

Dependent Care Flexible Spending Account vs. The Dependent Care Credit

Individuals incurring dependent care costs have two choices which would allow them to save taxes on these costs. One would be taking advantage of the income tax credit that is available from the federal government (Form 2441). The other option is available to individuals who are eligible to participate in a Cafeteria Plan sponsored by their employer. Many individuals are in a position where both these options are available to them and a decision must be made as to which will bring them more savings.

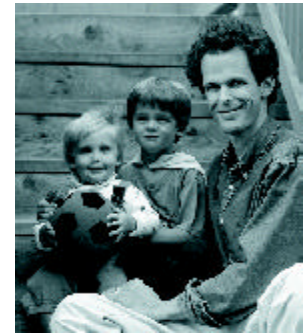
Many factors need to be considered by the individual or their family, when determining whether to take the dependent care credit or participate in the dependent care benefit under an employer's Cafeteria Plan.

<u>INCOME</u>	<u>CREDIT</u>	<u>INCOME</u>	<u>CREDIT</u>
0-10,000	.35	27,000-28,000	.28
10,000-12,000	.35	28,000-29,000	.28
12,000-14,000	.35	29,000-30,000	.27
14,000-15,000	.35	30,000-31,000	.27
15,000-16,000	.34	31,000-32,000	.26
16,000-17,000	.34	32,000-33,000	.26
17,000-18,000	.33	33,000-34,000	.25
18,000-19,000	.33	34,000-35,000	.25
19,000-20,000	.32	35,000-36,000	.24
20,000-21,000	.32	36,000-37,000	.24
21,000-22,000	.31	37,000-38,000	.23
22,000-23,000	.31	38,000-39,000	.23
23,000-24,000	.30	39,000-40,000	.22
24,000-25,000	.30	40,000-41,000	.22
25,000-26,000	.29	41,000-42,000	.21
26,000-27,000	.29	42,000-43,000	.21
		43,000 plus	.20

As a general rule under the Cafeteria Plan, the employee will save approximately 27.65 percent of each dollar that is run through the plan. This percentage is based on an employee with income in the lowest tax bracket; therefore the savings may be larger for an employee with larger earnings. The savings realized by the dependent care credit varies and is dependent upon the family's income. The following chart for the credit can be used. The credit column represents the multiplier. For example, if income is between 26,000 and 27,000, you will save 29 percent of each dollar spent on qualified dependent care expenses

within the respective limitations.

In looking at a true comparison of which is more beneficial, expense limitations do apply. If any individual is participating in the dependent care benefit under a Cafeteria Plan, the maximum they may run through the plan is \$5000. This is regardless of the number of children. \$5,000 may be used for one child or three children.



The limit on the expenses for purposes of the credit is \$3,000 for one child or \$6,000 for two or more children. So dependent upon the circumstances, this will have a considerable impact for families with only one child. If families with one child participate in the dependent care benefit under a Cafeteria Plan, they may take a maximum of \$5,000 through the plan. If these same families take the credit, they will only be able to consider \$3,000 in costs.

The next step is to consider the amount of income in order to estimate their savings. For the Cafeteria Plan, the minimum savings will be 27.65 percent of each dollar. This may be greater if the employee is in a higher income tax bracket. For the credit, the percentage savings is based on the income of both spouses if they file a joint return. For example, in looking at the above chart, husband and wife jointly earning \$40,000 will save 22 percent of each dollar. Under a Cafeteria Plan, this family will save 27.65 percent of each dollar. It is important to add that if an employee and their spouse have a joint income of \$30,000 or less and with only one child, they may likely realize a greater savings by taking advantage of the credit. (For the credit, the less the income, the greater the savings).

One final item to consider is the fact that by participating in the dependent care benefit under a Cafeteria Plan, the savings will be realized immediately. While the saving realized by taking the dependent care credit occurs only at the time the employee files their yearly tax return.

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