

HCR

19

HOUSE COMMITTEE REPORT

(7)

Date referred: 4/1/87

FURTHER REFERRALS: Finance

DATE: 4-15-87

The State Affairs Committee has considered HCR 19
Relating to dependent care benefits under the Supplemental Benefits System.

RECOMMENDS:

- replace with _____ the same title
- attached amendment(s) a new title
- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the _____ Committee

ADOPTS: _____ letter of intent

ATTACHES NEW FISCAL NOTE(s):

- fiscal impact same as previous fiscal note published _____
- zero fiscal note same as previous zero fiscal note published _____
- zero with analysis

SIGNING DO PASS:

John Wilmer

Tommy McManus

Cliff Danison

SIGNING OTHER RECOMMENDATIONS:

W. David Dingley NO REC
Larry Martin No Rec.

John Wilmer

Chairman's signature

Alaska State Legislature

STEVE FRANK

DISTRICT 20A
Finance Committee

1125 Sunset Drive
Fairbanks, Alaska 99701
(907) 452-3421



White in Juneau
P. O. Box V
Juneau, Alaska 99811
(907) 465-3709

House of Representatives

TO: Rep. Fran Ulmer, Chair
House State Affairs Committee

FROM: Rep. Steve Frank *SS*

RE: HCR 19 - "Dependent Care Benefits under SBS"

DATE: April 6, 1987

I would appreciate your scheduling a hearing for House Concurrent Resolution 19 at your earliest convenience.

The Resolution asks that the governor direct the Department of Administration to include dependent care services in the Supplemental Benefits System when they restructure the program to conform with the 1986 Tax Act. Dependent care services would thus become one of the benefits that state employees could choose under SBS.

Thank you for your consideration.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: CSHCR 19
Publish Date: _____

REQUEST _____

Revision Date: _____
Title: Relating to dependent care
benefits under SBS
Sponsor: Frank and Boyer
Requestor: House, State Affairs

Agency Affected: Administration
BRU: Retirement and Benefits
Components: Retirement and Benefits

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: Attach a separate page if necessary

Any costs required by changes in Supplemental Benefits System (SBS) will be borne by SBS participants through the program's administrative fees.

Prepared By: Michael B. Coughlin, Deputy Director Phone: 465-4470
Division: Retirement and Benefits Date: April 15, 1987

Approved by Commissioner: Garrey Peska Date: 4/16/87
Agency: Department of Administration

Distribution (by preparer):

Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)
Senate Secretary



Official Business

Alaska State Legislature

House

P.O. BOX V
State Capitol
Juneau, Alaska 99811

STATE AFFAIRS COMMITTEE

HOUSE CONCURRENT RESOLUTION 19

FILE CONTENTS

1. HCR 19: RELATING TO DEPENDENT CARE BENEFITS UNDER THE SUPPLEMENTAL BENEFITS SYSTEM
2. MEMORANDUM FROM REPRESENTATIVE STEVE FRANK TO HOUSE STATE AFFAIRS COMMITTEE
3. LETTER FROM MICHAEL COUGHLIN TO REPRESENTATIVE STEVE FRANK, DATED MARCH 23, 1987, AND ATTACHMENTS
4. MEMORANDUM FROM CHERIE SHELLY TO REPRESENTATIVE FRAN ULMER, DATED APRIL 15, 1987

Alaska State Legislature

STEVE FRANK

DISTRICT 20A
Finance Committee

1125 Sunset Drive
Fairbanks, Alaska 99701
(907) 452-3421



2
Jun. 1988
Alaska 99811
(907) 465-3709

House of Representatives

TO: all members, House State Affairs Committee
FROM: Rep. Steve Frank
RE: House Concurrent Resolution 19
DATE: April 15, 1987

The purpose of this resolution is to encourage the administration to include dependent care benefits in the list of options offered under the Supplemental Benefits System (SBS). This will allow state employees to pay for dependent care services with pre-tax dollars, instead of after-tax dollars.

In order to conform with the 1986 Tax Act, SBS will be revised and will requalify under a different section of the tax code (IRC 125). As such, SBS will be able to offer a dependent care plan, whereas previously their treatment by the IRS would not allow that.

Three compelling arguments for this legislation are:

- 1) as mentioned, SBS will be revised to conform to the new tax code,
- 2) the cost of dependent care will be paid for by those who opt for it, and
- 3) the state can set a standard that, hopefully, the private sector will adopt.

Probably the best model to look at regarding flexible benefit plans that offer dependent care services is the Anchorage Municipality. According to their benefits director they are pleased with the program and have about a 5.2% participation rate.

Statutory changes will be necessary later to accomplish the SBS requalifying. HCR 19 will send a message to the administration encouraging them to include dependent care in the revised SBS.

Thank you for your consideration.

STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

DIVISION OF RETIREMENT & BENEFITS

PLEASE REPLY TO:

P.O. BOX CR
JUNEAU, ALASKA 99811-0203
PHONE: (907)465-4460

2600 DENALI ST. SUITE 401
ANCHORAGE, ALASKA 99503
PHONE (907) 277-7504

Public Employees' Retirement System
Teachers' Retirement System
Judicial Retirement System
Elected Public Officers Retirement System
National Guard Retirement System
Territorial Retirement System
Retirees' Voluntary Dental-Vision Audio Plan
Supplemental Benefits System
Group Health/Life Insurance Benefits
Deferred Compensation Plan
Public Employers Social Security Contributions

STEVE COWPER, GOVERNOR

March 23, 1987

The Honorable Steve Frank
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Frank:

I am writing to confirm my discussions with Mr. Rick Solie of your office regarding a dependent care option under the Supplemental Benefits System (SBS).

The only way that an employee may pay for dependent care on a pre-tax basis is for the employer to offer such a program through a flexible benefit plan. The SBS is not currently a flexible benefit plan in the eyes of the Internal Revenue Service.

The Tax Reform Act of 1986 will require some important changes to the SBS. The most significant change will be the requalification of the plan as a flexible benefit plan under Internal Revenue Code (IRC) 125. This qualification would allow both taxable and non-taxable benefits to be offered to employees. Dependent care benefits could then be implemented. Other changes such as having the annuity portion of SBS become a freestanding plan, rather than an integral part of the SBS as it is now, will also be required.

Mr. Solie has stated your intentions of providing some assistance to employees requiring dependent care services. I believe that the requalified SBS plan would be an ideal vehicle to provide such a benefit after the changes required by Tax Reform are accomplished.

While I am confident that legislative changes will be required in the future to accommodate changes in the program, it is not clear at this time as to the extent of these changes. I have suggested to Mr. Solie that a resolution stating the Legislature's wishes regarding dependent care be introduced this year rather than legislation. Legislation can then be drafted in the next session to provide for any benefit changes or other changes that may be required.

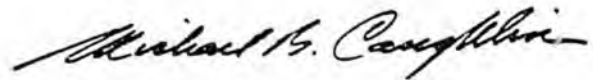
The Honorable Steve Frank

-2-

March 23, 1987

Please contact me should you have any questions or required further information on this subject.

Sincerely,



Michael B. Coughlin
Deputy Director

MBC/cam/3

cc: Marsha Hubbard
Deputy Commissioner
Administrative Management
Department of Administration

RECEIVED

MAR 05 1987

WILLIAM M.
MERCER - Meidinger
INCORPORATED

Division of Retirement & Ben

March 2, 1987

Mr. Michael B. Coughlin
Deputy Director
State of Alaska
Department of Administration
Division of Retirement & Benefits
P.O. Box CR (M0203)
Juneau, AK 99803

Re: SBS After-Tax Reform

Dear Mike:

The Tax Reform Act 1986 (TRA) requires important changes in the Supplemental Benefits System. Prior to discussing our recommendations on restructuring SBS, we believe that a brief history of SBS will be helpful.

Current Structure of SBS

A cafeteria plan, which is governed under IRC 125, permits employees to choose among various benefits. In the past, a plan had to offer both taxable and non-taxable benefits to satisfy the definition of a cafeteria plan. The only deferred compensation arrangement, allowed in a cafeteria plan, is a 401(k) profit sharing plan.

When SBS was designed in 1979, cafeteria plans and 401(k) plans were brand new. It was uncertain whether a public entity such as the State of Alaska could maintain a "profit-sharing" plan. Thus, the Supplemental Annuity Plan was established as a 401(a) Money Purchase Pension Plan, and SBS offered only non-taxable benefits.

SBS had to be structured to avoid any possibility of an employee choosing a taxable benefit to avoid being considered a cafeteria plan. For example, employer-paid group term life coverage over \$50,000 is a taxable benefit. For this reason, the maximum life insurance option in SBS was set at \$48,000, which, in conjunction with the \$2,000 of life insurance provided to all state employees, would prevent anyone from having more than \$50,000 of employer-paid life insurance.

*Impact of
SBA to introduce leg.
in 1986 for Medicare*

Mr. Michael B. Coughlin
Page Two
March 2, 1987

Tax Reform Act Changes

Since 1979, the IRS has formally approved 401(k) plans for the State of Tennessee, the Municipality of Anchorage, and other local governments. However, the Tax Reform Act of 1986 prohibits the state governments from establishing 401(k) Profit Sharing Plans after May 5, 1986 (existing plans may be continued). TRA also states that any plan which offers choices only among non-taxable benefits is now subject to the Section 125 rules. This creates a major dilemma for the Supplemental Benefits System. SBS is now considered a 125 cafeteria plan, and the only deferred compensation arrangement allowed under a cafeteria plan is a profit sharing plan. The very same law which caused SBS to become a cafeteria plan also prohibits the state from establishing a 401(k) profit-sharing plan. The inescapable conclusion is that the Supplemental Annuity Plan must be a free-standing plan, which is separate and apart from the Supplemental Benefit System. For your consideration, we recommend the following changes in the Supplemental Benefit System.

