



Using Dependent Care FSAs—What Expenses Can Be Reimbursed?

Internal Revenue Code (Code) Section 129 allows employers to provide dependent care assistance benefits for their employees on a tax-free basis. These benefit plans are commonly known as dependent care flexible spending accounts (FSAs) or dependent care assistance programs (DCAPs).

Most dependent care FSAs are structured so eligible employees fund their accounts with pre-tax payroll deductions through a Code Section 125 cafeteria plan. Employers may also contribute to employees' dependent care FSAs, subject to certain nondiscrimination requirements. Effective Jan. 1, 2026, the maximum annual contribution limit for dependent care FSAs increases to \$7,500, or \$3,750 for married individuals filing separate tax returns (up from \$5,000 and \$2,500, respectively, for prior years).

Employees may use their dependent care FSAs to pay for otherwise unreimbursed work-related dependent care expenses. An expense must satisfy two main requirements to be reimbursable:

1. The expense must be primarily for the **care of one or more qualifying individuals** (for example, a child under the age of 13); and
2. The expense must be incurred to **enable the employee (and the employee's spouse) to be gainfully employed**.

General Rules

Under Code Section 129, an expense is eligible for reimbursement from a dependent care FSA only if it is an **otherwise unreimbursed work-related expense**. To qualify as a work-related dependent care expense, the expense must satisfy the following two legal requirements:

1. The expense must be primarily for the **care of one or more qualifying individuals**; and
2. The expense must be incurred to enable the employee (and the employee's spouse) to be **gainfully employed**.

In addition, the dependent care FSA's **plan documents must permit reimbursement of the expense**. As background, employers that sponsor dependent care FSAs must have a written plan document in place that describes the dependent care assistance benefits and complies with the requirements of Code Section 129. Employers are also required to notify employees of the plan's availability and terms. A dependent care FSA can be designed to more narrowly define eligible expenses than is allowed under Code Section 129. For example, a dependent care FSA's reimbursement rules may be more restrictive as to the type of eligible expenses or the qualifying individuals whose care will be reimbursed. Only eligible expenses permitted under the terms of the dependent care FSA's plan documents should be reimbursed.

Federal tax law indicates that employers should have a **reasonable belief** that the expenses reimbursed under their dependent care FSAs are actually eligible expenses. To comply with this requirement, employers should clearly communicate the rules for eligible expenses to employees who participate in the dependent care FSA. Employers may also want to remind employees of these rules each time they submit a claim for reimbursement.

Requirement #1: Care of Qualifying Individuals

The expense must be to provide care for a qualifying individual to qualify as a work-related expense that may be reimbursed under a dependent care FSA.

Qualifying Individuals

For purposes of dependent care benefits under Code Section 129, a qualifying individual includes:

1. The employee's dependent child who has not attained **age 13**;

2. The employee's spouse who is mentally or physically incapable of self-care; or
3. A tax dependent of the employee who is mentally or physically incapable of self-care.

All qualifying individuals must have the **same principal place of abode as the employee for more than half of the year**. This means that a noncustodial parent of a child cannot treat the child as their qualifying individual for dependent care FSA reimbursements, even if they are financially responsible for paying for care. Only the custodial parent can treat a child as a qualifying individual for dependent care FSA purposes.

An employee's child includes a son, daughter, stepson, stepdaughter or eligible foster child of the employee. Based on federal tax rules, the child of an employee's domestic partner will not, in most cases, satisfy the requirements for a qualifying individual.

Individuals who cannot dress, clean or feed themselves because of physical or mental disabilities are considered unable to care for themselves. Also, individuals who must have constant attention to prevent them from injuring themselves or others are considered unable to care for themselves.

Whether someone is a qualifying individual must be calculated **on a daily basis**. For example, an employee may no longer seek reimbursement for dependent care expenses incurred after their dependent child's 13th birthday.

Care

In general, expenses are for the care of a qualifying individual only if their main purpose is the person's **well-being and protection**. An employee does not have to choose the least expensive care alternative that is available. The cost of a paid care provider may be an eligible care expense even if another care provider is available at no cost.

