HUMAN RESOURCES DEPARTMENT
SAN LUIS OBISPO COUNTY

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TO: ALL COUNTY EMPLOYEES

FROM: HUMAN RESOURCES BENEFITS

SUBJECT: INDIVIDUAL TAX SAVINGS PROGRAM (ITS)

The County is pleased to offer a three-part benefit program called the Individual Tax Savings (ITS) Program. The ITS Program allows eligible employees to pay certain personal expenses from their pre-tax salaries, and thus reduce their federal, state and Social Security taxes. **New employees can enroll in this program within their first 31 days of employment. Call Human Resources Benefits at 781-5959 if you have questions.**

1. ITS (Tax Free Premium) option allows you to pay from your pre-tax salary any premium contributions you make towards your San Luis Obispo County medical, dental or vision plans. It is not necessary to enroll in this option because it is provided for you automatically.

2. ITS Health Care Spending Account allows you to be reimbursed on a pre-tax basis for health care expenses you may have that are not paid by any insurance plan. Ordinarily, health care expenses are deductible on your income taxes only when they exceed 10% of your adjusted gross income. ITS will give you a tax benefit even for the smaller amounts you pay for health care.

3. ITS Dependent Care Spending Account allows you to pay, from your pre-tax salary, expenses you have for dependent care that you need in order to work. Depending on your individual tax situation, this program feature may substantially reduce your cost for dependent care, possibly even more than you are currently saving through an income tax credit, and it covers both adult care and child care.

The following information describes the various features of the ITS Program. Please read it carefully. While the Tax Free Premium feature will provide tax benefits for everyone with employee paid premium expenses, the Health Care and Dependent Care Spending Accounts may or may not be right for you. You may participate in one or more parts of the three-part program. You will want to evaluate each option according to your own situation before enrolling.

Each of the ITS Program options is governed by an official plan document. The official document is available for your review from County Risk Management.

Eligibility
All **permanent** full-time and part-time County employees working a minimum of 40 hours per pay period are eligible to participate in the ITS Program.

Enrollment
Each year, prior to the start of the plan year, eligible employees have the opportunity to enroll in the Cafeteria Plan during the Open Enrollment period by submitting an Enrollment Form. *For 2017, the plan year will run January 1, 2017 through December 31, 2017.* **(ELIGIBLE EMPLOYEES HIRED AFTER THE START OF THE PLAN YEAR CAN ENROLL WITHIN 31 DAYS OF HIRE).**

Mid-Year Election Changes
The Internal Revenue Code will not permit changes outside the Open Enrollment period unless you have a change in family status or significant cost changes. A "change in family status and significant cost changes " as defined by the County Plan includes:

- Marriage, divorce, death of spouse, legal separation and annulment;
- Birth, adoption, placement for adoption, and death;
- Termination or commencement of employment, strike or lockout, commencement or return from unpaid leave, and/or change in work site for the employee, spouse or dependent;
- A change in employment status that affects eligibility under an employer plan;
- Dependent satisfies or ceases to satisfy eligibility requirements (gain or loss of student status, reaches the limiting age for benefits or any similar circumstance);
- Significant Cost Changes: increases or decreases in costs during the Plan year that affect the amount of dependent care expenses. **Health Care Spending Accounts are excluded from this section.**

When a change in family status occurs, you may stop or change the amount of your contributions to the Program. The changes you make must be consistent with the change in your family status and must be within 31 days of the date the event (marriage, birth, etc.) occurs.

Termination of Participation

Participation in the "ITS" Program will terminate when the employee's earnings are not sufficient to make the bi-weekly premium payment. Once you terminate participation in the plan you may not re-enroll during the same plan year. You may continue to file claims only for expenses incurred prior to your termination of participation. Claims must be submitted no later than 60 days after termination of your participation in the plan. Additionally this plan is subject to COBRA Continuation rules.

THE TAX FREE PREMIUM OPTION

If you pay premiums toward the cost of your health care coverage, you are **automatically** enrolled in the ITS Tax Free Premium feature. If you do not want this tax free option you must complete a waiver form. Waiver forms can be obtained from Risk Management.