Supplemental Annuity Plan

As a freestanding plan, the Supplemental Annuity Plan should be amended so that the annual contribution, for every employee, is X% of salary up to the wage base. For example, X might be 6.13%, but need not be. The average SBS member contributes 11.3% to the Supplemental Annuity Plan. Thus, in the revised Annuity Plan, you might contribute 11.3% (up to the wage base) for each member.

This change to the Supplemental Annuity Plan can be accomplished with a relatively minor amendment to the current plan. Administration of the Supplemental Annuity Plan and all other aspects of the plan, would remain unchanged, except for the fact that each employee would have the same percentage contributed to the plan.

Supplemental Benefits System

Under the revised program, the Supplemental Annuity Plan is not technically a part of the Supplemental Benefit System. SBS is a 125 cafeteria plan which can allow employees to choose between taxable and non-taxable benefits. The new SBS could have life insurance in excess of \$50,000/year, could have a cash-option, and could have dependent care options, in addition to existing benefit options. The contribution to a new SBS would be Y%. Most likely, Y% would equal 12.26% minus X% (from the Supplemental Annuity Plan). The new SBS could also allow participants to elect additional salary deferrals (greater than Y%) in order to pay for additional SBS benefits with before-tax dollars.

Mr. Michael B. Coughlin
Page Three
March 2, 1987

Dependent Care

Section 125 allows employees to elect reimbursement of up to \$5,000 per year dependent care expenses. Under the new SBS, some of the dependent care money could come from the Y% and some from additional salary deferrals. In any event, this will be a very valuable benefit for some employees. In the Municipality of Anchorage Flexible Benefit Plan, 5.2% of the members have elected to utilize the dependent care option, at an average annual rate of approximately \$3,400. The ability to provide for this expense with before-tax dollars is a significant enhancement to SBS.

Cash Option

Because of the state's budget constraints, the lack of pay increases, and in fact pay decreases, some employees may be under financial strain. Thus, a new cash option in SBS may be appreciated by employees. Practically, cash is a necessary feature of the new plan. In the old plan, monies that did not go to health/life/disability, automatically went into the annuity plan. Now, a cash option can be the "safety valve" for monies not used for health/life/disability premiums.

Advantages

Some of the advantages of new SBS are:

- (1) The dependent care option.
- (2) The cash option.
- (3) More flexibility in adding additional benefits.
- (4) Via additional salary deferrals, employees can pay for benefits which are more costly than the 12.26% SBS contribution.
- (5) By utilizing the cash option, in conjunction with an increase in deferrals to the Deferred Compensation Plan, most employees will be able to continue to defer at least 12.26% of pay. Furthermore, employees will be able to select among investment options in DCP while they do not have investment choices in the Supplemental Annuity Plan.

Mr. Michael B. Coughlin
Page Four
March 2, 1987

- 7 OPTNL
- (6) The Supplemental Life Insurance Program could be eliminated while at the same time coverage limits for life insurance under SBS could be extended. This will simplify administration as well as eliminate the cost of one program.

Disadvantages

- (1) Approximately 6% of the state employees have already maximized their contributions to the Deferred Compensation Plan. Many of these employees, depending where the X% is established in the Annuity Plan, will see a net reduction in overall salary deferrals between the Annuity Plan and DCP. If "Y" is 11.26%, then these few employees would only lose deferrals on 1% up to the wage base; i.e., the most anyone could lose would be \$440 in deferrals. Based upon June 30, 1986 data, 526 employees would lose an average of \$237 in deferrals. Of course, if an individual elects pre-tax contributions to fund dependent care or other SBS benefits, DCP plan deferrals could be further limited.
- (2) Some legislators may feel the cash option is not in the spirit of the Social Security Opt Out Program.
- (3) Very few, if any, employees will have exactly 12.26% of their pay being contributed to the annuity plan and SBS. Virtually all employees will be having additional salary deferrals, or be receiving cash. Consequently, the payroll system will have to be modified to handle this.
- (4) Employees may no longer individually select the amount contributed to the annuity plan on their behalf.

Effective Dates

The changes required by the Tax Reform Act must become effective:

- (1) January 1, 1988, if the IRS issues regulations prior to October 1, 1987; or
- (2) on January 1, 1989.

There has been no indication from the IRS that regulations will be issued by this October. Consequently, I believe it is likely that the effective date for the Tax Reform Act changes will be January 1, 1989.

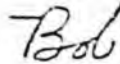
William M. Mercer-Meidinger, Incorporated

Mr. Michael B. Coughlin
Page Five
March 2, 1987

Summary

Because of the Tax Reform Act, several changes must be made to the Supplemental Benefit System. We believe that the recommended changes described in this letter are, for the vast majority of employees, a significant improvement. We look forward to working closely with you on SBS over the following months.