Not all expenses related to a qualifying individual are for the individual's care. Expenses for care do not include amounts that taxpayers pay for food, lodging, clothing, education and entertainment. However, small amounts paid for these expenses may be reimbursable if they are incidental to and cannot be separated from the cost of caring for the qualifying individual.

Child support payments are not for care and cannot be reimbursed through a dependent care FSA. Expenses for household services may qualify as reimbursable expenses if the services are performed in connection with the care of a qualifying individual. Services performed by chauffeurs, bartenders or gardeners are not household services.

The following table addresses whether certain types of common expenses are eligible care expenses:

Type of Expense	Eligible Expense?
Babysitters (inside or outside of the taxpayer's home)	Expenses for babysitters may be eligible care expenses, unless the babysitter is: • The employee's child, stepchild or eligible foster child who is under the age of 19; • A tax dependent of the employee or the employee's spouse; • The employee's spouse; or • The parent of the employee's qualifying child who is under the age of 13.
Camp	The cost of day camp is an eligible care expense, even if the camp specializes in a particular activity, such as computers or soccer. The cost of sending a child to an overnight camp is not considered a work-related expense.
Custodial Care	The cost of care services outside of the employee's household is reimbursable only if the care is for a qualifying individual and, if the qualifying individual is not a qualifying child under the age of 13, the individual must regularly spend at least eight hours each day in the employee's household. Due to this restriction, a dependent care FSA cannot reimburse nursing home expenses, but elder day care may be reimbursable.
Dependent Care Centers (or childcare centers or day care centers)	Expenses for care provided outside a taxpayer's home at a dependent care center are eligible care expenses, assuming the center complies with all state and local regulations. A dependent care center is a facility (including a nonprofit facility) that provides care for more than six individuals (not counting individuals who reside at the center) and receives a fee, payment or grant for providing these services.
Fees and Deposits	Fees and deposits an employee must pay for care are eligible expenses even though they are not directly for care. Examples of fees and deposits include the following: • Fees paid to an agency to get obtain the services of a care provider; • Deposits paid to an agency or preschool; • Application fees; and

Type of Expense	Eligible Expense?
	Other indirect expenses. However, a forfeited deposit is not an eligible expense if care is not provided.
Home Care	The cost of home care (by a nanny or au pair, for example) is an eligible expense if it is attributable to the care of a qualifying individual.
Housekeeping	Expenses for a housekeeper generally are not eligible care expenses, unless their duties include caring for a qualifying individual.
Lessons (e.g., dance, music or theater)	Expenses for lessons are not eligible care expenses when they are charged separately because they are primarily for educational purposes.
School	Expenses for a child in nursery school, preschool or a similar program for children below the level of kindergarten are eligible care expenses. Expenses to attend kindergarten or a higher grade are not eligible care expenses because they are for an educational purpose. Similarly, expenses for summer school or tutoring programs are ineligible. However, expenses for before- or after-school care of a child may be eligible care expenses because these programs generally are not for an educational purpose.
Transportation	If a care provider takes a qualifying individual to or from a place where care is provided, the transportation is for the care of the qualifying individual. This includes transportation by bus, subway, taxi or private car. Transportation costs for a care provider to come to an employee's home are not eligible care expenses.

Requirement #2: Gainfully Employed

To qualify as a dependent care expense that may be reimbursed under a dependent care FSA, the expense must be incurred to enable the employee (and the employee's spouse) to be gainfully employed. In other words, the expense must be incurred to **allow the employee (and the employee's spouse) to work or look for work**.

If an employee is married, generally both the employee and the spouse must work or look for work. However, a spouse may be treated as working for any month when they are a full-time student or mentally or physically incapable of self-care with the same principal abode as the employee for more than half of the year.

An employee's (or spouse's) gainful employment may consist of work within or outside the home, including self-employment. This work can be on a full- or part-time basis. Gainful employment also includes time spent actively looking for work.

An expense is not considered work-related merely because it is incurred while an employee (or spouse) is working. Rather, the purpose of the expense must be to allow the taxpayer to work. Whether an expense allows a taxpayer to work or look for work depends on the facts of each situation and is determined on a daily basis.

