan year, so plan carefully.
- ◆ The services may be provided in your home or another location but not by someone who is your minor child or dependent for income tax purposes (for example, an older child).
- ◆ If the services are provided by a day care facility that cares for six or more children at the same time, the facility must comply with state and local day care regulations.
- ◆ Services must be for the physical care of the child, not for education, meals, etc.

Qualified dependent care expenses also include **costs for the care of a spouse or dependent who is incapable of self-care and regularly spends at least eight hours per day in your home** (i.e., an invalid parent). The same rules that apply for child care apply to the care of other dependents, except that the dependent need not be under age 13.

## Tax credits vs. dependent care FSAs

If you participate in the plan, you cannot claim credits on your income tax return for the same expenses. Also, amounts reimbursed under this plan will reduce the amount of other dependent care expenses that you can claim for purposes of tax credits. Before you sign up, evaluate whether or not taking federal income tax credit will save you more money than a dependent care FSA. The worksheet included with this newsletter will help you decide.

## The "Use it or lose it" rule:

*If you contribute dollars to a reimbursement account and do not use all of the monies you deposit, you will lose any remaining balance in the account at the end of the plan year.*

A very important thing to remember...the rule exists because the IRS has established strict guidelines on plans with tax advantages. So estimate carefully the amount you want to contribute to the FSA, and only contribute dollars you're confident will be used before the end of the plan year.

## What do I need to know when I file my taxes?

You must report on your tax return the correct name, address, and taxpayer identification number (TIN) of your dependent care provider to claim exclusion for employer-provided dependent care assistance benefits or the dependent care credit.

If your dependent care provider is exempt from federal income taxation, you are not required to report the TIN on your tax return. However, you must report the correct name and address of the exempt provider and you must write "tax-exempt" in the space provided for reporting the TIN.

If you fail to report the correct name, address, and TIN of your dependent care provider and cannot establish upon request by the IRS that you exercised due diligence in attempting to provide that information, you are not entitled to either the Section 21 credit nor the Section 129 exclusion.

Due diligence can be proven by having obtained and retained a copy of the Social Security card (or driver's license) of your dependent care provider, or by having obtained the required information from a recently printed letterhead or printed invoice from the dependent care provider.



## What if I want to make a change in my election?

The latest set of cafeteria plan regulations develops a process for determining if a participant is allowed to make a change in election during the plan year. The two-step process is:

- 1) *A change in status must have occurred.* A change in status has occurred if the event falls into one of the categories below:
  - ◆ Legal marital status
  - ◆ Number of dependents
  - ◆ Employment status
  - ◆ Dependent satisfies (or ceases to satisfy) eligibility requirements
  - ◆ Change of residence
- 2) *The participant's election change must be consistent with the status change event.* In order to be consistent, a requested change must be on account of and correspond with the change in status.

## What if the tax laws change?

Tax advantages currently available are based on the law as it stands today. If a change in the law takes place, you will be notified.

## Will pretaxing have an impact on Social Security benefits?

Any reduction in your taxable pay may also lead to a reduction in your Social Security benefits; however, for most employees, the reduction in Social Security benefits is insignificant compared to the value of paying lower taxes today.



## Understand your choices.

With this program, you have benefit choices and opportunities you've never had before, and it's important to understand everything completely.

Reading this newsletter is the first step. The next step is to attend a planning session. At the session, your Colonial representative will answer questions and estimate your tax savings, based on the amount you plan to contribute.

## The value of additional benefits

During enrollment, you can take advantage of your increased spendable income by adding more benefits. Through your employer's flexible benefits plan, you'll be able to pay the premiums for qualifying benefits with pretax dollars and your benefits become even more affordable.

Let's take another look at Mary's situation. If Mary chooses to deduct \$10.60 per week in qualified premiums from her gross pay, along with her \$50 dependent care deduction, here's how it would affect her paycheck:

## Dependent care FSA and pretax premiums illustration

Mary's status: Married, three fed./state exemptions  
Weekly salary: \$500  
Eligible expenses: Dep. Care FSA/\$50  
Colonial coverages/\$10.60

	w/Dep. Care FSA & After-tax Premium	w/Dep. Care FSA & Pretax Premium
Gross pay	\$500.00	\$500.00
Pretax dep. care reduction	- 50.00	- 60.60
Taxable gross	450.00	439.40
FICA, fed. & state taxes	- 59.45	-56.80
Net pay	390.55	382.50
Insurance	-10.60	
Dep. care reimbursement	+50.00	+50.00
<b>Spendable income</b>	<b>\$429.95</b>	<b>\$432.50</b>

Mary's taxes are again lowered—\$56.80 versus \$59.45.

