A PUBLICATION OF THE NEW JERSEY DIVISION OF PENSIONS AND BENEFITS

Tax$ave

State Employees who are Eligible for the State Health Benefits Program

Tax$ave, a benefit program available under Section 125 of the Federal Internal Revenue Code, allows eligible employees to set aside before-tax dollars to pay for certain medical, dental, and dependent care expenses, thereby avoiding federal taxes and saving money.

An eligible employee is any **full-time** employee of the State, a State college or university, or other State agency who is eligible to participate in the State Health Benefits Program.

Tax$ave consists of three separate component plans, and an eligible employee may elect to participate in any combination — all, some, or none of the plans.

The three components of Tax$ave are:

- The **Premium Option Plan** (POP) allows an employee to pay any State Health Benefits Program medical and/or dental payroll contributions or premiums with before-tax dollars;
- The **Unreimbursed Medical Flexible Spending Account** allows an employee to set aside money to pay for qualified medical and dental expenses not paid by any group benefits plan under which the employee and dependents are covered; and
- The **Dependent Care Flexible Spending Account** allows an employee to set aside funds to pay for anticipated expenses related to dependent care required to permit the employee and spouse to work.

Note: Tax savings on commuter mass transit and parking expenses are available as a separate benefit to State employees under the Commuter Tax$ave Program. See Fact Sheet #67, *Commuter Tax$ave Program*, for details.

PREMIUM OPTION PLAN

If you are an employee eligible to participate in the State Health Benefits Program (SHBP), you can save tax dollars by participating in the Premium Option Plan (POP). The plan allows you to pay any of your SHBP medical and/or dental payroll contributions or premium deductions with before-tax dollars. The contributions or premiums you already pay for your coverage are deducted from each paycheck before federal income and FICA (Social Security and Medicare) taxes are calculated, thereby saving money on taxes withheld. The amount of your savings depends on a variety of factors, such as the amount of the contributions or premiums and your income tax filing status. The plan runs on a calendar-year basis.

If you have a payroll contribution or premium deduction for medical and/or dental coverage, you are automatically enrolled in POP and will pay less taxes. If you choose to decline enrollment in the POP, you must sign and return a *Declination of POP* form each year to your benefits administrator.

POP will increase your take-home pay by reducing your taxes; it does not change the medical and/or dental contributions or premiums you are required to pay.

EFFECT OF POP ON SHBP RULES AND PROCEDURES

The Internal Revenue Service (IRS) strictly regulates the POP plan because of the tax advantages provided. IRS rules require that for an employee covered by the POP, payroll deductions for medical and dental plan benefits remain the same for the entire plan year. Therefore, no coverage level change can be made which results in a change in the amount of your medical and/or dental plan deduction *unless* a "qualifying event" occurs. If a qualifying event does occur, you may make a change by submitting a completed SHBP medical and/or dental plan application to your employer within 60 days of the event or during the annual Open Enrollment period.

Qualifying Events

Plan elections in effect at the beginning of the plan year will continue throughout the calendar year or upon the occurrence of a "qualifying event." The following is a list of what is considered a qualifying event:

- A marriage (you may enroll your spouse and any other eligible dependents). See also “Civil Union Partners, Domestic Partners, and Tax$ave” on page 4.
- Addition of an eligible dependent due to birth, adoption, or legal guardianship.
- A change in family status involving the loss of eligibility of a family member (divorce, death; child marries or no longer lives at home).
- A move outside an HMO service area.
- The termination of your employment for any reason, including retirement.
- An approved unpaid leave of absence (you are entitled to elect the POP upon return to active employment).
- A change in your spouse's or eligible dependent's employment status resulting in their loss of medical and/or dental coverage.
- A child under the age of 23 has divorced and moves back into your household and is dependent upon you for support and maintenance.
- Such other events that may be determined to be appropriate and in accordance with applicable IRS regulations.

UNREIMBURSED MEDICAL FLEXIBLE SPENDING ACCOUNT

The Unreimbursed Medical Flexible Spending Account (FSA) allows you to save taxes on out-of-pocket medical and dental expenses that reduce your spendable income. Contributing money to the Medical FSA can result in a reduction in taxes because the money you contribute to your account is free from federal income, Social Security, and Medicare taxes and remains tax-free when you receive it.

