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Understanding Dependent Care FSAs: A Valuable Benefit for Working Families

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Managing the costs of dependent care can be a significant financial burden for many families with young children or aging parents. A Dependent Care Flexible Spending Account (DCFSA) is a powerful tool to plan for known expenses in the year and get a tax benefit if the entire household is working. Approximately 60% of companies within the US offer a DCFSA, which you can enroll into during the fall open enrollment period (mid-Nov to Dec) or following a qualifying life event (i.e. new child/dependent, change of care, etc.).

Here's what you need to know about how it works, its benefits, and important rules to keep in mind:

WHAT IS A DEPENDENT CARE FSA?

A Dependent Care FSA is a pre-tax benefit account offered by employers that allows employees to set aside a portion of their income (up to \$5,000 for individuals who are single or married filing jointly, and \$2,500 for those who are married filing separately) to cover eligible dependent care expenses. The primary advantage of contributing to this account lies in its tax-saving feature. By using pre-tax dollars for dependent care costs, families can effectively lower their taxable income, thereby reducing their overall tax liability. For example, a family contributing the full \$5,000 to their FSA could save up to \$1,500 annually, assuming a 30% tax bracket. This saving can be redirected towards other essential expenses or financial goals, providing much-needed financial relief.

ELIGIBLE DEPENDENTS AND EXPENSES

The scope of eligible expenses under a Dependent Care FSA is quite broad, covering a variety of dependent care needs. Qualified dependents typically include children under the age of 13 and any adults who are physically or mentally incapable of self-care, emphasizing the account's applicability to diverse caregiving situations.

Qualified expenses can include daycare, preschool, before or after school care, babysitting or nanny expenses, day summer camp (if during work hours), and even care for dependent adults while you work. It is important to keep detailed receipts and double-check any expenses you are using an DCFSA to reimburse yourself for to make sure they qualify.

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THE USE-IT-OR-LOSE-IT RULE

Despite its benefits, the Dependent Care FSA comes with specific rules that must be adhered to, the most critical being the “use-it-or-lose-it” provision. Funds allocated to the FSA must be used within the plan year, typically aligning with the calendar year, or they will be forfeited. Some employers may offer a grace period or allow a limited carryover amount, but these are exceptions rather than the rule. Therefore, careful planning and accurate estimation of dependent care costs are essential to maximize the benefits of the FSA and avoid losing unused funds.

USING A DEPENDENT CARE FSA ALONGSIDE THE DEPENDENT CARE CREDIT

If your dependent care expenses exceed the \$5,000 maximum contribution limit of the Dependent Care FSA, you may still be able to benefit from the Dependent Care Tax Credit. This credit allows you to claim a portion of your additional dependent care expenses on your tax return. While you cannot use the same expenses for both the FSA and the credit, this combination can be a strategic way to maximize your tax savings when you have high dependent care costs. If your expenses don't exceed the \$5,000 threshold and a DCFSA is available, simply using that account would be the best avenue.

MAKING THE MOST OF YOUR DEPENDENT CARE FSA

To make the most of a Dependent Care FSA:

1. **Estimate Your Expenses Accurately:** Review your anticipated dependent care costs at the beginning of the year to decide how much to contribute to your FSA. Aim to contribute an amount that closely matches your expected expenses to minimize the risk of losing unused funds.
2. **Keep Detailed Records:** Maintain accurate records and receipts for all dependent care expenses. This will make it easier to substantiate your claims and ensure you maximize the benefits of your FSA.
3. **Coordinate with Other Benefits:** If you're eligible for other dependent care benefits or tax credits, coordinate these with your FSA contributions to ensure you're maximizing your overall tax savings.

A DCFSA is a great tool to get some tax relief from known dependent care expenses when the entire household is employed. If we can be of any help answering any questions about DCFSA's in general or for you specifically, please let us know.