How the Tax Free Premium Option Works

Any contributions you make toward insurance premiums will be deducted from your pre-tax salary; in other words, deducted before federal income taxes, Social Security taxes and state income taxes are calculated. The net effect will be your "real cost" is lowered by the amount you save in taxes.

THE HEALTH CARE SPENDING ACCOUNT

This ITS option will allow you to be reimbursed for medical, dental or vision care expenses you and your dependents incur, that are not reimbursed by any insurance plan. Such expenses can include any deductibles you pay, your co-payments, and charges for services not covered by your health plan. ***Amounts reimbursed under this account are not taxable.***

Effective January 1, 2011 FSA’s cannot be used to pay for over-the-counter medications and drugs without a doctor’s prescription. Over-the-counter medical supplies and products that are not considered medicines or drugs will be covered without a prescription. For example, equipment such as crutches, supplies such as bandages, and diagnostic devices such as blood sugar kits will still qualify for reimbursement.

Enrollment

Eligible employees may set up a Health Care Spending Account **within their first 31 days of hire** and during the annual enrollment period. When you enroll, you designate the amount of reimbursement you want available during the plan year. The elected amount will be contributed in equal installments taken from every paycheck throughout the year on a **pre-tax basis**. **For the 2017 plan year the maximum amount you can elect to have reimbursed from your Health Care Spending Account is $2,500.**

Once you have elected your reimbursement amount you cannot change your decision during the plan year unless you have a change in family status.

Eligible Expenses

During the plan year, you may submit bills for most health care expenses (as defined in the Internal Revenue Code) which you are legally obligated to pay, and **which are not covered by any medical, dental or vision insurance plan**. Reimbursement may only be made for expenses which are incurred during the Period of Coverage. Expenses are considered incurred on the date of treatment, service or purchase of goods.

Expenses may have been incurred for any person who is your dependent for income tax purposes (even if those dependents are not covered under your San Luis Obispo County health plan). Special rules apply for children of divorced or separated parents; details can be found in IRS Publication 502.

Eligible expenses include:

- health care that is not covered by a medical plan;
- medical and dental plan deductibles and co-payments;
- the cost of essential transportation to and from medical care (subject to verification);
- expenses that are higher than reasonable and customary fees, and thus excluded from coverage under a health plan;
- prescription drugs;
- capital expenses related only to the sick person and not related to permanent improvement or betterment of property;
- adult or child orthodontia;
- services and supplies not covered under a plan because of limitation, such as having your teeth cleaned more often than provided by a dental plan;
- vision care and supplies;
- Acupuncture;
- Chiropractors

This is not a complete listing of eligible expenses. A complete list of eligible expenses can be found in IRS Publication 502 (see exception noted below), available from your local Internal Revenue Service office.

Note: *Although listed in IRS Publication 502 as an eligible expense, premiums you pay for other health care coverage cannot be reimbursable through the "ITS" Program.*

Expenses **<u>not</u> considered eligible** by the IRS include any expense that is not primarily for the prevention or treatment of a physical or mental illness or defect, such as health club dues, weight reduction programs, health foods, vacations, cosmetic surgery or treatments undertaken only to improve appearance, such as teeth whitening. Current tax law **also excludes** the reimbursement of premiums you pay for other health care coverage. (Remember, premiums for your County health care coverage are automatically paid through the Tax Free Premium feature of the "ITS" Program.)

The "Use it or Lose It" Provision

<u>Plan your contributions carefully!</u> Any amount that remains unreimbursed from your Health Care Spending Account after the end of the plan year will be forfeited, as required by the Internal Revenue Code. You can file claims until March 1st of the following year for expenses incurred during the prior plan year; after that date you will lose the balance (see note). Any forfeited amounts will be used to defray the cost of administering the "ITS" Program.

