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## Take Two Aspirin -- And Deduct Them

Steady Expansion of Tax Breaks Offers  
Benefits, but Most People Don't Bother

By **RON LIEBER**  
Staff Reporter of THE WALL STREET JOURNAL

It has come to this: Even a headache now entitles you to a tax break.

In a move that could save some taxpayers more than 30% on such things as aspirins and cough drops, the U.S. Treasury Department last month opened the door for people to pay for over-the-counter drugs out of pretax money.

It is only the latest in a growing list of government-approved tax deductions that go beyond the usual breaks for retirement investors or homeowners. Millions of workers are now eligible to set aside money for such varied expenses as parking and subway passes, babysitters and even Tums.

Unlike past tax breaks, many of the latest batch seem more about helping people cope with everyday expenses than about encouraging good investment behavior. And the rules include some odd distinctions that can make it hard to sort out exactly how to best take advantage of them.

For example, the cost of summer day camp for youngsters can be reimbursed -- but not the cost of overnight camp. Over-the-counter cold medicine is covered; vitamin C isn't unless a doctor orders it. And, strangely, there is a bigger tax break for people who drive their car to work than there is for those who take a commuter train.

These deductions are provided through employer-provided spending accounts, which most larger companies offer. The accounts allow workers to periodically take a certain amount of money out of their paycheck before it is taxed. The most common use: a flexible spending account, which allows workers to pay for medical costs that their insurance plans don't cover. For taxpayers in the top bracket, it effectively chops the cost of these expenditures by almost a third.

### THE TAX-BREAK QUIZ



Which of the following are eligible for tax savings? For answers, [click here](#)<sup>0</sup>.

- A. Health club membership
- B. Toothpaste

The recent decision to include over-the-counter medicines eases one of the biggest obstacles to getting people to sign up for flexible spending accounts in the first place: You automatically lose any money set aside that isn't spent during the year. But with the addition of non-prescription drugs, there is no excuse for losing a single cent. That's because the rules now allow for the possibility of an end-of-the-year shopping spree at the drug store.

### TAX DODGES FROM YOUR BOSS

Many employers are offering accounts where workers can set aside pretax money to pay for everyday expenses. [Click here](#)<sup>1</sup> for a roundup.

### GO FIGURE



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Got pre-tax dollars to spend on medication?<sup>3</sup>

See how the costs of prescription drugs and over-the-counter medicines compare.

C. Aspirin

Bonnie Levitt, a benefits lawyer in San Francisco, has become a power user of all of the tax-free accounts. Her budgeting trick? She has to decide in June how much to save in her employer's plan, but her husband's plan requires him

D. Public transportation

to make his election in December. So they've signed up for accounts from both employers. "We assess where we're at [in December] to see if we need to add additional funds to what I've already put aside in my account, so we can play the system that way," she says.

From the corporations' point of view, the growth of these special tax-advantaged accounts comes at a time when many are shifting costs to workers, and the accounts can make cutbacks seem less painful.

But some question the fairness of all these deductions, given that they are mostly aimed at middle- and upper-income taxpayers who work for big corporations. "It's an advantage of the rank and file who happen to be fortunate enough to work for a company that has them," says Martin R. Press, a tax lawyer in Fort Lauderdale, Fla.

Surprisingly, the majority of workers eligible for these accounts don't bother with them. Only 18% signed up for health-care accounts in 2002, according to a survey by Mercer Human Resource Consulting. Just 7% contributed to a dependant care account, and Mercer consultants figure that is less than one-third of employees who had expenses that would have been eligible.

But it makes more sense than ever to sign up for as many of these programs as possible. Here is a run-down of how they work, and some tricks for maximizing the tax breaks you can extract from them.

### Flexible Spending Accounts

These plans could already be tapped for a multitude of uses, and the list just got a lot longer. Before this year, the IRS had given the OK to reimburse for eyeglasses, laser-eye surgery, all forms of birth control as well as abortion, all dental work except for cosmetic procedures, co-payments for drugs and doctor visits. The newest ruling adds over-the-counter medicines and specifically names antacids, allergy medications, cold medicines and pain relievers. Now, there is a big debate in the benefits industry as to whether the new ruling covers items like acne medication, sun block and tampons.