Sincerely,



Robert F. Richardson, ASA
Principal

RFR/js

cc: Mr. Kevin Wilma

Percent of Wage Base Contributed
to Supplemental Annuity Plan
As of June 30, 1986

<u>Contribution Rate</u>	<u>Number of Employees</u>	
to 9.99%	751	
10.0 - 10.49%	1398	
10.5 - 10.99%	2592	
11.0 - 11.49%	3182	Average Rate = 11.30%
11.5 - 11.99%	2471	
12.0 - 12.26%	<u>3419</u>	
	13,339	

Percentage of Wage Base Contributed
to Deferred Compensation Plan
As of June 30, 1986

<u>Contribution Rate</u>	<u>Number of Employees</u>	
0%	11,727	
.1 - 4.9	376	
5.0 - 9.9	126	
10.0 - 14.9	257	Average Rate =
15.0 - 19.9	435	
20.0 - 24.9	<u>312</u>	
	13,339	

*From Jeff Johnson
CPA - PHS.*

WAGE REDUCTION PLAN

(Section 125 Cafeteria Plan)

The basic idea is to pay for child care with pretax dollars.

Employer allows employee to have his gross taxable wage reduced by an amount the employee selects. Annual maximum \$5,000 or may not exceed the total gross income of the lowest paid spouse. Such amount is used by the employer to pay the employee upon submittal by the employee of paid child care expense.

Employee makes his estimate of child care expenses annually and can not change the amount unless the employee terminates from the company or a change in family status occurs.

How does it work?

EXAMPLE

ATTACHED

BENEFITS TO EMPLOYER -

Saves social security taxes which will offset plan administration expenses.

AFFECT ON SOCIAL SECURITY BENEFITS -

Because taxable income is reduced, social security benefits that you will receive upon retirement may be slightly reduced as well.

AFFECT ON UNEMPLOYMENT -

Unemployment benefits may also be reduced as a result of lower taxable income.

ADDITIONAL COMMENT -

This type of plan can be combined with a similar wage reduction to fund--

Medical premiums and medical payments (deductibles)

WAGE REDUCTION PLAN VS. NO PLAN

EXAMPLE

- Mr. & Mrs. Smith
- Mrs. Smith employer has a wage reduction program
- 2 children under age 15
- Child care expenses of \$5,000
- 1987 marginal tax rate of 28%
- AGI \$40,000

	<u>PARTICIPANT</u>	<u>NONPARTICIPANT</u>
Annual wages, Mrs. Smith	\$18,000	\$18,000
Pretax payment of child care expense	(5,000)	-
	13,000	19,000
Less		
FICA .0715	(930)	(1,287)
Federal (28% bracket)	(3,640)	(5,040)
After tax payment of child care expense	-	(5,000)
Plus		
Child care credit	-	960
	<u>\$ 8,430</u>	<u>\$ 7,633</u>
Savings	<u>\$ 797</u>	

Department of the Treasury
Internal Revenue Service (O)

▶ Attach to Form 1040.
▶ See instructions below.

Name(s) as shown on Form 1040

Your social security number

1 Write the number of qualifying persons who were cared for in 1985. (See the instructions below for the definition of qualifying persons.)

1	
	Yes No

2 If payments listed on line 3 were made to an individual, complete the following:

- a If you paid \$50 or more in a calendar quarter to an individual, were the services performed in your home?
- b If "Yes," have you filed appropriate wage tax returns on wages for services in your home (see the instructions for line 2)?

2a		
2b		

c If the answer to b is "Yes," write your employer identification number.

2c	Employer ID number
----	--------------------

3 Write the amount of qualified expenses you incurred and actually paid in 1985 for the care of the qualifying person, but do not write more than \$2,400 (\$4,800 if you paid for the care of two or more qualifying persons).

3	
---	--

4 You must write your earned income on line 4c. See the instructions for line 4 for the definition of earned income.

- If you were **unmarried** at the end of 1985, write your earned income on line 4c. **OR**
- If you are **married**, filing a joint return for 1985, you must complete lines 4a and 4b.

a Write your earned income.

4a	
4b	

b Write your spouse's earned income.

c Compare amounts on lines 4a and 4b, and write the smaller of the two amounts on line 4c.

4c	
----	--

5 Compare amounts on lines 3 and 4c, and write the smaller of the two amounts on line 5.

5	
---	--

6 Write the percentage from the table below that applies to the adjusted gross income on Form 1040, line 33.

6	
---	--

If line 33 is:		Percentage is:	If line 33 is:		Percentage is:
Over—	But not over—		Over—	But not over—	
	\$0-10,000	30% (.30)	\$20,000-22,000		24% (.24)
	10,000-12,000	29% (.29)	22,000-24,000		23% (.23)
	12,000-14,000	28% (.28)	24,000-26,000		22% (.22)
	14,000-16,000	27% (.27)	26,000-28,000		21% (.21)
	16,000-18,000	26% (.26)	28,000		20% (.20)
	18,000-20,000	25% (.25)			

7	
---	--

7 Multiply the amount on line 5 by the percentage shown on line 6, and write the result.

8 Multiply any child and dependent care expenses for 1984 that you paid in 1985 by the percentage that applies to the adjusted gross income on Form 1040, line 33, for 1984. Write the result. (See line 8 instructions for the required statement.)