Under the Medical FSA, each calendar year you may set aside up to $2,500 of your salary before taxes in a health care spending account, so that you and your eligible dependents can be reimbursed for eligible expenses incurred during the year. These include such expenses as copayments and deductibles for medical, prescription, and dental bills, expenses for medical services not covered by health plans or your State vision coverage such as contact lens solution, hearing aids, etc., and any other health care expense you can deduct on your income tax, except payroll contributions or premium deductions for health care which are covered under the POP (see above for details).

Additionally, the IRS has stated that certain expenses for medical care, i.e., costs for diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, may be reimbursed by a Medical FSA even though not deductible on income taxes. Examples of these expenses are antacids, aspirin, cough medicine, allergy medication, and certain other over-the-counter drugs purchased without a prescription.

IRS Publication #502, *Medical and Dental Expenses*, provides a complete list of services eligible for reimbursement.

> **Note:** The IRS does not consider vitamins and dietary supplements not prescribed by a physician as reimbursable expenses under a Medical FSA even if purchased for one of the medical care purposes listed above.

Using Your Unreimbursed Medical FSA

First, you must estimate how much you will spend on unreimbursed health care during the plan year. Based on the amount you elect, contributions will be taken out of your paycheck each pay period throughout the calendar year. It is important to base this estimate on past experience **because unused contributions must be forfeited**. Carefully review your history of unreimbursed health care expenses before making an election, to anticipate what you will spend in the coming year and eliminate the possibility of having to forfeit unused contributions at the end of the calendar year.

You may submit claims to the Medical FSA for unreimbursed expenses between January 1 of the plan year and March 15 of the following year (For example: January 1, 2009 through March 15, 2010). Claim forms for eligible expenses must be submitted no later than April 30 of the following year.

When you file your claim, you will be reimbursed for up to the total amount you have elected to contribute, whether or not the deductions from your pay to date have totaled the amount of your claim. When filing for reimbursement, you must verify that you have not been reimbursed for the expense from any other source.

While the federal government offers a federal income tax deduction for unreimbursed eligible health care expenses which exceed 7.5% of your adjusted gross income, the Medical FSA offers tax-free reimbursement on each and every dollar of your eligible expenses, which may provide immediate tax savings for those who do not meet the medical expense deduction threshold. In addition, the Medical FSA saves you Social Security and Medicare taxes, another 7.65% on every dollar. Keep in mind, however, that you cannot deduct expenses reimbursed by the Medical FSA on your federal income tax.

DEPENDENT CARE FLEXIBLE SPENDING ACCOUNT

If you have to pay for care for your dependents in order to work, you may want to take advantage of the Dependent Care Flexible Spending Account (FSA) plan. Contributing money to the Dependent Care FSA can result in a reduction in taxes because the money you contribute to your account is free from federal income, Social Security, and Medicare taxes and remains tax-free when you receive it. The plan allows you to set aside up to $5,000 of your salary before-taxes each calendar year to pay for qualified dependent care expenses incurred in that calendar year. You then file claims for reimbursement of eligible expenses. Note that when you file your Dependent Care FSA claim, you cannot be fully reimbursed until your deductions to date from your pay are at least equal to the amount of your claim.

Eligible dependents include an employee's children below age 13, the employee's non-working spouse if physically or mentally incapable of self-care, and any other person considered a dependent for tax purposes who is incapable of self-care and who normally spends at least eight hours each day in the employee's home. The types of services eligible for reimbursement include a qualified day care center, nursery school, or summer day camp (but not overnight camping), a baby-sitter if needed to allow the employee to work, a housekeeper whose duties include day care, and someone who cares for an elderly or incapacitated dependent.

IRS Publication #503, *Child and Dependent Care Expenses,* provides a complete list of dependent care expenses.

Using Your Dependent Care FSA

First, you must estimate how much you will spend on dependent care during the plan year. Based on the amount you elect, contributions will be taken out of your paycheck each pay period throughout the calendar year. It is important to base this estimate on past experience **because unused contributions must be forfeited**. Carefully estimate of your dependent care expenses before making an election to eliminate the possibility of having to forfeit unused contributions at the end of the calendar year.

You may submit claims to the FSA for dependent care provided between January 1 of the plan year and March 15 of the following year (For example: January 1, 2009 through March 15, 2010). Claim forms for eligible services must be submitted no later than April 30 of the following year.

The federal government offers a dependent care tax credit on your federal income tax that you can use the *instead of* the Dependent Care FSA. You will have to decide which method is better for you based on your income and personal tax status. Keep in mind, however, that any payment received from the Dependent Care FSA will reduce dollar-for-dollar the amount that can be considered for dependent care tax credit and vice versa.

