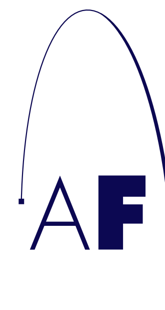
A Quick Reference

MEDICAL FLEXIBLE SPENDING ACCOUNT
DEPENDENT CARE SPENDING ACCOUNT



www.flex125.com

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The following table illustrates how an employee saves money by participating in a Medical Flexible Spending Account:

Without This Plan

GROSS PAY (ANNUAL)	$ 30,000.00
TAX DEDUCTIONS (@25%)	$ 7,500.00
TOTAL TAKE-HOME PAY	$ 22,500.00
• Unreimbursed Medical Expenses	$ 1,000.00
BALANCE OF TAKE-HOME PAY	$ 21,500.00

With This Plan

GROSS PAY (ANNUAL)	$ 30,000.00
• Unreimbursed Medical Expenses	$ 1,000.00
TOTAL TAXABLE INCOME	$ 29,000.00
TAX DEDUCTIONS (@25%)	$ 7,250.00
TOTAL TAKE-HOME PAY	$ 21,750.00
• Result (increased take-home pay)	$ 250.00

The unreimbursed medical expenses shown in the example above may consist of expenses that are eligible for tax deduction as defined by IRS Publication 502* and Revenue Ruling 2003-102, both available at www.flex125.com <http://www.flex125.com> . Examples of eligible items include coinsurance, deductibles, most medical expenses not covered by your health plan, and over-the-counter medications.

*Insurance Premiums and Long Term Care Expenses are listed as expenses that are eligible for exclusion from income in IRS Publication 502, however, these items are not allowable expenses for reimbursement under the Medical Flexible Spending Account.

DCSA
MFSA

AMERIFLEX

A Plan That Enhances Your Benefits

If you're one of the many people who spend money on medical expenses or the care of dependents, a Medical Flexible Spending Account (MFSA) or Dependent Care Spending Account (DCSA) can make these expenses more affordable. These valuable benefits are available through your employer's flexible benefits plan and are qualified under Code Section 125 of the Internal Revenue Code.

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 subtracted from your gross earnings before taxes and put into a flexible spending account. After you submit a receipt for a qualified expense, you will be reimbursed from this account. To be reimbursed for a dependent care expense, you must have contributed the funds and incurred the service. The full annual election of your MFSA is available from the first day of the plan. MFSA claims must be incurred within the time period specified in your summary plan description. By contributing pretax dollars to a reimbursement account, you lower your taxable income; therefore, you pay less in taxes and increase your spendable income!

How Much Can I Contribute?

The maximum you can contribute to a Medical Flexible Spending Account is determined by your employer. The IRS has set these maximum allowable contributions, per calendar year, for a Dependent Care Flexible Spending Account:

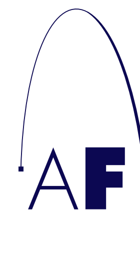
- $5,000 for a married couple filing jointly
- $5,000 for a single parent
- $2,500 for a married person filing separately

DCSA Eligible Expenses

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

- The care of the dependent must enable you and your spouse to be employed.
- The amount to be reimbursed must not be greater than your spouse's income or your income, whichever is less.
- The child must be under 13 years old and must be your dependent under federal tax rules.
- 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 simultaneously, 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.

Please note: Expenses for overnight camps and kindergarten are not eligible for reimbursement. Qualified dependent care expenses also include costs for the care of a spouse or dependent who is incapable of self-care, regularly spends at least eight hours per day in your home, has gross income below the exemption amount in Code 151, ($3,200 for 2005), you provide over half of the individual's support, and they are not anyone else's qualifying child (e.g., an invalid parent). The same rules that apply for child care apply to the care of other dependents, except the dependent need not be under age 13.



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MFSA Eligible Expenses

A medical FSA may be used to pay healthcare expenses not covered under any other plan. Qualified expenses may include:

- Deductibles and other payments you are responsible for under your medical plan
- Charges that may not be covered by your medical plan, such as:
  - Dependent physicals
  - Hearing aids
  - Well-baby care
  - Dental care
  - Eyeglasses/contact lenses
  - Orthodontic
  - Birth control pills
  - Routine exams
- Miscellaneous expenses, such as:
  - Over-the-counter-drugs
  - Individual psychiatric or psychological counseling
  - Cost of acquiring and training a dog for the deaf or blind
  - Transportation, tolls, and parking to receive medical care
- Other healthcare services that qualify as medical deductions under IRS rules:
  - Durable medical equipment
  - Qualified medical products or services prescribed by a doctor for which you must pay out-of-pocket expenses

Some examples of ineligible expenses include teeth whitening, prescription drugs for male-patterned baldness, and all cosmetic procedures.