8	
---	--

9 Add amounts on lines 7 and 8. Write the total here and on Form 1040, line 41. This is the maximum amount of your credit for child and dependent care expenses.

9	
---	--

General Instructions

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

What Is the Child and Dependent Care Expenses Credit?

You may be able to take a tax credit for amounts you paid someone to care for your child or other qualifying person so you could work or look for work in 1985. The credit will lower the amount of your tax. The credit is based on a percentage of the amount you paid during the year. The most you may take as a credit is \$720 if you paid for the care of one qualifying person, or \$1,440 if you paid for the care of two or more qualifying persons.

Additional information.—For more information about the credit, please get Publication 503, Child and Dependent Care Credit, and Employment Taxes for Household Employers.

Who Is a Qualifying Person?

A qualifying person is any one of the following persons:

- Any person under age 15 whom you claim as a dependent (but see the special rule later for Children of divorced or separated parents).
- Your disabled spouse who is mentally or physically unable to care for himself or herself.
- Any disabled person who is mentally or physically unable to care for himself or herself and whom you claim as a dependent, or could claim as a dependent except that he or she had income of \$1,040 or more.

Note: You must have shared the same home with any person you claim as a qualifying person.

Children of divorced or separated parents.—If you were divorced, legally separated, or lived apart from your spouse during the last 6 months of 1985, you may be able to claim the credit even if your child is not your dependent. If your child is not your dependent, he or she is a qualifying person if all five of the following apply:

1. You had custody of the child for the longer period during the year; and
2. The child received over half of his or her support from one or both of the parents; and
3. The child was in the custody of one or both of the parents over half of the year; and
4. The child was under age 15, or was physically or mentally unable to care for himself or herself; and

(Continued on back)

Department of the Treasury
Internal Revenue Service (0)

▶ Attach to Form 1040.
▶ See instructions below.

1985
23

Name(s) as shown on Form 1040

Your social security number

1 Write the number of qualifying persons who were cared for in 1985. (See the instructions below for the definition of qualifying persons.)

1		
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2 If payments listed on line 3 were made to an individual, complete the following:

- a If you paid \$50 or more in a calendar quarter to an individual, were the services performed in your home?
- b If "Yes," have you filed appropriate wage tax returns on wages for services in your home (see the instructions for line 2)?

	Yes	No
2a		
2b		

c If the answer to b is "Yes," write your employer identification number.

2c	Employer ID number
----	--------------------

3 Write the amount of qualified expenses you incurred and actually paid in 1985 for the care of the qualifying person, but do not write more than \$2,400 (\$4,800 if you paid for the care of two or more qualifying persons).

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14,000—16,000		27% (.27)	26,000—28,000		21% (.21)
16,000—18,000		26% (.26)	28,000		20% (.20)
18,000—20,000		25% (.25)			

7 Multiply the amount on line 5 by the percentage shown on line 6, and write the result.

7	
---	--

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- Any disabled person who is mentally or physically unable to care for himself or herself and whom you claim as a dependent, or could claim as a dependent except that he or she had income of \$1,040 or more.

Note: You must have shared the same home with any person you claim as a qualifying person.

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1. You had custody of the child for the longer period during the year; and
2. The child received over half of his or her support from one or both of the parents; and
3. The child was in the custody of one or both of the parents over half of the year; and
4. The child was under age 15, or was physically or mentally unable to care for himself or herself; and

(Continued on back)

Credit for Child and Dependent Care Expenses

▶ Attach to Form 1040.
▶ See instructions below.

Name(s) as shown on Form 1040

MR. & MRS. SMITH

Your social security number

111-11-1111

Note: If you paid cash wages of \$50 or more in a calendar quarter to an individual for services performed in your home, you must file an employment tax return. Get Form 942, Employer's Quarterly Tax Return for Household Employees, for details.

1	Enter the number of qualifying persons who were cared for in 1986. (See the instructions below for the definition of qualifying persons.)	1
2	Enter the amount of qualified expenses you incurred and actually paid in 1986 for the care of the qualifying person. (See What Are Qualified Expenses in the instructions.) Do not enter more than \$2,400 (\$4,800 if you paid for the care of two or more qualifying persons)	4,800
3a	You must enter your earned income on line 3a. See the instructions for line 3 for the definition of earned income	12,000
b	If you are married, filing a joint return for 1986, you must enter your spouse's earned income on line 3b	9,000
c	If you are married filing a joint return, compare the amounts on lines 3a and 3b, and enter the smaller of the two amounts on line 3c	9,000
4	<ul style="list-style-type: none"> If you were unmarried at the end of 1986, compare the amounts on lines 2 and 3a, and enter the smaller of the two amounts on line 4. If you are married filing a joint return, compare the amounts on lines 2 and 3c, and enter the smaller of the two amounts on line 4. 	4,800
5	Enter the percentage from the table below that applies to the adjusted gross income on Form 1040, line 33	23

