

# NC STATE UNIVERSITY

## Understanding the Taxation of the NC State 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 two types of pre-tax childcare benefits, both of which are subject to the \$5,000 total:

1. A **Sliding-Scale** subsidy for all program participants (at nine Triangle area Bright Horizon locations), based on family income;
2. 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 NC State's SUBSIDIES COUNT TOWARD THE \$5,000 LIMIT?**

In partnership with Bright Horizons, **NC State University pays the difference** in the cost of tuition for each child so that faculty & staff may receive the NC State Child Care Tuition Rate at their desired Bright Horizons Triangle Area Location.

NC State will provide an 11% subsidy on Bright Horizons tuition rates for a families with total income of \$70,000 or more per year, and a 31% subsidy on Bright Horizon tuition rates for families with income less than \$70,000 per year.

NC State contributes on your behalf each month a percentage of your tuition rate based upon your household income. 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, the subsidies (based on family income) are considered employer- provided tax-free childcare benefits [provided the total does not exceed the \$5,000 limit].

**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.

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

For example, if your total annual employer-provided subsidies are \$2,172, the amount left over from subtracting \$2,172 from \$5,000 is \$2,828. You may elect to have \$2,828 (\$235.67/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 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 \$1,000 benefit for only \$300. The additional amount for which you are taxed is called "childcare imputed income"

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 \$70,000**

- The full cost for infant care is \$1,790 per month
- The rate after the 31% **Tuition Subsidy** is \$1,238 per month This gives you a total subsidy of \$552 off the \$1,790 monthly rate
- Your \$552/mo. subsidy for the first nine months of the year (January - September) equals \$4,968. In October, you cross over the \$5,000 limit by \$520, which would be taxable.
- The remaining \$552 in the months of November and December are also taxable.
- Your "childcare imputed income" will be \$1624.

#### **EXAMPLE 2: Two-Year-Old Care; Family Income over \$70,000**

- The full cost for a two-year-old is \$1,481 per month
- The rate after the 11% Tuition Subsidy is \$1,323 per month (your out-of-pocket) Therefore, your employer-provided benefit is \$158 per month, or \$1896 per year
- You want to take advantage of the maximum, pre-tax FSA benefit. Since you're already receiving the equivalent of \$1,896 as a tuition subsidy, you can direct the remaining \$3,104 (\$5,000 annual limit - \$1,896 tuition subsidy) into to a pre-tax FSA to reimburse your out-of- pocket expenses

#### **EXAMPLE 3: HIRED Mid-Year**

- You are hired by NC State on July 1, and immediately place your preschooler in BH, where the full cost is \$1,295/month
- Your family income is \$75,000, so you are eligible for the 11% Sliding-Scale subsidy
- You will pay \$1,160/mo. out-of-pocket for six months, or a total of \$6,960
- Your total subsidy would be \$135 per month, or \$810 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 \$4,190 (\$5000 maximum - \$810) 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 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 Consultant at: [go.ncsu.edu/benefitconsultant](http://go.ncsu.edu/benefitconsultant).