#### QUIZ ANSWERS

A: Usually not allowed.

B: Not allowed.

C and D: Allowed

Ultimately, many of the coverage decisions will be made by the account administrator picked by your employer. Some workers may be able to submit expenses for this year going back to Jan. 1, though it may mean digging up old receipts. Others may have to wait until next year.

Meanwhile, some administrators may decide not to cover expenses until they reach a certain amount, or they will demand a doctor's note explaining why they are necessary.

The accounts are also slowly becoming easier to use. Many employers are issuing debit cards for their plans to reduce paperwork from claim forms. Bottom line: Your plan administrator has a lot of leeway, and it behooves you to submit every receipt you think may be eligible.

### Transportation Accounts

At first glance, it looks as if the government wants you to drive to work. The transportation accounts, which have been around for about a decade, allow employees to save as much as \$190 a month for parking a car at work. Users of public transportation can put aside only \$100 a month. The money doesn't immediately evaporate if you don't use it by the end of the month, and you can change the amount you save during the year -- two big differences from the health-care accounts.

Why is parking reimbursed at a higher rate than mass transit? The drafters of the bill based the amounts on District of Columbia prices on parking and subway service, according to Jon Kessler, chief executive officer of WageWorks, a plan administrator. Mr. Kessler, formerly an economist for the Environmental Protection Agency, was consulted before the government issued the rules for these accounts.

Ten years later, the \$100 public-transportation cap favors urban dwellers who don't travel far. There have been periodic efforts to raise the cap through legislation, but none have come to fruition yet.

Particularly because you don't lose the money at the end of the month, almost everybody with covered commuting expenses should be using one of these accounts.

### **Dependent Care Accounts**

These accounts can be a godsend if you are caring for a child or aging parent who lives under your roof.

If you need help caring for a dependant in order to work, you can use pretax money to do it, whether the dependant is a child under 13, a senior citizen or disabled.

The big drawback: You can save only \$5,000 per year per household, an amount that hasn't changed for years. And the benefit favors people who play by the rules. When you submit receipts to make a claim from your account, you will have to turn over information about who is providing the care for your dependant. If you are using a day-care center, there's no problem.

But if use a nanny and you are paying her under the table, you could be inviting trouble by paying it out of the dependent care account.

**Write to Ron Lieber at [ron.lieber@wsj.com](mailto:ron.lieber@wsj.com)**<sup>1</sup>

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### **Tax Dodges From Your Boss**

More and more employers are offering accounts where workers can set aside pretax money to pay for everyday expenses. Here's a roundup:

<b><i>Dependant Care Account</i></b>		
<b>ELIGIBLE ITEMS</b>	<b>INELIGIBLE ITEMS</b>	<b>QUIRKS</b>
Day camp	Overnight camp	Dependants must live with you and can include children under 13, the disabled, and parents. The key is that you need care for them so you can go to work.
Day care for an older parent who lives with you	Day care for an older parent who is financially independent	
Preschool	Kindergarten	

<b>Flexible Spending Account</b>		
<b>ELIGIBLE ITEMS</b>	<b>INELIGIBLE ITEMS</b>	<b>QUIRKS</b>
Cold medicine	Vitamin C (unless a doctor prescribes it)	Thanks to a recent ruling, over-the-counter drugs are now eligible for reimbursement. Antacids and pain relievers are fine. On the fence: acne creams, sunblock and tampons.
Multiple pairs of fashionable eyeglasses	Eye lift	
Weight Watchers (if a doctor prescribes it)	Health club dues to stay fit	
<b>Transportation Reimbursement Account</b>		
<b>ELIGIBLE ITEMS</b>	<b>INELIGIBLE ITEMS</b>	<b>QUIRKS</b>
Public transportation up to \$100 per month	The balance of your commuter train pass that's over \$100	Legislation is expected soon that will call for the same reimbursement amounts for mass transit and parking.
Parking at work up to \$190 per month, even if public transportation is available	Maintenance on a car you use to get to work	

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(1) <mailto:ron.lieber@wsj.com>

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