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UPDATE NEWSLETTER FOR FLEXIBLE BENEFIT PLANS

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NEW PROPOSED REGULATIONS FOR DEPENDENT CARE EXPENSES

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The IRS has just issued proposed regulations under Code Section 21 regarding dependent care expenses, replacing regulations that were issued 22 years ago. The regulations have been substantially rewritten and reorganized (highlights listed below). Fortunately, these new rules and clarifications are generally more expansive than the old regulations. **The regulations are only proposed at this point (and may change in response to comments), however, taxpayers may use them now.**

Kindergarten, Day Camp The proposed regulations indicate that expenses of programs below kindergarten (e.g., preschool) may be employment-related expenses (and thus may qualify for the DCTC or DCAP reimbursement, even though education may be a significant part of these programs. However, kindergarten expenses are primarily educational and do not qualify as employment-related expenses. Before- and after-school care for children in kindergarten (and higher grades) does generally qualify. The cost of a day camp may be a qualifying expense, even though the camp specializes in a particular activity, such as soccer or computers.

Transportation to and from care The cost of transportation furnished by a dependent care provider to or from a place where care is provided (e.g., a day camp or an after-school program not on school premises) may also be a qualifying expense.

Indirect Expenses The proposed regulations clarify that expenses that relate to but are not directly for the care of a qualifying individual (e.g., application fees, agency fees, and deposits) may be employment related if the expenses must be paid in order to obtain the care. However, such expenses will not be for the care of a qualifying individual if care isn't ultimately provided (e.g., if a deposit reserving a place at a preschool is forfeited because the child ends up going to a different preschool).

Temporary Absences and Part-Time Work The proposed regulations provide that in general, dependent care expenses for a period in which the taxpayer is absent from work (whether paid or unpaid) are not employment related. For administrative convenience, however, the regulations disregard short, temporary absences from work (such as for vacation or minor illness) for taxpayers who must pay for dependent care on a weekly, monthly, or longer basis. Likewise, taxpayers who work part-time but are required to pay for dependent care on a periodic basis (such as weekly or monthly) that includes both days worked and days not worked are not required to allocate expenses between work and non-work days.

Payments to Related Individuals Under the proposed regulations, payments to the taxpayer's spouse or to a parent (who is not the taxpayer's spouse) of the taxpayer's qualifying child under age 13 are not qualifying expenses. Remember, payments to an employee's child under age 19 or to someone for whom the taxpayer (or the taxpayer's spouse) could claim a deduction for are also not qualifying expenses.

[Prop. Treas. Regs. Secs. 1.21-1, 1.21-2, 1.21-3, and 1.21-4, 71 Fed. Reg. 29847 (May 24, 2006)] For a copy: <http://edocket.access.gpo.gov/2006/pdf/E6-7390.pdf>