Military OneSource Podcast — Dependent Care Flexible Spending Account

MCSP Program

Episode transcript

Intro voiceover: Welcome to the Military OneSource Podcast. Military OneSource is an official program of the Defense Department with tools, information and resources to help families navigate all aspects of military life. For more information, visit militaryonesource.mil.

Bruce Moody: Welcome to the podcast. I'm Bruce Moody. Today, we're going to talk about Dependent Care Flexible Spending Accounts, and with me today are two folks from the Defense Department. Jennifer Walker is executive director for Dependent Care Flexible Spending Accounts. Also joining us is Susan Mitchell, who is executive director of the Armed Forces Tax Council. We'll hear from Susan later in the podcast, but I just want to say welcome to the both of you.

Jennifer Walker: Thank you, Bruce.

Susan Mitchell: Thank you.

Bruce Moody: Excellent, excellent. Well right to it and we'll start with you, Jennifer. What is a Dependent Care Flexible Spending Account, and why are we talking about it today?

Jennifer Walker: Dependent Care Flexible Spending accounts, that's certainly a mouthful. You might see it listed as a Dependent Care FSA or also abbreviated as DCFSA. These accounts, simply put, are an opportunity for service members to save on taxes for the funds that they're already spending on dependent care.

This is new for service members this year. It's something that's been available to DOD civilians as well as employees in the private sector for many years. We are very excited to offer these accounts to our service members. They'll be able to enroll starting in mid-November this year, and when service members enroll, they can decide whether to contribute anywhere from $100 all the way up to $5,000 for each household, and those funds will not be subject to payroll taxes. So, it's a great way for service members to save money when they have dependent care expenses.

Bruce Moody: Okay, so these have been around. It's new for service members, and what we're going to do in this podcast episode is really kind of get into the nuts and bolts so people do it right, which is really important so I hope people stick around. So Jennifer, why should service members and families consider signing up for this new benefit?

Jennifer Walker: Well, first of all, as I already said, less taxes. I think everyone's ears should really perk up when they hear that, up to $5,000 tax-free, which is really, really great for service members who are already struggling with the high cost of child care and other dependent care expenses.

I think another great reason that families should look at these accounts is it's a way to budget for their care expenses. Many service members use care on a monthly basis or a weekly basis, so they have a really good idea of how much their dependent care costs are going to be. So they can calculate for next year, which is the year they would be enrolling, what their estimated costs are and then contribute that to this account and set those funds aside so those funds are already budgeted to pay for dependent care. Then of course, as I already said, they would be tax-free.

I think the other really important thing that members should know about these accounts is that they're very flexible. They can be used for a variety of dependent care expenses. I know I keep on saying dependent care, that is an IRS term. Many of us know it as child care or day care, but they specifically use the word dependent care, because these accounts can be used for nonchildren. They can be used all the way up to adulthood if you have a dependent who is physically or mentally incapable of self-care. That's a tax definition, but that's generally someone who is unable to care for themselves, and they do have care expenses. Again, I think the biggest selling point is that these funds will not be subject to payroll taxes, which means more money in the pocket for service members and their families.

Bruce Moody: Excellent. So again, one of the things we want to get into is the specific nuts and bolts here. So specifically, who is eligible to sign up for a Dependent Care Flexible Spending account?

Jennifer Walker: That's a great question. There are some eligibility requirements. So first of all, as I already mentioned, DOD civilians have been able to sign up for these accounts for many years. This year, new eligibility is for service members who are in the regular component as well as our Active Guard Reserve members who are on Title 10 orders.

Additionally, there are some tax requirements. These are some IRS requirements for who is eligible, and those are, families who have tax dependents who are under the age of 13. So the day they turn age 13, you can no longer use this account for them unless they are a person who is physically or mentally incapable of self-care. That could be an elder parent, it could be a special needs child or a special needs adult. So this is an area that I really want to highlight for families who have members enrolled in the EFMP or the Exceptional Family Member Program. They should really be looking at this because they may have dependents who are eligible beyond age 13.

It's also important to point out that there are some members who will not be eligible this year. That's anyone who's on Title 32 orders, any other reserve members outside of the Active Guard Reserve on Title 10 orders. Unfortunately, this year it also will not be available for those uniformed service members who are outside of DOD, that's the Coast Guard, NOAA and Public Health Service uniform members. They will not be eligible for the open season that's coming up in November of 2023.