If line 33 is:		Percentage is:	If line 33 is:		Percentage is:
Over —	But not over —		Over —	But not over —	
\$0 — 10,000		30% (.30)	\$20,000 — 22,000		24% (.24)
10,000 — 12,000		29% (.29)	22,000 — 24,000		23% (.23)
12,000 — 14,000		28% (.28)	24,000 — 26,000		22% (.22)
14,000 — 16,000		27% (.27)	26,000 — 28,000		21% (.21)
16,000 — 18,000		25% (.26)	28,000		20% (.20)
18,000 — 20,000		25% (.25)			

6	Multiply the amount on line 4 by the percentage shown on line 5, and enter the result	1,104
7	Multiply any child and dependent care expenses for 1985 that you paid in 1986 by the percentage that applies to the adjusted gross income on your 1985 Form 1040, line 33, or Form 1040A, line 15. Enter the result. (See line 7 instructions for the required statement.)	
8	Add amounts on lines 6 and 7. Enter the total here and on Form 1040, line 41. This is the maximum amount of your credit for child and dependent care expenses	1,104

EXAMPLE II

- 2 Children under age 15	
- Qualifying child care expenses	\$ 4,800
- Mr. Smith's W2 wages	12,000
- Mrs. Smith's W2 wages	9,000
- Adjusted gross income	
Form 1040, Line 33 or 32	23,000

5. The child is not your dependent because—

- a. As the custodial parent, you have signed **Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents**, or a similar statement, agreeing not to claim the child's exemption for 1985; or
- b. You were divorced or separated before 1985 and your divorce decree or written agreement states that the other parent can claim the child's exemption, and the other parent provides at least \$600 in child support during the year. (*Note: This rule does not apply if your decree or agreement was changed after 1984 to specify that the other parent cannot claim the child's exemption.*)

Who May Take the Credit?

To claim the credit all five of the following must apply:

1. You paid for the care so you (and your spouse if you were married) could work or look for work (but see the rules at the line 4 instructions for **Spouse who is a full-time student or is disabled**).
2. You and the qualifying person(s) lived in the same home.
3. You (and your spouse if you were married) paid over half the cost of keeping up your home. The cost includes: rent; mortgage interest; property taxes; utilities; home repairs; and food eaten at home.
4. The person you paid to provide the care was not your spouse or a person you could claim as a dependent.

Note: If the person you paid to provide the care was your child, he or she must have been 19 or over by the end of 1985.

5. If you were married at the end of 1985, generally, you must file a joint tax return. However, there are two exceptions to this rule. You will be treated as unmarried and still be eligible to take the credit if:
 - a. You were legally separated; or
 - b. You were living apart from your spouse during the last 6 months of the year, and:
 - The qualifying person lived with you in your home over 6 months, and
 - You provided over half the cost of keeping up your home.

What Are Qualified Expenses?

Qualified expenses include amounts paid for household services and care of the qualifying person while you work or look for work.

Household services.—These services must be needed to care for the qualifying person as well as to run the home. They include, for example, the services of a cook, maid, babysitter, housekeeper, governess, or cleaning person if the services were partly for the care of the qualifying person.

Care of the qualifying person.—Care includes the cost of services for the qualifying person's well-being and protection.

Generally, care does not include food or schooling expenses. However, if these items

are included as part of the total care, and they are incident to, and cannot be separated from, the total cost, you may count the total payment. However, you may not count the cost of schooling for a child in the first grade or above.

Care outside the home.—You may count care provided outside your home if the care was for:

- a. Your dependent under age 15; or
- b. Any other qualifying person who regularly spends at least 8 hours each day in your home.

Care that is provided by a dependent care center may be counted if the center complies with all applicable state and local laws and regulations. A dependent care center is a place that provides care for at least seven persons (other than persons who live there), and receives a fee, payment, or grant for providing the services for any of those persons, regardless of whether the center is run for profit.

Medical expenses.—Some dependent care expenses may qualify as medical expenses. If you itemize deductions, you may want to take all or part of these medical expenses on Schedule A (Form 1040). If you cannot use all the medical expenses on Form 2441 because of the dollar limit or earned income limit (explained later), you may take the rest of these expenses on Schedule A. But if you deduct the medical expenses first on Schedule A, you may not use any part of these expenses on Form 2441.

Specific Instructions

The following are specific instructions for most of the lines on the form. Lines which have no instructions here are self-explanatory.

Line 2.—In general, if you paid cash wages of \$50 or more in a calendar quarter for household services provided by a person such as a housekeeper, maid, babysitter, or cook, you must file an employment tax return. If you are not sure whether you should file an employment tax return, get **Form 942, Employer's Quarterly Tax Return for Household Employees**.

Note: You should file a **Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return**, for 1985 by January 31, 1986, if you paid cash wages of \$1,000 or more for household services in any calendar quarter in 1984 or 1985.

Line 3. Dollar limit.—On line 3 write the amount of qualified child and dependent care expenses you incurred and actually paid in 1985. However, the most you may figure the credit on is \$2,400 a year for one qualifying person, or \$4,800 a year for two or more qualifying persons. Do not include amounts paid or incurred by your employer if, and to the extent, such amounts are excluded from your gross income.