Under the federal dependent tax credit provision, you can take a direct tax credit on your income taxes ranging from 20% to 30% of your eligible dependent care expenses. With the tax credit, eligible care expenses are limited to an annual maximum of $2,400 for one dependent or $4,800 for two or more dependents.

Generally, if your adjusted gross income is more than $24,000 a year, using the Dependent Care FSA is better. For example, if you're paying $90 per week (about $4,700 per year) for day care and you're in the 15% federal tax bracket, you would save $1,060 in taxes by paying your day care bills through your Dependent Care FSA. If you are in the 28% federal tax bracket, your savings would be $1,670.

USE IT OR LOSE IT

Under either the Unreimbursed Medical FSA or the Dependent Care FSA, ***any unused contributions remaining in an account at the end of the plan year are forfeited.*** *You have until* ***April 30*** *of the following year to file for eligible reimbursement.*

FSA PLAN ADMINISTRATOR

Fringe Benefits Management Company (FBMC), is the administrator of the Unreimbursed Medical Flexible Spending Account and Dependent Care Flexible Spending Account plans for the State of New Jersey and the Division of Pensions and Benefits.

If you have questions about the Unreimbursed Medical FSA or the Dependent Care FSA, contact FBMC Customer Service at 1-800-342-8017, Monday through Friday from 7:00 a.m.-10:00 p.m., or visit the FMBC Web site at: *www.myFBMC.com*

FBMC's Web site is also available through the Tax$ave link on the Pensions and Benefits' Web site at: *www.state.nj.us/treasury/pensions/taxsave.htm*

SOCIAL SECURITY IMPLICATIONS

Since payments to the Premium Option Plan and Flexible Spending Accounts lower annual earnings against which Social Security deductions or employer contributions are made, there is a concern that participation in these plans would result in reduced Social Security benefits at retirement.

If you were born after 1928, your Social Security benefits are calculated using a 35-year average of your earnings. A reduction of $2,000 a year or even $5,000 a year over some portion of this 35-year span would have little effect on your average salary and, therefore, minimal impact on your Social Security benefits. The Social Security Administration has provided us with an example of an employee who retired in 1998 at age 65 whose wages had been at the maximum wages subject to Social Security deductions. Upon retirement, this individual's monthly Social Security allowance was $1,343. If that same person had been contributing $2,000 a year for the last 10 years to a Flexible Spending Account, the subsequent reduction in Social Security wages would have produced a monthly Social Security allowance of $1,335, a difference of only $8 per month.

CIVIL UNION PARTNERS, DOMESTIC PARTNERS AND TAX$AVE

The Internal Revenue Service <u>does not</u> recognize a New Jersey civil union partner or same-sex domestic partner as a dependent for tax purposes in the same manner that it recognizes a spouse or the dependent children of an employee. Therefore, your employer may have to treat civil union or same-sex domestic partner benefits as federally taxable.

As a result, a partner must be able to qualify as a "tax dependent" of the employee for federal tax filing purposes — under Internal Revenue Code Section 152 — before an out-of-pocket medical expense incurred by the partner can be reimbursed under the Unreimbursed Medical Flexible Spending Account and before any premiums that the employee pays for the partner's coverage can be made on a pre-tax basis under the Premium Option Plan. See ***IRS Tax Topic #354,*** *Dependents,* for additional information on the requirements for establishing dependent status for federal tax purposes.

If the civil union partner or same-sex domestic partner is <u>not</u> a "qualified tax dependent" of the employee, the partner's SHBP coverage is considered federally taxable and the employee <u>cannot</u> be reimbursed under the Unreimbursed Medical FSA for any out-of-pocket medical expense incurred by the partner, nor make pre-tax payments for the cost of the partner's coverage under the Premium Option Plan. (Pre-tax dollars may still be used to pay for the employee's portion of the cost of his or her own and dependent children's coverage.)

Civil union partners or same-sex domestic partner SHBP benefits are <u>not</u> subject to New Jersey State income tax. If you live outside of New Jersey, you should check with your State's tax agency to determine if the civil union or same-sex domestic partner benefit is subject to state taxes.

Additional information about New Jersey Civil Unions can be found in Fact Sheet #75, *Civil Unions.* For more information about the New Jersey Domestic Partnership Act, see Fact Sheet #71, *Benefits Under the Domestic Partnership Act.*

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