



Understanding the Taxation of NC State “WolfPup” Childcare Program

TAX LIMITS

The Internal Revenue Service (IRS) limits employer-provided, tax-free childcare benefits to \$5,000 per family per year. If you file your taxes as “Married Filing Separately,” you and your spouse may each claim \$2,500. NC State University provides three types of pre-tax childcare benefits, all of which are subject to the \$5,000 total:

1. A **Tuition Reduction** subsidy for all program participants, regardless of family income;
2. An additional **Sliding-Scale** subsidy for eligible program participants, based on family income;
3. A voluntary **Dependent Care Flexible Spending Account** (FSA) program allows employees to be reimbursed with pre-tax payroll contributions for qualified child and/or dependent adult care expenses. Because the money is deducted from your pay before taxes are calculated, and because it's not taxed when it is reimbursed, this money becomes tax-free income. For example, if someone would otherwise pay 30% in taxes (including federal income and FICA taxes) but they contribute \$5,000 a year to a dependent care FSA, they could possibly avoid paying \$1,500 in taxes.

The \$5,000 annual maximum includes all sources, such as a previous employer within the same calendar year or the employer of your child's other parent. The \$5,000 is a per-family (not per-child) maximum.

HOW & WHY DO WOLFPUP SUBSIDIES COUNT TOWARD THE \$5,000 LIMIT?

You might think that Bright Horizons (BH) is cutting its fees and simply charging less to NC State employees. This is not the case. BH wouldn't have sufficient revenue to provide the excellent level of care it offers if it didn't charge full price. Instead, **NC State University pays the difference** in the cost of tuition for each child.

On the pricing chart above, the amount that NC State contributes on your behalf each month is shown in the last column. That's the difference between what BH charges and what you actually pay. The university does not give you that money directly as additional income because it would be taxed. Instead, NC State pays that money directly to BH on your behalf. Since that money is never considered *your* income, you are not taxed on it. However, both the 15% **Tuition Reduction** subsidy (for all employees) and the additional 10% - 30% **Sliding-Scale** subsidies (based on family income) are considered employer-provided tax-free childcare benefits [provided the total does not exceed the \$5,000 limit].

WHAT HAPPENS IF I EXCEED THE \$5,000 LIMIT?

IRS regulations do not limit the level of childcare benefits you can receive. It only limits the amount you can receive TAX-FREE. Any childcare benefits in excess of \$5,000 will be assessed all the applicable federal and state taxes. So if you get \$6,000 a year in childcare benefits, \$1,000 will be taxed. Assuming a 30% federal tax rate, that means that you will pay an additional \$300 in taxes. Of course, even with taxes, it's still a good deal – you're receiving a \$1000 benefit for only \$300. The additional amount for which you are taxed is called “childcare imputed income.”

HOW MUCH CAN I CONTRIBUTE TO THE Dependent Care Flexible Spending Account (FSA)?

- First, consider how much **employer-provided benefit** you will receive through the **Tuition Reduction** and the **Sliding Scale** subsidies -- Not how much YOU pay, but how much the *University contributes on your behalf*. Add that to any other child care benefits you will receive from another source in the year.
- If that figure is *LESS THAN \$5,000*, then the difference between that amount and \$5,000 is how much you can contribute to a FSA to avoid taxation.
- Divide that number by the number of months you will contribute to a DDCFSA (the remaining number of months in the tax year if you are enrolling mid-year) to determine how much you can contribute to a DDCFSA each month.

WolfPup Benefits (including Tuition Reduction Discount and/or the Sliding Fee Scale Benefit)	+	Other Child Care Benefits	=	Employer Provided Benefits
IRS Limit \$5,000	-	Employer Provided Benefits	=	Annual Dependent Care Account Contribution Allowed
FSA Amount	/	Months remaining in the year	=	Monthly FSA contribution

For example, if your total annual employer-provided subsidies are \$3,444, the amount left over from subtracting \$3,444 from \$5,000 is \$1,556. You may elect to have \$1,556 (\$129.67/month) deducted in pre-tax dollars as your FSA deduction. Determining the right FSA contribution amount is crucial -- because once you enroll in the FSA, you cannot change or cancel your enrollment during the year (unless you have a legally-qualifying "status" change).

If you contribute too much -- more than the amount calculated by using the method above -- you will lose the tax advantages of participating in the FSA on that excess amount. In addition to not realizing additional tax savings, it may also make your tax situation more complicated.

WHAT IF MY WOLFPUP BENEFITS EXCEED \$5,000?