Bruce Moody: You alluded to this earlier, dependent care is not a term that we commonly use, but it's a legal term, something that the IRS uses. So walk us through, explain what is meant by this and what these funds can be used for.

Jennifer Walker: Yeah, absolutely. Dependent Care is a more inclusive term because there's a lot under the umbrella that you can use a Dependent Care FSA to pay for. It's not just child care. It can include elder care, it can include incapacitated adult care, it can include summer camps. There are a number of expenses. This is a very flexible program that you can use for a variety of dependent care expenses for your dependents.

Another key criteria for this program is it's intended to enable families, either a single parent or spouses to both work, look for work or go to school. So there is a requirement that both the service member and their spouse, if they're married, are doing one of those things, that they must be working, looking for work or going to school.

There are a number of expenses this can be used for. As I said, this is a very flexible program. So I kind of want to go through some of the most frequent expenses that are able to be used for this program and the expenses that are not able to be used for this program. So summer camps, absolutely, you can use a Dependent Care FSA to pay for them, but overnight camps you cannot. You can use this for day care and you can use it for before and after-school care, but you aren't able to use it for private school tuition for your children.

Finally, you can use it for a babysitter as long as that babysitter is enabling you and your spouse, if you're married, to work, look for work and go to school, but you cannot use it for a babysitter for your date night. There's a laundry list of various expenses that Dependent Care FSAs can be used for, and you can find more about these at fsafeds.com. There's a full list. I think there's over 60 items on that list that service members can look at and try to plan for what they expect, the types of dependent care and the amount of dependent care expenses they're going to have for next year.

Bruce Moody: Exactly. So as we said, there's a lot of details here, knowing what's covered and what's not covered. That's why you really need to go to this site that you just mentioned, the fsafeds.com. We'll put a link in the program notes, just click on it and get that [00:08:00] list,

Moving forward, are there any potential pitfalls that service members should be aware of?

Jennifer Walker: Biggest one that I hear of from members who are asking questions about this is, am I going to lose my money? Certainly, there is a potential to lose your money as this is a use or lose plan, but if you plan appropriately, you can prevent that from happening. This plan does have a grace period. So what that means is, you can continue to incur expenses up until March 15 of the year after the year that you enrolled for, and you can continue to submit your claims all the way through April 30 of the following year.

An example here is if a member enrolls in November of 2023, their plan year will be the 2024 tax year. They can continue to use these funds for child care expenses all the way through March 15 of 2025, and they can continue to submit claims through April 30 of 2025, but after that date, if they have any funds remaining in their account, they will be forfeited.

I can tell you that FSA Feds sends a number of reminders via email, via text to make sure that members who are enrolled in these accounts are aware of these deadlines and make sure that they can spend their funds. But unfortunately, every year there are enrollees in these accounts who do forfeit funds.

Another potential pitfall that I do want to talk about is, that the funds in these accounts will not be available until early February. The accounts do start on Jan. 1, but a member has to get paid in 2024 and the funds in the allotment have to get over to FSA Feds. So what that means is, that a member can start to incur expenses on Jan. 1. They can pre-submit the claims, but they won't actually receive their claims paid out until February once the funds are available in the account. So that's just something for members to really be aware of as they do their budgeting for the months of January and February to make sure that they don't miss any of their bills.

Bruce Moody: Thanks, Jennifer, for that really important information. I want to get into the taxes. Susan Mitchell, you're with the Armed Forces Tax Counsel. Susan, what I'd like you to do is, kind of dig into the aspects of the Dependent Care Flexible Spending Accounts. What tax considerations should families be thinking about?

Susan Mitchell: Well, thanks Bruce. It's good to be back. We hear that contributions to the DCFSAs are made on a pre-tax basis, which in turn, of course, reduces the taxable income. But really what does that mean? When less of your income is taxed, your total annual pay is going to increase. You're basically sheltering income from taxation.

The magnitude of this benefit depends on not only the employee's tax rate, but it will vary from family to family. Among the uniformed services, for example, the effective tax rate for more senior personnel who are obviously earning more income can be 25% or higher. In comparison, junior personnel may have tax rates as low as 12%. So as I mentioned, the benefit a DCFSA can provide is going to vary from family to family, and it's going to depend on the family's tax bracket, the number of dependents [00:11:30] that they have, the age of those dependents and of course whether both parents are working.