Note: Do not include on line 3 qualified expenses that you incurred in 1985 but did not pay until 1986. Instead, you may be able to increase the amount of your 1986 credit when you pay the 1985 expenses in 1986.

Line 4. Earned income limit.—Figure your earned income limitation on line 4. The amount of your qualified expenses may not be more than your earned income or, if married filing a joint return, the smaller of your earned income or your spouse's earned income.

In general, earned income is wages, salaries, tips, and other employee compensation. It also includes net earnings from self-employment. For more information on what is earned income for purposes of the credit, see Publication 503.

Unmarried taxpayers.—If you were unmarried at the end of 1985 or are treated as being unmarried at the end of the year, write your earned income on line 4c.

Married taxpayers.—If you are married, filing a joint return, figure each spouse's earned income separately and disregard community property laws. Write your earned income on line 4a and your spouse's earned income on line 4b. Then, write the smaller of your earned income or your spouse's earned income on line 4c.

Spouse who is a full-time student or is disabled.—If your spouse was a full-time student or was mentally or physically unable to care for himself or herself, figure your spouse's earned income on a monthly basis to determine your spouse's earned income for the year. For each month that your spouse was disabled or a full-time student, your spouse is considered to have earned income of not less than \$200 a month (\$400 a month if more than one qualifying person was cared for in 1985).

If, in the same month, both you and your spouse were full-time students and did not work, you may not use any amount paid that month to figure the credit. The same applies to a couple who did not work because neither was capable of self-care.

A full-time student is one who was enrolled in a school for the number of hours or classes that the school considers full time. The student must have been enrolled at least 5 months during 1985.

Self-employment income.—You must reduce your earned income by any loss from self-employment. If your net earnings from self-employment are less than \$1,600, and you use the optional method to figure your self-employment tax, you may be able to increase your net earnings to \$1,600 for this credit. See Publication 533, **Self-Employment Tax**, for details. If you only have a loss from self-employment, or your loss is more than your other earned income and you do not use the optional method, you may not take the credit.

Line 8.—If you had qualified expenses for 1984 that you did not pay until 1985, you may be able to increase the amount of credit you may take in 1985. To do this, multiply the 1984 expenses you paid in 1985 by the percentage from the table on line 6 that applies to the adjusted gross income shown on your 1984 Form 1040, line 33. Your 1984 expenses must be within the 1984 limits. Attach a computation showing how you figured the increase. (Use the example in Publication 503 as a guide.)

ANCHORAGE
DEPENDENT CARE ASSISTANCE PLAN
(A COMPONENT PLAN OF THE ANCHORAGE
FLEXIBLE BENEFIT PROGRAM)

ADOPTED
EFFECTIVE APRIL 1, 1985

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PREAMBLE

The Municipality of Anchorage (hereinafter "Employer") establishes this "Anchorage Dependent Care Assistance Plan" (hereinafter "Plan") effective April 1, 1985, to allow Eligible Employees of the Employer to elect to receive dependent care assistance benefits which are excludable from gross income under Section 129(a) of the Internal Revenue Code of 1954, as amended (hereinafter "Code"), as provided herein and in the terms of the "Anchorage Flexible Benefit Program" (hereinafter "Program").

The Anchorage Dependent Care Assistance Plan is a Component Plan of the Anchorage Flexible Benefit Program and, except to the extent otherwise expressly provided herein, is governed by the rules and regulations of that Program. The Plan is intended to qualify as a "dependent care assistance program" within the meaning of Section 129(d) of the Code and to meet the requirements of any other applicable provisions of law.

SECTION 1
DEFINITIONS

When used herein, the terms defined in Section 1 of the Program shall have the same meaning as therein defined and the following additional terms shall have the following meanings:

1.01 Dependent

"Dependent" means:

- (a) a child who is under the age of 15 and with respect to whom an employee or his spouse is entitled to a dependency exemption under Section 151(e) of the Code; or
- (b) a relative or household member of an employee over half of whose support is received from the employee and who is physically or mentally incapable of caring for himself; or
- (c) the spouse of an employee who is physically or mentally incapable of caring for himself.

1.02 Dependent Care Expenses

"Dependent Care Expenses" means the expenses specified in Section 3 that qualify as Eligible Expenses.

1.03 Earned Income

"Earned Income" means wages, salaries, tips and other employee compensation, plus net earnings from self-employment, computed without regard to any community property laws and excluding any amounts received as a pension or annuity, as reimbursement of Eligible Expenses under the Program or as dependent care assistance under any other employer's program. An employee's spouse who is either a student or incapable of caring for himself shall be deemed, for each month during which such spouse is either a full-time student at an educational institution or a Dependent, to be gainfully employed and to have Earned Income of not less than;

- (a) \$200 per month, if the employee has only one Dependent for the Plan Year, or
- (b) \$400 per month, if the employee has two or more Dependents for the Plan Year.

1.04 Plan

"Plan" means the Anchorage Dependent Care Assistance Plan as described in this document and any amendments thereto.