Note: *If your period of coverage ends during the plan year due to a change of status or termination of employment, you must apply for reimbursement within sixty (60) days after the end of such period of coverage. You may elect to continue coverage in this plan after your termination of employment by paying your contribution amount on an after-tax basis for the remainder of the plan year. Additionally, this plan is subject to the COBRA continuation rules.*

ITS HEALTH CARE SPENDING ACCOUNT
OVER THE COUNTER (OTC) MEDICAL EXPENSES

Claim Documentation

Reimbursement of OTC medicine or drug expenses requires the same documentation as other eligible medical expenses and a prescription:

- Cash register receipts are acceptable, but they must contain the date, dollar amount and *specific name* of the item in order to be considered for reimbursement.
- No miscellaneous (i.e., pharmacy, Target) receipts will be accepted even if accompanied by a box-top or label.

Eligible OTC Drugs and Medicines Requiring a Prescription

- Acid Control
- Allergy & Sinus
- Anti-Diarrheal
- Aspirin
- Anti-Gas
- Anti-Itch & Insect Bite
- Antibiotic Products
- Antiparasitic Treatments
- Digestive Aids
- Pain Relief
- Eye Drops
- Feminine Anti-Fungal/Anti-Itch
- First aid cream
- Respiratory Treatments
- Baby Rash Ointments/Creams
- Hemorrhoidal Preps
- Sleep Aids & Sedatives
- Cold Sore Remedies
- Laxatives
- Stomach Remedies
- Cold, Cough & Flu Motion Sickness
- Rubbing Alcohol

NOTE: The above items are only eligible in reasonable quantities. While the Internal Revenue Code does not give a specific definition of reasonable, a 2-bottle limit will be applied to the County's program.

Examples of Eligible OTC Supplies/Equipment

- Band-Aids
- Bandages
- Blood Pressure Kit
- Carpel Tunnel Wrist Supports
- Cold-Hot Packs for Injuries
- Condoms
- Contact Lens Cleaning Solution
- First Aid Kits
- Gauze Pads
- Incontinence Supplies
- Nasal Strips
- Reading Glasses
- Thermometers

Examples of Ineligible OTC Items

Chapstick & lip balms
Cosmetics
Medicated shampoos & soaps
Moisturizes and face creams
Special food and food replacements
Suntan lotion
Toiletries
Toothpaste, dental floss & toothbrushes
Vitamins and nutritional supplements
Lotions/soaps with sanitizing ingredients

HEALTH CARE SPENDING ACCOUNT

ESTIMATED WORKSHEET

Estimate your expenses for the calendar year

		You	Your Spouse	Dependent	Total
1.	Medical and dental deductibles	________	+________	+________	=________
2.	Medical and dental co-payments	________	+________	+________	=________
3.	Health dental and vision care expenses not covered by your insurance plan.	________	+________	+________	=________
4.	Prescriptions not covered by your medical plan	________	+________	+________	=________
5.	Expenses exceeding reasonable and customary limits or other coverage limitations (e.g. having teeth cleaned more often than dental plan provides)	________	+________	+________	=________
6.	Special equipment for disabled persons	________	+________	+________	=________
7.	**Total Annual Health Care Reimbursement*** May not exceed $2,500				$________

THE DEPENDENT CARE SPENDING ACCOUNT

This ITS feature will let you pay for dependent (child or adult) care expenses with pre-tax money. In order to receive benefits from a Dependent Care Spending Account, you must have expenses for dependent care that is required so you can work. If you are married, your spouse must also work unless he or she is a student or is disabled and thus unable to provide the required care. During the year, as you incur eligible expenses, you simply **attach a bill** or receipt to your claim for reimbursement. **Your funds are still tax free, even after you withdraw them as reimbursements.**

The County can only process claims for dependent care expenses when the dates of service shown on the claim have already occurred. Section 125 of the Internal Revenue Code allows reimbursement of incurred expenses. An expense is incurred when the services have been provided, not when you are billed or pay for the service. This means, if you file a claim for January's dependent care expenses, all of January's services must have occurred prior to submitting the claim.

Enrollment

Eligible employees may set up a Dependent Care Spending Account **within their first 31 days of employment** and during the annual enrollment period. When you enroll, you designate how much of your pre-tax salary you want deducted and placed in your account to pay eligible dependent care expenses during the plan year. Deposits will be taken in equal installments from each paycheck throughout the plan year.