You, too, can tailor your benefits package by choosing products you want and need, while reducing your tax burden.

**Save this newsletter.**

Keep this newsletter and worksheet for future reference. Additional copies are available through your employer. Take the time to complete the attached worksheet and determine whether the dependent care flexible spending account will benefit you. Then plan to meet with your Colonial representative. You'll be amazed at the benefits you can enjoy through The Colonial Advantage.

# Dependent Care Reimbursement Plan Worksheet

LAST YEAR

THIS YEAR

Day Care .....	_____	_____
Nursery Schools .....	_____	_____
Other Eligible Care .....	_____	_____
Total Dependent Care .....	_____	_____

## Reimbursement vs. Tax Credit

Dependent care expenses eligible for reimbursement from your account are also eligible for a federal income tax credit. You can apply one or the other of these two tax advantages, but not both for the same expense. State income tax may impact this result. Your Colonial Representative will help explain this program to you.

## How Does the Tax Credit Work?

The tax credit applies to a maximum of the first \$3,000 of expenses if you have one eligible dependent. The credit applies to the first \$6,000 of expenses with two or more eligible dependents. Depending on your adjusted gross income, a certain percentage of those expenses may be taken as a credit.

## Maximum Annual Contributions to Dependent Care Reimbursement Account

Maximum \$5,000—Single-parent household, or married, filing jointly.

Maximum \$2,500—Married, filing separately.

*Note: Dependent care expenses shall not include any amount paid for services outside the taxpayer's household at a camp where the qualified individual stays overnight.*

## Tax Credit

Complete the following to determine the maximum tax credit for your dependent care expenses.

- Write the amount of qualified expenses you incurred and actually paid last year and expect to pay this year for the care of the qualified person\*. **DO NOT** write more than \$3,000 (\$6,000 if you expect to pay for the care of two or more qualified persons\*)..... 1. \$ \_\_\_\_\_
- Write your estimated earned income\*\* for this year. .... 2. \$ \_\_\_\_\_
- Write your spouse's estimated earned income for this year ..... 3. \$ \_\_\_\_\_
- Compare amounts on line 2 & 3, and write the smaller of the two amounts on line 4. .... 4. \$ \_\_\_\_\_
- Compare amounts on line 1 & 4, and write the smaller of the two amounts on line 5. .... 5. \$ \_\_\_\_\_
- Write the percentage from the table below that applies to the Adjusted Gross Income (AGI) on Form 1040, line 36 ..... 6. \$ \_\_\_\_\_

If AGI is over:	But not over:	Percentage is:	If AGI is over:	But not over:	Percentage is:	If AGI is over:	But not over:	Percentage is:
\$0	-15,000	35% (.35)	\$25,000	-27,000	29% (.29)	\$35,000	-37,000	24% (.24)
15,000	-17,000	34% (.34)	27,000	-29,000	28% (.28)	37,000	-39,000	23% (.23)
17,000	-19,000	33% (.33)	29,000	-31,000	27% (.27)	39,000	-41,000	22% (.22)
19,000	-21,000	32% (.32)	31,000	-33,000	26% (.26)	41,000	-43,000	21% (.21)
21,000	-23,000	31% (.31)	33,000	-35,000	25% (.25)	43,000	no limit	20% (.20)
23,000	-25,000	30% (.30)						

- Multiply the amount on line 5 by the percentage shown on line 6 and write result ..... 7. \$ \_\_\_\_\_  
This is the maximum amount of your credit for dependent care expenses (amount of credit may not exceed the amount you pay in taxes).

### \*Qualifying Person:

- Under age of 13 whom you claim as a dependent.
- Disabled Spouse who is mentally or physically incapable of self-care.
- Any disabled person who is mentally or physically incapable of self-care and whom you claim as a dependent or could claim as a dependent except that the individual had an income of \$3,050 or more.

\*\*Earned Income: Wages, salaries, tips, and other employee compensation. It also includes earnings from self-employment.

*Neither Colonial Life & Accident Insurance Company nor the employer assumes responsibility for the accuracy of the calculations nor the resulting tax savings and neither is in any way rendering tax advice.*

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**Colonial Life & Accident Insurance Company**  
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www.coloniallife.com

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