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Intro to Dependent Care Assistance Programs

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Dependent Care Benefits

- If employee receives dependent care benefits from his/her employer during the year, employee may be able to exclude all or part of them from income.
- Dependent care benefits include:
 - Amounts employer paid directly to either employee or care provider for care of employee's qualifying person while employee works
 - Fair market value of care in a daycare facility provided or sponsored by the employer, and
 - Pre-tax contributions made under a dependent care flexible spending arrangement.

Dependent Care Benefits

- Employee's salary may be reduced to pay for these benefits.
- If employee receives dependent care benefits as an employee, they are shown in box 10 of Form W-2.
- Employer must give employee a Form W-2 (or similar statement), showing in box 10 the total amount of dependent care benefits provided during the year under a qualified plan.
- Employer must also include in wages shown in box 1 of your Form W-2 any dependent care benefits that exceed the maximum amount of dependent care benefits allowed to be excluded.

Fringe Benefits

- A fringe benefit is a form of pay for the performance of services.
- For example, employer provides employee a fringe benefit when employee is allowed to use a business vehicle to commute to and from work.
- Fringe benefits are generally included in an employee's gross income (there are some exceptions).
- Benefits are subject to income tax withholding and employment taxes.
- In general, the amount employer must include is the amount by which the fair market value of the benefits is more than the sum of what employee paid for it plus any amount the law excludes.
- There are other special rules employers and employees may use to value certain fringe benefits.
- See <https://www.irs.gov/publications/p15b> for more information.

Dependent Care Assistance

- Exclusion applies to household and dependent care services employer directly or indirectly pay for or provide to an employee.
- Must be under a written dependent care assistance program (DCAP) covering only employees.
- Services must be for a qualifying person's care.
- Must be provided to allow employee to work.
- Requirements are similar as tests employee would have to meet to claim the dependent care credit if employee paid for the services.
- For more information, see <https://www.irs.gov/publications/p503>.

Dependent Care Assistance

For the exclusion, IRS allows treatment of the following individuals as employees.

- Current employee.
- A leased employee who has provided services to employer on a substantially full-time basis for at least a year if services are performed under employer's primary direction or control.
- Employer (if employer is a sole proprietor).
- A partner who performs services for a partnership.

Dependent Care Assistance

- Employer can exclude value of benefits provided to an employee under a DCAP from employee's wages if employer reasonably believes employee can exclude benefits from gross income.
- Employee can generally exclude from gross income up to \$7,500 (\$3,750 if married filing separately) of benefits received under a DCAP each year.
- However, exclusion can't be more than smaller of earned income of either employee or employee's spouse.
- Special rules apply to determine earned income of a spouse who is either a student or not able to care for themselves.
- For more information on the earned income limit, see <https://www.irs.gov/publications/p503>.

Dependent Care Assistance

- Employer unable to exclude dependent care assistance from wages of highly compensated employees unless benefits provided under the program don't favor highly compensated employees and program meets requirements of IRC section 129(d)
- For this exclusion, a highly compensated employee for 2026 is an employee who meets either of the following tests.
 - Employee was a 5% owner at any time during year or preceding year.
 - Employee received more than \$160,000 in pay for preceding year.
 - Employer can choose to ignore test #2 if employee wasn't also in top 20% of employees when ranked by pay for preceding year.

Dependent Care Assistance

- Report the value of dependent care assistance employer provided to employee under a DCAP in box 10 of employee's Form W-2.
- Include amounts employer can't exclude from employee's wages in boxes 1, 3, and 5.
- Report in box 10 both nontaxable portion of assistance (up to \$7,500) and any assistance above that amount taxable to employee.
- Example. Employer provides a dependent care assistance FSA to employees through a cafeteria plan. In addition, it provides occasional on-site dependent care to employees at no cost. An employee had \$7,000 deducted from pay for dependent care FSA. In addition, employee used on-site dependent care several times. FMV of the on-site care was \$700. Employee's Form W-2 should report \$7,700 of dependent care assistance in box 10 (\$7,000 FSA plus \$700 on-site dependent care). Boxes 1, 3, and 5 should include \$200 (amount in excess of nontaxable assistance), and applicable taxes should be withheld on that amount.

Employer-provided Childcare Credit

- If employer provides childcare services to employees, employer may be eligible for this general business credit.
- It covers qualified expenditures for a childcare facility and for childcare resource and referral.
- The Employer-Provided Childcare Credit offers employers a tax credit up to \$150,000 per year to offset 25% of qualified childcare facility expenditures, 10% of qualified childcare resource and referral expenditures.
- Credit is an incentive for employers to provide childcare services to their employees.

Employer-provided Childcare Credit

- To be eligible for the credit, employer must have paid or incurred qualified childcare expenditures during tax year to provide childcare services to employees.
- Qualified childcare expenditures are:
 - Costs associated with acquiring, constructing, rehabilitating or expanding property used employer's qualified childcare facility.
 - Qualified childcare facility expenditures are operating expenses made by employer, including amounts paid to support childcare workers through training, scholarship programs, and providing increased compensation to employees with higher levels of childcare training.
 - Qualified resource and referral expenditures which include amounts paid or incurred under a contract with a qualified childcare facility to provide childcare services to employees of employer.

What is a Qualified Childcare Facility

- A qualified childcare facility is a space meeting requirements of applicable laws and regulations of the state or local government where located.
- Includes licensing of facility as a childcare facility.
- Facility must also meet the following:
 - Principal use of the facility must be to provide childcare assistance (unless facility is also principal residence, within meaning of IRC section 121, of the person operating the facility).
 - Enrollment in facility must be open to employees of employer during the taxable year.
 - If facility is principal trade or business of employer, at least 30% of enrollees of facility must be dependents of employees of employer.
 - Use of facility (or the eligibility to use facility) must not discriminate in favor of highly compensated employees (within meaning of IRC section 414(q)).