SECTION 2

BENEFITS

2.01 Reimbursement Options

Subject to the conditions set forth in the Plan and Program, each Participant who elects to participate in the Plan may elect to receive reimbursement for Dependent Care Expenses in any amount which is a multiple of \$25 up to a maximum of \$300 per bi-weekly period, subject to the following limitation. The total amount of reimbursement elected per Plan Year, combined with any other dependent care assistance received through an employment-related plan by the Participant or his spouse, may not exceed the lesser of;

- (a) the Participant's Earned Income for the Plan Year, and
- (b) if the Participant is married on the last day of the Plan Year, the spouse's Earned Income for the Plan Year.

Although this benefit is described in biweekly terms, the benefit elected for a Plan Year may be paid and expenses may be incurred at any time during the Plan Year, subject to the other provisions of the Plan and Program. For example, a Participant may elect a \$50 biweekly benefit to cover \$1,300 of Dependent Care Expenses incurred during the last three months of the Plan Year.

2.02 Election of Reimbursement

A Participant may elect to participate in the Plan by submitting an Annual Election Form to the Employer as provided in Section 4.04 of the Program, and may claim reimbursement on a bi-weekly basis by submitting a Request for Reimbursement to the Employer. In the event a Participant does not qualify for reimbursement of the amount elected during the Plan Year, the difference between the amount elected and actual reimbursement shall be forfeited at the end of the Plan Year or upon termination.

2.03 Payment of Reimbursements

The Employer shall pay reimbursements offered under Section 2.01 only to the extent permitted by a Participant's account balance and the maximum reimbursement elected. The Employer shall pay reimbursements as soon as practicable after receipt of each Request for Reimbursement. No Participant shall have any rights or be entitled to any such reimbursements under the Plan unless a Request for Reimbursement is submitted. The Employer will review each Request for Reimbursement submitted to determine whether (i) the expenses for which reimbursement is sought are reimbursable Eligible Expenses and (ii) the request is accompanied by any required documentation.

2.04 Maximum Reimbursements

Reimbursements during a Plan Year shall not exceed the lesser of:

- (a) the amount designated on an Annual Election Form for dependent care assistance for such Plan Year, or
- (b) the amount of Eligible Expenses for which reimbursement is properly requested.

SECTION 3

DEPENDENT CARE EXPENSES

3.01 Dependent Care Expenses are amounts paid by a Participant for expenses for household services and for the care of a Dependent which are incurred to enable the Participant to be gainfully employed by the Employer for any period for which he has one or more Dependents, provided that:

- (a) if such expenses are incurred for services outside a Participant's household, they are incurred for the care of a child as defined in Section 1.01(a), or of an other Dependent defined in Section 1.01(b) or (c) who regularly spends at least eight hours each day in the Participant's household, and
- (b) if such outside services are provided by a dependent care center, such center (i) complies with the applicable State and local government laws and regulations, (ii) provides care for more than six individuals (other than individuals who reside at the facility), and (iii) receives a fee, payment or grant for providing services for any of the individuals (regardless of whether such facility is operated for profit).

3.02 Dependent Care Expenses shall in no event include amounts paid by a Participant to an individual;

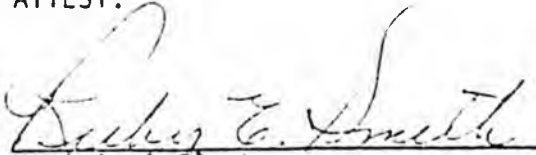
- (a) with respect to whom a deduction is allowable to the Participant or the spouse under Section 151(e) of the Code (relating to personal exemptions for dependents), or
- (b) who is a child (within the meaning of Section 151(e)(3) of the Code) of the Participant under the age of 19 at the close of the Plan Year in which such amounts are paid.

IN WITNESS WHEREOF, the Municipality of Anchorage has caused this Anchorage Dependent Care Assistance Plan to be executed by its duly authorized representative this 31st day of December 1985, effective April 1, 1985.

MUNICIPALITY OF ANCHORAGE


Robert E. Smith
Municipal Manager

ATTEST:


Municipal Clerk



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Alaska Public
Employees Association **APEA**

State Headquarters: 340 N. Franklin, Juneau, AK 99801 (907) 586-2334

MEMORANDUM

TO: Representative Fran Ulmer, Chairwoman
House State Affairs Committee

FROM: Cherie Shelley, *CS* Executive Director

SUBJECT: HCR 19 - Dependent Care Benefits

DATE: 15 April 1987

The Alaska Public Employees Association supports House Concurrent Resolution 19 and urges the committee to consider the measure favorably.

The Tax Reform Act of 1986 will require substantive changes to the Supplemental Benefits System. In the process of complying with federal law, the options available under the SBS can be expanded to provide additional benefit offerings to employees. Among those options now available is that of dependent care.

APEA has long supported addition of dependent care benefits to the SBS program. Similar options are available to employers of the Municipality of Anchorage and numerous corporations.

It is appropriate at this time to direct the Department of Administration to offer dependent care assistance as an option in the revised SBS.

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