[IRS regulations](#) provide the following guidance on gainful employment:

- Volunteering**—An individual who works as a volunteer or for nominal consideration is not considered to be gainfully employed.
- Short, temporary absences**—An individual is not required to allocate expenses during short, temporary absences from work, such as for minor illness or vacation, if the taxpayer is required to pay for care during the absence. An absence of two weeks or less is considered a short, temporary absence. An absence of more than two weeks may also be considered a short, temporary absence, depending on the circumstances.
- Part-time employment**—Part-time employees may seek reimbursement only for dependent care expenses incurred on working days. If the employee works at least one hour, dependent care expenses for that day are eligible. Also, if a part-time employee is required to pay for care on a weekly or monthly basis and that period includes working and non-working days, the employee is not required to allocate expenses.

Example: An employee works three days each week. While the employee works, their six-year-old child attends a day care center. The employee can pay the center \$150 for three days of care per week or \$250 for five days of care per week. The employee's child attends the center five days a week. The employee's work-related expenses are limited to \$150 per week. However, if the center does not offer the three-day option and requires the employee to pay \$250, the entire \$250 weekly fee may be a work-related expense.

Other Rules for Reimbursements

"Use or Lose" Rule

Dependent care FSAs are subject to the Code's "use or lose" rule for FSAs. Under this rule, any unused funds in the FSA at the end of the coverage period generally cannot be carried over to the next coverage period and **must be forfeited**. A dependent care FSA's coverage period, or plan year, must be 12 months long, although short plan years are permitted in some situations.

The IRS allows employers to design their dependent care FSAs with an extended deadline, or **grace period**, of 2.5 months after the end of a plan year to use funds. Thus, for a plan year ending Dec. 31, the employees would have until March 15 to spend the funds in their dependent care FSA. Allowing a grace period is optional for employers that sponsor dependent care FSAs.

Timing Restrictions

A dependent care FSA can reimburse only eligible dependent care expenses incurred during the plan's coverage period (including any grace period, if applicable). Dependent care expenses incurred before or after the coverage period are not eligible for reimbursement for that coverage period. Dependent care expenses are incurred when the services are provided, and not when an employee is billed for the cost or pays for the care. In general, dependent care FSAs **cannot provide advance reimbursements of future dependent care expenses**.

[IRS regulations](#) permit dependent care FSAs to incorporate a spend-down provision for employees whose participation terminates during a coverage period. At the employer's option, a dependent care FSA may allow terminated participants to use unused amounts in their accounts for dependent care expenses incurred during the remainder of the coverage period (or grace period immediately after that plan year, if applicable). If an employer does not incorporate a spend-down provision in its dependent care FSA, terminated employees forfeit any unused balances remaining in their accounts at the time of the termination, subject to any run-out period for submitting claims.

The uniform coverage rule for health FSAs does not apply to dependent care FSAs. The uniform coverage rule requires the maximum amount of reimbursement from a health FSA to be available at all times during the coverage, reduced only for prior distributions during the coverage period. Because dependent care FSAs are not subject to the uniform coverage rule, they may limit reimbursement of eligible expenses to the amount that has been contributed to the employee's account at the time when they request reimbursement, reduced by any amounts already reimbursed.

Third-party Substantiation

All employee requests for dependent care FSA reimbursements **must be substantiated with information from a third party** (that is, someone other than the employee and their spouse or dependents) to ensure that only eligible expenses are reimbursed. The independent third party must provide information describing the expense, the date of the service or sale, and the amount (e.g., a detailed receipt from a day care provider). Employers typically use third-party administrators to manage their dependent care FSA claims process, including reviewing this third-party documentation. According to an [IRS memorandum](#) from 2023, FSA expenses are not considered properly substantiated if employees self-certify expenses, if the plan uses sampling, if only amounts over a certain level are substantiated or if charges from favored providers are not substantiated.

LINKS AND RESOURCES

- [Internal Revenue Code Section 129](#)
- [IRS Publication 503](#) - Child and Dependent Care Expenses
- [Instructions](#) for IRS Form 2441 (Child and Dependent Care Expenses)

Provided to you by Liberty Insurance Agency

This Compliance Overview is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice. ©2025 Zywave, Inc. All rights reserved.