



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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COR-105927-00

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Dear ██████████

This is in response to your letter dated February 28, 2000, in which you ask for information about the tax treatment of payments by your organization and by parents for "after school" care for their children.

We understand the situation to be as follows: ██████████ is an organization, qualified for tax exemption under § 501(c)(3) of the Internal Revenue Code, that provides financial assistance to parents who cannot afford to provide their children with after-school child care. ██████████ plans to expand its program to include the employees of businesses and corporations that contribute to ██████████. You ask for information about the tax consequences to the employees who would receive funds for child care under the expanded program. Specifically, you inquire whether amounts received by ██████████ from companies and directed to the employees' child care centers may be excluded from the employees' income, and whether the employees may deduct the balance of their child care payments as charitable contributions. This is not a private letter ruling but will provide you with general information about the tax treatment of child and dependent care expenses under the Internal Revenue Code.

We will address first the issue of whether payments may be excluded from income. Generally, under § 61 of the Code, gross income includes income from whatever source derived. This general rule applies where the income consists of amounts directly received by a taxpayer or where the income is received indirectly by means of payments by another party of the taxpayer's personal expenses. There is an exception to this general rule under § 102, which provides that gross income does not include the value of property acquired by gift. However, a payment by or for an employer to or for the benefit of an employee is not a gift. See § 102(c). Therefore, except for gifts or

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unless another exclusion applies, payments by others for child and dependent care expenses of a taxpayer must be included in the taxpayer's gross income.

An exclusion might be allowed if child and dependent care expense payments are part of a qualified dependent care assistance program under § 129. There are several requirements for a program to qualify. Foremost, only an employer may establish and maintain the program on behalf of its employees. The employer must adopt a separate written plan that explains the program and must not favor those employees who are considered to be highly compensated employees when deciding which employees are eligible to participate in the program. If the program qualifies, amounts paid or incurred by the employer for dependent care may be excluded from the gross income of the employee, as long as the amount does not exceed \$5000, or \$2500 in the case of a separate return by a married individual. All of these requirements for a dependent care assistance program are explained in detail in § 129(d)(1)-(8).

With regard to the second question about whether child care payments may be deducted as charitable contributions, § 170 only allows a deduction for a voluntary transfer of money or property without adequate consideration. United States v. American Bar Endowment, 477 U.S. 105 (1986); Rev. Rul. 67-246, 1967-2 C.B. 104. No deduction is allowed where a taxpayer gives money or property to a charity and receives something in return. Thus, for example, tuition expenditures by a taxpayer to an educational institution are not deductible as charitable contributions to the institution, because they are required payments for which the taxpayer receives benefits presumably equal in value to the amount paid. Rev. Rul. 83-104, 1983-2 C.B. 46. Where the benefits received by the taxpayer are less than the amount paid to charity, the deduction under § 170 is limited to the amount (if any) by which the payment to charity exceeds the value of the goods or services received.

Even where child care payments on behalf of or by taxpayers are not excludible under § 129 and not deductible under § 170, certain child and dependent care expenses paid by the taxpayer might be able to be taken as a credit on the taxpayer's income tax return. For your convenience, we enclose a copy of Publication 503, "Child and Dependent Care Expenses," and Form 2441 and Instructions, which explain the requirements of this provision in detail.

I hope that this information is helpful to you. If you have any further questions, please contact Susan Kassell of this office at (202) 622-4930.

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Sincerely,

Michael D. Finley  
Chief, Branch 3  
Income Tax & Accounting

Enclosures (2)