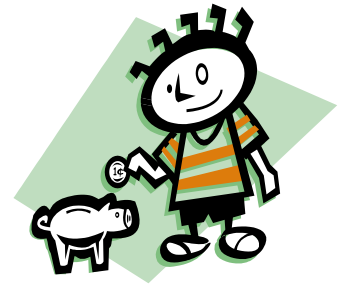


Dependent care options A Federal tax credit or exclusion from taxable income is available for taxpayers who pay for child or dependent care in order to work or search for employment.



Who:

The child/dependent must live with the taxpayer more than half of the year and be one of the following:

- The taxpayer's child under age 13 that can be claimed as a dependent
- The taxpayer's disabled child of any age
- The taxpayer's disabled spouse

Dependent care expenses can be paid by the taxpayer or excluded under a pretax dependent care benefit plan at work (DCB).

Option 1- Taxpayer pays the dependent care expenses:

- The credit for one child is calculated on dependent care payments of up to \$3,000. Two children or more have a \$6,000 maximum.
- The credit is nonrefundable (can not reduce Federal tax below 0).
- The credit percentage reduces from 35% for taxpayers with income less than \$15,000 to 20% for taxpayers with income of \$43,000 or more.

For example: A taxpayer with income of \$14,000 who pays \$3,000 for dependent care would get a credit of \$1,050, and a taxpayer with income of \$43,000 paying \$3,000 would get a credit of \$600.

*Observations: -As income increases, the percentage of the credit decreases
-Since the tax credit is nonrefundable, taxpayers at lower incomes might not have any tax to offset.*

Option 2- Taxpayer uses pretax dependent care benefit plan:

- Up to \$5,000 per tax return can be excluded each year for dependent care.
- The amount excluded reduces the amount qualifying for the credit, dollar for dollar.

For example: If a taxpayer in the 15% tax bracket defers \$3,000 in a dependent care benefit plan for the care of one child, \$450 in Federal tax + \$229.50 in FICA/Medicare + state tax is saved. Taxpayers in the 25% tax bracket would save \$750 in tax + \$229.50 in FICA/Medicare +state tax.

*Observations: -As income increases, DCB's benefit increases.
-A taxpayer with one child can defer \$5,000 in a DCB, but could only use \$3,000 for the credit.
-The pretax DCB will lower income which may enable other tax benefits to increase, such as the earned income credit, medical expenses, student loan interest, etc...
-A taxpayer with two or more children can defer \$5,000 in the DCB account and use an additional \$1,000 for the credit.*

Conclusions:

- Taxpayers in at least the 25% bracket would be better off by using the pretax DCB. For example, \$3,000 in dependent care expense would save \$600 using the credit and \$979.50 in federal tax plus additional state tax using DCB.
- Taxpayers in lower tax brackets might be better with the credit. Income of \$40,000 is the approximate break point.