What are Qualified childcare facility expenditures

Qualified expenditures for a childcare facility are amounts paid or incurred to:

- Acquire, construct, rehabilitate or expand property that is:
 - To be used as part of a qualified childcare facility of employer.
 - Depreciable (or amortizable) property.
 - Not part of the principal residence (within meaning of IRC section 121) of employer or any employee of employer.
- Operate a qualified childcare facility of employer. Includes training employees, providing scholarship programs, and providing increased compensation to employees with higher levels of childcare training.
- Qualified childcare facility expenditures do not include expenses over fair market value of the care.

What are Qualified Resource & Referral Expenditures

- Amounts paid or incurred under a contract to provide childcare resource and referral services to employees.
- Provision of services (or eligibility to use services) must not discriminate in favor of highly compensated employees (within meaning of IRC section 414(q)).

How to Claim the Credit

- To claim the credit, use Form 8882, Credit for Employer-Provided Childcare Facilities and Services.
- Credit amount claimed may not exceed \$150,000.
- Employer may deduct eligible expenditures that exceed the amount of the credit determined. See IRS Form 8882 General Instructions.
- <https://www.irs.gov/forms-pubs/about-form-8882>.
- No double benefit allowed
- Employer must reduce these items by the amount of the credit determined:
 - The basis of qualified childcare facility
 - Certain business deductions & credits

IRS Form W-2 Reporting

- When an employee is eligible and chooses to participate in a dependent care assistance program through his/he employer, employer reports value in box 10 of Form W-2.
- This type of plan is a voluntary agreement to reduce employee's salary in return for an employer-provided fringe benefit.
- Employer will also include in wages shown in box 1 of Form W-2 any dependent care benefits that exceed the maximum amount of dependent care benefits allowed to be excluded.
- Employee is receiving a tax benefit because under the plan, employee is not paying taxes on money set aside to pay for dependent care expenses.

Flexible Spending Arrangements (FSAs)

- FSA allows employees to be reimbursed for eligible expenses.
- FSAs are usually funded through voluntary salary reduction agreements with employer.
- No employment or federal income taxes are deducted from the contributions.
- Reimbursements may be tax free if employee pays qualified expenses.

Qualifying for an FSA

- FSAs are employer-established benefit plans.
- These may be offered in conjunction with other employer-provided benefits as part of a cafeteria plan.
- Employers have flexibility to offer various combinations of benefits in designing their plans.
- Self-employed persons aren't eligible for FSAs.
- Certain limitations may apply if employee is a highly compensated participant or a key employee.

Contributions to an FSA

- Employees contribute to their FSA by electing an amount to be voluntarily withheld from pay by employer.
- Commonly known as “salary reduction agreement.”
- Employee doesn’t pay federal income tax or employment taxes on salary contributed.
- At the beginning of the plan year, employee must designate contribution.
- Then employer deducts amounts each payroll period in accordance with the annual election.
- Employees can only change or revoke election if allowed by law and the plan.

Distributions From FSA

- Generally, distributions from FSA must be paid only to reimburse for qualified expenses incurred during the period of coverage.
- Maximum amount employee can receive tax free is total amount elected to contribute to the FSA for the year.
- Employee must provide the FSA with a written statement from an independent third party stating the expense has been incurred and amount.
- Employee must also provide a written statement the expense hasn't been paid or reimbursed under any other plan.
- The FSA can't make advance reimbursements of future or projected expenses.

Balance in FSAs

- FSAs are generally “use-it-or-lose-it” plans.
- Amounts in the account at the end of the plan year can’t generally be carried over to the next year.
- However, plan can provide for either a grace period or a carryover.
- Plan can provide for a grace period after end of plan year.
- If there is a grace period, any qualified expenses incurred in that period can be paid from any amounts left in the account at the end of previous year.
- Employer isn’t permitted to refund any part of the balance to employee.

Dependent Care FSA

- Dependent Care FSA (DCFSA) is a pre-tax benefit account used to pay for eligible dependent care services.
- Examples include preschool, summer day camp, before or after school programs, and child or adult daycare.
- <https://www.fsafeds.gov/explore/dcfsa/expenses> will have list of what can and can't be included.
- Simple way to allow employees to save money while taking care of loved ones so they can continue to work.

Why Offer a Dependent Care FSA?

- Reduces employee's tax burden.
- Funds are withdrawn from employee's paycheck for deposit into FSA account before taxes are deducted.
- Advantage of convenient payments and reimbursement options.

Dependent Care FSA Eligible Expenses

- Care for dependent under age 13
 - Before and after school care
 - Babysitting and nanny expenses
 - Daycare, nursery school, and preschool
 - Summer day camp
- Care for spouse or relative who is physically or mentally incapable of self-care and lives in employee's home

HEA 1177

- <https://iga.in.gov/legislative/2026/bills/house/1177/details>.
- Signed by Governor March 3, 2026.
- Increases maximum number of individuals an entity may employ to be eligible for the employer child care expenditure income tax credit.
- Provides costs incurred: (1) for operating costs of a child care facility operated for employees; or (2) under a contract with a child care facility to provide child care services to employees, or under a contract with an intermediate entity that contracts with one or more child care facilities for child care services; are qualified expenditures for purposes of the employer child care expenditure income tax credit.
- Allows a redevelopment commission to use revenue collected in a tax increment financing district to expend money or provide financial assistance to entities for the purpose of encouraging or incentivizing the construction or expansion of child care facilities.

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