The maximum amount you can put into your Dependent Care Spending Account will depend upon your income and your marital income tax filing status, as follows:

Married, filing separate returns	$2,500 maximum
Single/Head of Household or Married filing jointly The lesser of:	-$5,000 -your spouse's income -your income for the Plan Year

Eligible Dependents

Expenses are covered only for "qualifying dependents", as defined by the IRS. The dependent must be (1) under the age of 13 and be your child or any other child in your custody for whom you are entitled to claim a tax exemption on your federal tax return or (2) your spouse or other dependent who is physically or mentally incapable of taking care of himself or herself, such as a parent who is invalid. Special rules apply for children of divorced or separated parents; details can be found in IRS Publication 503, available from your local IRS office.

Eligible Expenses

The expenses reimbursable under your Dependent Care Spending Account are the same as those for which you could claim a tax credit on your federal income tax return. However, any expenses paid through this program cannot also be claimed for a tax credit. The tax credit is discussed in more detail below. Qualifying expenses include:

- In-home services provided by a baby-sitter, nursing aide or attendant. Services provided by a housekeeper or maid may be reimbursed if the person is responsible for the care of an eligible dependent during the day. Included are any employer's taxes you must pay on behalf of the provider.

- Services provided by a day care center (for children or adults), a baby-sitter, or attendant. A day care center must be licensed if it provides for more than six individuals who do not normally reside there. Care provided outside your home is a covered expense only if the qualifying dependent regularly spends at least eight hours a day in your home. This requirement does not apply for children under age 13. Transportation to and from the place where care is provided is not an eligible expense.

Not covered for reimbursement are any expenses you pay to a person for whom you could claim a tax exemption as a dependent on your income tax return, or care by a child of yours (whom you do not claim as a tax exemption) who is under the age of 19 at the end of the current tax year.

The "Use It or Lose It" Provision

Just as with the Health Care Spending Account, the "use it or lose it" provision applies to the Dependent Care Spending Account. You can file claims for expenses incurred during a plan year any time before March 1st of the following year. Any funds remaining in your account after that date will be forfeited (see note below). There is no carryover or refund of unused money allowed by the IRS.

Note: *If your period of coverage ends during the plan year due to a change of status or termination of employment, you must apply for reimbursement within sixty (60) days after the end of such period of coverage.*

Any forfeited amounts will be used by the County to defray the cost of administering the plan.

Tax Credits vs. Your Dependent Care Spending Account

The IRS currently allows you to take a "tax credit" for money you spend on dependent care. The credit is based on your adjusted gross household income and the number of children you have. The maximum in expenses you can apply toward the credit is $3,000 a year if you have one dependent and $6,000 if you have two or more. Your dependent care tax credits are subtracted from your income taxes.

Expenses paid through the Dependent Care Spending Account cannot be applied toward the federal tax credits. Any amount that is reimbursed through a Dependent Care Spending Account reduces the amount available as a tax credit, dollar for dollar. In other words, if you have a Dependent Care Spending Account that reimburses $1,000 of your expenses, your maximum expenses available for a tax credit will be $2,000 for one dependent ($3,000-$1,000) or $5,000 for two or more dependents ($6,000-$1,000).

Whether you are better off using the Dependent Care Spending Account or taking the tax credit depends on your individual tax situation. Factors such as your adjusted gross income, the number of dependents for whom you require care, and the amount which you pay for the care will affect the outcome. We are providing you with a worksheet which can be used to roughly estimate which option is better for you, but the final determination should be made in consultation with your tax advisor.

Claiming Reimbursement for ITS Health Care or Dependent Spending Accounts

Employees have the option of submitting claims through Employee Self-Service (ESS) or downloading Health Care and Dependent Care reimbursement claim forms online at http://myslo.intra/RM/RM_Benefits.htm. Claims can be filed at any time (a minimum of $5.00 per claim) and reimbursement for several expenses can be included on one form, so long as they are for the same kind of expense (that is, either dependent care or health care).

The County can only process claims for dependent care expenses when the dates of service shown on the claim have already occurred. Section 125 of the Internal Revenue Code allows reimbursement of incurred expenses. An expense is incurred when the services have been provided, not when you are billed or pay for the service. This means, if you file a claim for January's dependent care expenses, all of January's services must have occurred prior to submitting the claim.