Please refer to IRS Publication 502 for the complete list of deductible medical expenses that are eligible for reimbursement.

Please note: Insurance premiums and long term care expenses are not eligible for reimbursement.

The "Use It Or Lose It" Rule

If you contribute dollars to a reimbursement account and do not use all the monies you deposit, you will lose any remaining balance in the account at the end of the eligible claims period. A very important thing to remember is that the rule exists because the IRS has established strict guidelines for plans with tax advantages. Estimate carefully the amount you want to contribute to your FSA, and only contribute dollars you're confident will be used before the end of the eligible claims period.

What If I Want to Make a Change to My DCSA or MFSA 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.

A change in status must have occurred. A change in status has occurred if the event falls into one of the following categories:

- Change in provider (DCSA only)
- Change in cost of day care (DCSA only)
- Change in legal marital status
- Change in number of dependents
- Change in employment status
- Change in work schedule (increase or decrease in hours)
- Dependent satisfies (or ceases to satisfy) requirements for eligibility

The participant's election change must be consistent with the status change event. A change is consistent with the event for Medical Flexible Spending Accounts if the following occurs:

- The employee, spouse, or dependent is gaining or losing eligibility for health FSA coverage.
- The election change corresponds with that gain or loss of a coverage.

Will Pretaxing Have an Impact on Social Security Benefits?

Any reductions 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 when compared to the value of paying lower taxes now.

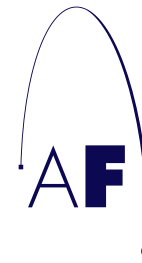
What Do I Need to Know When I File My Taxes?

On your tax return you must report 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 or 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.



Tax Credits vs. Dependent Care Spending Accounts

If you participate in the plan, you cannot claim credits on your income tax return for the same expenses. Also, any amount 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 taking federal income tax credit will save you more money than a Dependent Care Spending Account.

Dependent Care Spending Account (DCSA) vs. Dependent Care Tax Credit

Determining the relative tax benefits of participating in a DCSA vs. claiming the Dependent Care Tax Credit requires an understanding of not only the DCSA rules and the Dependent Care Tax Credit rules, but also the rules governing the Earned Income Credit (EIC) under Code 32 and the Child Tax Credit under Code 24. This is because the amount of the EIC and Child Tax Credit is influenced in part by whether an employee participates in a DCSA as opposed to claiming the Dependent Care Tax Credit. Thus, in determining the tax benefits of DCSA participation vs. claiming the Dependent Care Tax Credit, an employee must also take into account the increase or decrease in EIC or Child Tax Credit benefits that may result from one choice or the other.

A General Rule of Thumb for Determining Which Approach Produces the Greatest Tax Benefits

If a taxpayer has no income other than W-2 wages, uses the standard deduction for calculating federal income taxes, and is eligible for the EIC, participating in a DCSA on a salary reduction basis will usually produce the greatest overall tax benefits. However, there are two situations where claiming the Dependent Care Tax Credit will usually produce the greatest tax benefit: (1) when an employee's W-2 income before DCSA salary reductions is about $35,000 to $39,000, the employee has only one qualifying individual, and the employee incurs less than $3,000 in dependent care expenses; and (2) when an employee's W-2 income before DCSA salary reductions is about $12,000 to $15,000 or less.

If You Want to Crunch the Numbers Yourself to Find Out Which Approach Is Best for You, Refer to the Following Federal Tax Forms and Publications (available at www.irs.gov)

- Form 2441 (Child and Dependent Care Expenses)
- Form 1040 Schedule EIC and IRS Publication 596 (Earned Income Credit)
- Form 8812 and IRS Publication 972 (Child Tax Credit)

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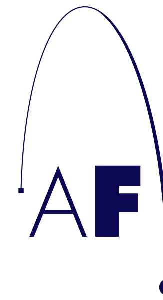

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	Last Year	This Year
Medical		
Deductibles	$	$
Doctor's office visits		
Well-baby care		
Pap smear		
Physicals		
Immunizations		
Prescription drugs		
Over-the-counter drugs		
Others		
Dental		
Fillings		
Bridges		
Crowns		
Dentures		
Orthodontia		
Braces		
Exams		
Vision		
Exams		
Lenses		
Frames		
Contact Lenses		
Miscellaneous		
Total Eligible Medical Expenses	$	$

Please refer to Section 213(d) of the Internal Revenue Code for the definition of deductible medical expenses that are eligible for reimbursement. Note: An expense is not eligible if it is for cosmetic reasons only. Also, insurance premiums and long term care expenses are not eligible for reimbursement.

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