Take the time to review and understand the advantages and tax consequences of the University's employer-provided childcare benefits. If you receive over \$5,000 in employer-sponsored childcare benefits, then you will be charged taxes on the amount in excess of the limit. On your paycheck, you will see an amount listed as "childcare imputed income," and taxes will be charged to you.

EXAMPLES

EXAMPLE 1: Infant Care, Family Income less than \$40,000

- The full cost for infant care at BH is \$1,362 per month
- The rate after the 15% **Tuition Reduction** is \$1,158 per month
- With a family income under \$40,000, you receive an additional 30% (\$347/mo) from the **Sliding-Scale** subsidy
- This gives you a total subsidy of \$551 off the \$1,309 monthly rate
- So you pay \$811 per month out-of-pocket
- Your \$551/mo subsidy for the first nine months of the year (January through September) equals \$4,959.
- In October, you cross over the \$5,000 limit, so only \$41 of October is tax-free.
- The remaining \$510 in the month of October is taxable.
- In November and December, your entire \$551 discount would be taxable since the discount is over the \$5,000 limit.
- Your "childcare imputed income" will be \$510 (Oct) + \$551 (Nov) + \$551 (Dec) = \$1612
- You will pay taxes on that \$1612. (Hey! Taxes on \$1612 are still better than *paying* all \$1612!)

EXAMPLE 2: Preschool Care, Family Income between \$40,000 & \$69,999

- The full cost for a preschooler at BH is \$985 per month
- The rate after the 15% **Tuition Reduction** is \$837 per month
- You fall in the \$40,000 to \$69,999 income bracket, so you'd receive an additional 30% (\$251/mo) from the **Sliding-Scale** subsidy
- This gives you a total subsidy of \$399
- So you pay \$586 per month out-of-pocket
- Your \$391 discount for 12 months would be \$4,788.
- Since you're still under the \$5,000 dependent care annual limit, you could contribute the remaining \$212 to the FSA using pre-tax dollars, and reimburse yourself for some of your out-of-pocket childcare expenses.

EXAMPLE 3: Two-Year-Old Care; Family Income over \$90,000

- The full cost for a two-year-old at BH-RCC is \$1,126 per month
- The rate after the 15% **Tuition Reduction** is \$957 per month (your out-of-pocket)
- Therefore, your employer-provided benefit is \$169 per month, or \$2028 per year
- With a family income of \$98,000, you are not eligible for any additional sliding scale subsidy
- You want to take advantage of the maximum, pre-tax FSA benefit. Since you're already receiving the equivalent of \$2028 as a tuition reduction, you can direct the remaining \$2972 (\$5000 annual limit - \$2028 tuition reduction) into to a pre-tax FSA to reimburse your out-of-pocket expenses

EXAMPLE 4: HIRED Mid-Year

- You are hired by NC State on July 1, and immediately place your toddler in BH, where the full cost is \$1,270/month
- Your family income is \$75,000, so in addition to the 15% **Tuition Reduction**, you are eligible for another 10% **Sliding-Scale** subsidy
- You will pay \$971/mo out-of-pocket for six months, or a total of \$5,826.
- Your total subsidy would be \$299 per month, or \$1794 for the remaining 6 months of the year
- Prior to coming to NC State University, you did not contribute into a dependent care FSA or receive other employer-sponsored childcare benefits, so you are entitled to the full \$5,000 annual limit
- You can direct the remaining \$3206 (\$5000 maximum - \$1794) to a pre-tax FSA to reimburse your out-of-pocket expenses.

HOW DOES NC STATE UNIVERSITY REPORT CHILDCARE IMPUTED INCOME TAXES?

Your childcare benefits will be tracked in the University's payroll system and reported on your W-2. (NC State cannot track childcare benefits that you receive from another source, such as your spouse's employer. You will need to factor any additional benefits you receive when you estimate your additional taxation, and report it properly when preparing your federal tax return.) You will be taxed on the childcare benefits you receive from NC State in excess of \$5,000 *only in the months during which you exceed that limit*. Please keep in mind that some paychecks during the year will have more taxes taken out than others. Be sure to anticipate that when you budget.

FOR MORE INFORMATION on the TAXATION of NC STATE'S WOLFPUP CHILDCARE PROGRAM:

If you have questions about the tax implications of your child care benefits or how much you may contribute to a dependent care FSA, please contact your Benefits Counselor at: www.ncsu.edu/hr/benefits/counselor.asp or call (919) 515-2151.