Submit your completed claim form with the required documentation to the Auditor's Office. When properly completed claims are received in the Auditor's Office by noon on Thursday preceding a pay week, every attempt will be made to process claims and issue your reimbursement through the next regular payroll process. Any questions you have about claims processing can be addressed to the Payroll Section of the Auditor's Office.

Important: When you file your tax return, you will be required to provide the name, address and taxpayer identification number (or Social Security number) for all dependent care providers, whether you claim a tax credit or use a dependent care reimbursement account. It is best to get this information at the time you are paying your provider.

DEPENDENT CARE SPENDING ACCOUNT

Estimated Worksheet

Eligible dependent care expenses for children under age 13 and dependent family members incapable of self-support.

	Dependent #1	Dependent #2	Dependent #3	Total
Pre-School Children All care expenses eligible	________	+________	+________	=________
School Age Children (Under age 13) Includes only non-educational expenses before/after school. Be sure to include expenses for school holidays and summer vacation from school during your working hours. This may include a summer day camp in lieu of day care.	________	+________	+________	=________
Dependent Adult Care Expenses for care during your working hours for dependent adult(s) who lives in your home	________	+________	+________	=________
Total Annual Dependent Care Reimbursement* May not exceed $5,000, or $2,500 if you are married and file a separate tax return				$________

*	Enter these totals on your Enrollment Form

ESTIMATING DEPENDENT CARE SPENDING ACCOUNT
TAX SAVINGS vs. TAX CREDIT

This worksheet does not account for personal tax deductions or other details. Completing this worksheet will give you an estimate of what the tax effect of the two choices would have been in the new tax year. 2017 tax rates and laws may be different. You may want to consult a qualified tax advisor.

		With Dependent Care Spending Account	**With Tax Credit**
1.	Enter your estimated 2016 family earned income	$__________	$
2.	Enter the amount you would deposit in your Dependent Care Spending Account	$__________	N/A
3.	SUBTRACT line 2 from line 1	$__________	$
4.	Using the tax tables in the Federal tax package, find your estimated income taxes on the amounts on line 3	$__________	$
5.	SUBTRACT line 4 from line 3	$__________	$
6.	Using the tax tables in the State tax package, find your estimated income taxes on the amounts on line 3	$__________	$
7.	SUBTRACT line 6 from line 5	$__________	$
8.	Calculate your Social Security taxes (6.2% of the first $106,800 Plus 1.45% Medicare) on line 3	$__________	$
9.	SUBTRACT line 8 from line 7	$__________	$
10.	Refer to the attached Tax Credit Table to find the Federal tax credits that may be available	N/A	$
11.	ADD lines 9 and 10	$__________	$
12.	Enter amount shown in line 2 under Dependent Care Plan.	N/A	$
13.	Net income after taxes subtract Line 12 from 11.	$__________	$

The amounts on line 13 are an estimate of your net income after taxes with a Dependent Care Spending Account and with the Tax Credit.

NOTE: *Any expenses paid through your Dependent Care Spending Account will reduce the amount of expenses available for a tax credit, dollar for dollar, even if the expenses claimed for a tax credit are different from those paid through your Dependent Care Spending Account. For this estimate, assume you are using only the Dependent Care Spending Account or the tax credit.*

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Tax Credit Table

Estimated Taxable Income (Federal Form 1040)	**Percent of Dependent Care Expenses Eligible for Tax Credit** (Maximum: $3,000 for one dependent; $6,000 for two or more)
$ 0 - 15,000	35%
15,000 - 17,000	34
17,000 - 19,000	33
19,000 - 21,000	32
21,000 - 23,000	31
23,000 - 25,000	30
25,000 - 27,000	29
27,000 - 29,000	28
29,000 - 31,000	27
31,000 - 33,000	26
33,000 - 35,000	25
35,000 - 37000	24
37,000 - 39,000	23
39,000 - 41,000	22
41,000 - 43,000	21
43,000 - No limit	20