I'll speak a little to tax brackets. A lot of people don't realize that portions of their income can fall into different tax brackets to be taxed at different rates. That marginal tax rate is the highest tax rate that an individual's income is subject to. In other words, it's the tax rate paid on your last dollar [00:12:00] of taxable income, essentially, your highest tax bracket.

Your effective tax rate is the percentage of your taxable income that you pay in taxes. So to determine your effective tax rate, or I sometimes call it your average tax rate, you divide your total tax owed after all of your credits and deductions, by your total taxable income. By having this knowledge, families can get a better estimate of how much a DCFSA can actually save them for a particular year.

Bruce Moody: What is the impact, if anything, on the earned income tax credit or the child and dependent care tax credit on Dependent Care Flexible Spending Accounts?

Susan Mitchell: That's a great question, Bruce. Regarding the impact on a DCFSA for the earned income tax credit, just remember that, earned income tax credit, the EITC is a refundable tax credit that supports low and moderate-income working families. The amount of the credit is based on a family's earned income and the number of children that they have under the age of 19, or it could be under the age of 24 if the child is a full-time student. Just remember the EITC is calculated based on a taxpayer's taxable earnings. So contributions to a flexible spending account will lower the taxpayer's earned income and affect the amount of that tax credit.

A special consideration for service members is that they can choose to include or not include nontaxable pay for the purposes of the EITC. This decision is also going to be affected by FSA contributions that are also going to reduce the service member's earned income.

In terms of another credit, the child tax credit, this is a credit that's calculated based on the taxpayer's adjusted gross income, the AGI. It's important to remember that contributions to a DCFSA will lower a taxpayer's AGI and also affect the amount of that tax credit.

Regarding the dependent care tax credit, which is different than the child tax credit, it's important to know that you can use a DCFSA in conjunction with the dependent care tax credit. However, the same dollars cannot count for both benefits.

For example, let's say you pay for child care for one dependent so that you can work full time. You put $5,000 into your FSA and you also pay $4,000 out of pocket for child care. As a result, your FSA [00:15:00] contributions lower your taxable income, and plus, when you file taxes, you can use up to $3,000 of your out-of-pocket expenses that are not paid by your FSA to lower the amount of taxes that you may owe.

In situations where only one of the benefits can be used, generally, the DCFSA is more helpful, because it reduces your taxable income instead of your potential taxes that are due. But it also depends on a family's combined earnings. Generally, I always tell folks that high-income individuals and families will generally receive less benefit from the tax credit than they will from the dependent care tax credit.

As I indicated earlier, the tax credit allows up to $3,000 in expenses per year for one qualifying dependent and then up to $6,000 in expenses for two or more qualifying dependents. Then in terms of the actual savings, if they're claiming the tax credit, the tax credit can range from between $600 to $1,500 for taxpayers for savings. Again, that just depends on how many dependents they have. It could even go up to between $1,200 and $2,100 for taxpayers with multiple dependents.

Then finally, people may be wondering about how child care fee assistance or child care subsidies may impact their DCFSA. This is a benefit that you can claim actually on top of the DCFSA. In other words, service members who receive a child care subsidy may still fully participate in a DCFSA assuming all requirements for this flexible spending account is met.

Since we're talking about how other benefits may impact a DCFSA, I'll just mention here that the monthly contributions that a service member makes to his or her flexible spending account is counted for purposes of benefits like the Basic Needs Allowance, the Family Supplemental Subsistence Allowance, the FSSA, the Supplemental Nutrition Assistance Program, the SNAP program or the Supplemental Nutrition Assistance Program for Women, Infants and Children, the WIC program that we often hear about. In other words, receiving these benefits have no impact on whether a service member can contribute to a DCFSA.

Jennifer Walker: Hey Susan, I'd like to add something onto what you just said.

Susan Mitchell: Absolutely.

Jennifer Walker: So I've been talking to a lot of service members about this benefit and a lot of leaders throughout the DOD and certainly the tax parts of this are very complex. So Susan just explained them fairly clearly, but there's going to be a unique situation for every service member. So we'd really encourage service members to go out to fsafeds.com, go out to the FINRED website to learn more information and contact a personal financial counselor, call Military OneSource. You can also call FSA Feds. All of those resources can help with every family's unique situation and help service members to really understand the benefit and how it's going to work for their unique situation. Certainly, it's complex. We don't intend to cover all of that information in this short podcast, but we do want to make sure everyone knows where to get more help.

Bruce Moody: Well, thanks to the both of you for going through this. One question I have is, how will I know that using a DCFSA has reduced my taxes?

