



On May 24, 2006, IRS published new proposed regulations for Dependent Care Assistance Plans. Following are some questions and answers based on the new proposed regs that may be helpful to you. These Q&As are intended only as informal guidance based solely on our understandings. You can access the proposed regs as published in the Federal Register at <http://edocket.access.gpo.gov/2006/pdf/E6-7390.pdf>

#### Dependent Care Assistance Plans Q&A based on May, 2006 Proposed Regulations

- When are the new rules effective? **Now.**
- Who is a qualifying individual under the new rules? **The taxpayer's dependent who has not reached age 13; the taxpayer's dependent who is physically or mentally incapable of self care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year; or the taxpayer's spouse who is physically or mentally incapable of self-care and who have the same principal place of abode as the taxpayer for more than one-half of the taxable year.**
- What expenses now qualify for dependent care reimbursement? **This has not changed. Expenses must be employment related. They are employment related only if (1) the expenses are primarily for household services or for the care of a qualifying individual, and (2) the taxpayer's purpose in obtaining the services is to enable the taxpayer to be gainfully employed.**
- Have the timing and substantiation requirements for eligible reimbursement requests changed? **This has not changed. There must be third-party substantiation that the expense was incurred and the service provided before it becomes eligible. Also, new guidance regarding use of debit cards for dependent care expenses reinforces that dependent care fees paid in advance are not eligible until the service is actually provided.**
- Has the dependent care account maximum of \$5,000 has been changed? **Unfortunately, it did not change.**
- How do the tax savings of a Dependent Care Assistant Plan (DCAP) compare to the Dependent Care Tax Credit? **Each situation will vary depending on your adjusted gross income. The big difference is that the DCAP reduces all taxes (Federal, State, FICA, Medicare), while the Tax Credit only applies to Federal taxes. You may want to refer to your orientation material for a comparison.**
- Will I have to amend my plan document and/or my SPD? **No.**
- Which parent is able to get reimbursed for dependent care expenses if an employee is divorced or legally separated? **Only the custodial parent may claim the expense, regardless of whether the noncustodial parent may claim the dependency exemption under section 152(e).**
- Does it matter if the employee is under a court order to pay childcare expenses or if the employee claims the child as a dependent on his/her tax return? **Apparently not.**
- Can a person work out of his or her house and still be reimbursed for dependent care expenses? **Yes.**
- What dependent care expenses can be reimbursed if a participant is not at work because she is on vacation and her child is not at day care because he is on vacation with her? Is the answer different if the participant is not at work because she is out sick? **In general, dependent care expenses for a period in which the taxpayer is absent from work (whether paid or unpaid) are not employment-related expenses. However, for administrative convenience, short, temporary absences from work, such as for minor illness or vacation are disregarded for taxpayers who must pay for dependent care expenses on a weekly or longer basis. Whether an absence is short and temporary depends on the facts and circumstances, and IRS requests comments on appropriate periods to constitute temporary absence safe harbors.**

- If a part-time employee only works three days a week, but has dependent care for his child five days a week, what portion of the expenses can be reimbursed? **The answer depends on whether or not the actual expense must be paid for a week or longer period of time. If the cost for three days of care is the same as the cost for 5 days, then all of the expense is eligible. Otherwise, only the daily (or hourly) rate multiplied by the number of days (or hours) is eligible.**
- What expenses can be reimbursed if the dependent care provider is also a housekeeper who provides cleaning, cooking, and transportation services in addition to the dependent care services? **All of the expenses (up to the maximum allowed) are eligible as long as the principal purpose is to care for the qualifying individual. Performance of household services necessary to the maintenance of the household and attributable to the qualifying individual constitutes eligible expense.**
- What if this provider cares for two children of the participant, and one of the children is age 13? **Only one qualifying individual is required for the expense to be eligible.**
- What are the rules for overnight camps and day camps? **Overnight camps are not eligible.**
- Does it matter if a day camp specializes in a particular activity, such as a computer camp or a soccer camp? **No, specialty day camps are eligible.**