Susan Mitchell: Great question, Bruce. Families will be pros at doing this after a year or so, but if they want an easy way to check that the DCFSA actually reduced their taxes, they can look at box 10 on their W2 form, which should indicate the total annual amount of their Dependent Care FSA deductions.

They'll also need to attach a Child and Dependent Care Expenses Form, which is the Form 24-41 if they're filing a form 10-40 return or a Schedule A form for a form 10-40 return. So just a couple of things for them to keep in mind when they are filing their tax returns.

Bruce Moody: Thanks, Susan. Certainly, the first year is when you want to make sure you're getting it all right. Jennifer, to bring you in, can you share with us a couple of examples of when a DCFSA is a good fit for a family?

Jennifer Walker: Thanks, Bruce. I think it does certainly help for families to see themselves in this benefit and to understand from others who have used something similar. So first of all, I talked earlier in the podcast about the eligibility criteria. Essentially, if your family meets those eligibility criteria and you have dependent care expenses, this can be a great fit for your family.

I mentioned that you need to enroll for as little as $100 or up to $5,000. So, if you have some uncertainty about your dependent care expenses, you can start at a lower amount and see how this program works for you and for your family.

I will share a couple of examples so families can see themselves and understand how this might work. So first, I'll talk about if you have a child who's entering kindergarten, maybe your spouse previously stayed home and now when the child is entering kindergarten, your spouse is going to enter the workforce. A DCFSA would be great to help pay for before and after-school care for their child to enable that spouse to work, or as I also mentioned previously, look for work or even go to school full-time.

Another great example is, we have a lot of dual military families whose children are using various child care services to include day care and before and after-school care. This can be a great option for dual military families, although I do want to caution that the limit is $5,000 per household. So if you have dual military, or if you have a military member and a spouse who works for a private employer, the total combined Dependent Care FSA contribution for that family is $5,000. It also does not change based upon the number of children you have, the total is $5,000 per household.

Finally, I do want to mention that in cases of divorce, it's really important to know your tax return and know what your filing status is. Unfortunately, if you have an ex-spouse and you have children and those children are on the ex-spouse's tax return and they're not going to be dependents on the service member's tax return, they would not be eligible for a Dependent [00:22:00] Care FSA. In order to sign up for this, it has to be for a dependent who will be on your tax return for the tax year that you are enrolling for.

So overall, every family is unique. Military families have all sorts of different situations, types of families, number of children, types of child care arrangements. So it's really important that they learn more about this benefit and learn how it might help their unique family's situation.

Bruce Moody: Yeah, you really nailed it. It's a great benefit, but there's stuff [00:22:30] you got to learn before you sign up. So where can service members and their families go to learn more?

Jennifer Walker: Just a few other things to add. There is support available in other languages. So I mentioned that you can contact the FSA Feds call center. You can contact Military OneSource. They can also put you in touch with a MilTax advisor, and those services are available in the Spanish language and FSA Feds also provides multiple language support for family members who may need translation services.

I also want to make sure people are aware of the signup timeline. So you can sign up during open season. That is from November through December of this year. We'll be announcing the specific dates as it gets closer. Then you can also sign up even into 2024 if you have a qualifying life event. That could be a birth, a divorce, a change in child care arrangements, a change in job status for your spouse, a deployment, a PCS. Those are all opportunities where you could change your election for Dependent Care FSA throughout the year.

We have a ton of FAQs that are available both on FSA Feds and on the FINRED website, and we'd really encourage members to go out, look at the FAQs, call the resources that I mentioned to get additional help, and then of course sign up when we get to open season so they can take advantage of this benefit and help with the child care expenses as well as help to budget [00:24:00] for their family.

Bruce Moody: Wonderful. The links you've just referenced, we're going to have them in the program notes. Jennifer Walker, Susan Mitchell, thanks to the both of you for joining us today and going over this new benefit.

Jennifer Walker: Thank you, Bruce. It was a pleasure.

Susan Mitchell: Absolutely.

Bruce Moody: All right, want to remind everybody that Military OneSource is an official resource of the Defense Department and we want to hear from you. If you have any questions or comments, maybe an idea for a future podcast, go ahead and click in the program notes and send us a note.

Be sure to subscribe to this podcast wherever you listen to your podcast because we cover a wide range of topics to help military families navigate military life.

I'm Bruce Moody. Thank you so much for listening. Take care. Bye-bye.