

# How Might a Child Care Stabilization Grant Affect the Taxes of Michigan Child Care Providers?

*Frequently Asked Questions (FAQs) for Sole Proprietors  
November 11, 2021*

Michigan has received \$700 million in federal funding to provide non-competitive grants to child care providers to help stabilize their businesses and support the health and safety of children and staff. While this funding will be of great benefit to almost every provider in Michigan, providers should be aware of the potential tax implications of the funding. The grants are considered taxable income, so it is important that providers plan to spend grant funding with this understanding.

*These FAQs have been prepared for informational purposes only and should not be relied on for tax, legal, or accounting advice. You should consult your own tax, legal, and/or accounting advisors before making the final decision to apply for grant funding.*

## QUESTIONS ABOUT THE BIG PICTURE

### 1. Are the grants considered taxable income?

*The Child Care Stabilization Grant is business income and is taxable on the federal, state, and local levels.*

### 2. How much tax will I pay on this grant income?

*This depends on many factors unique to your tax return. Contacting your 2020 tax preparer is the best way to get an accurate answer to this question. As a general rule, most child care providers pay between 15–40% of their net profit in federal, state, and local taxes.*

### 3. You said I should consult my own tax advisor. How do I do that?

*If a tax professional prepared your 2020 tax return, you should contact that person, tell them that you are receiving a taxable grant and specify the amount. You should then ask the tax preparer how the grant will affect your taxes. After asking a few questions, the tax preparer should be able to give you an estimate of how much tax will be due on the grant income. This estimate will be based on your own tax situation and will be the most accurate answer to how much tax you will pay on the grant.*

*If you, a friend, family member, or volunteer prepared your 2020 tax return, you could ask that person the same question. If that person is not able to answer your question, you could ask a professional tax preparer for advice. That tax preparer will need information from your 2020 tax return in order to give you an accurate answer.*

### 4. Won't I have to pay that tax professional? Is it worth the cost?

*If the tax professional prepared your 2020 return, there may be no charge for advice. That said, the tax preparer may charge to consult with you. While only you can decide if this advice is worth the cost, keep in mind that the cost of tax preparation is a deductible business expense and that good tax advice will most likely save you money on taxes.*

**5. If I use all of the grant money on allowable expenses that I wouldn't otherwise incur, doesn't that mean those expenses are deductible and I won't have taxable income?**

*It depends. If you use all of the grant money on **child care-only expenses** that you would not otherwise incur, you will most likely have no additional taxable income or income tax.*

*If you use all of the grant money on **business-use-of-home expenses** that you would not otherwise incur, only your time-space percentage of the expense will be deductible and you will have taxable income.*

*Appendix A at the end of this document provides examples of how different types of expenses have different implications for your taxes.*

**6. If I use all of the grant money on allowable expenses that are normal for my child care, doesn't that mean those expenses are deductible and I won't have taxable income?**

*If you use all of the grant money on allowable expenses that are normal for your child care, it is likely that you will have taxable income. The grant income will make your gross income go up, while your expenses will stay the same. This means that your taxable income (net profit) will go up.*

*For a more detailed explanation on how your business is taxed and some examples, please see Appendix B at the end of this document.*

**7. Should I apply for the grant or will the tax burden outweigh the benefits?**

*In almost every situation, you will be better off accepting the grant. As an example, a grant of \$10,000 without any extra expenses could result in a tax burden of \$3,300. However, this means you will have \$6,700 more in your pocket than you would have without the grant. Consult your tax preparer to be sure, but the goal of the grant is to provide you with funding to support you and your staff, not to make you less well off.*

**8. Will my other government benefits be affected by this income? Are there any circumstances where I would not want to apply for the grant?**

*Maybe. Certain government benefits like Medicaid, CHIP, Pell Grants, and SNAP food benefits may be income-based and an increase in taxable income could affect your eligibility for these programs. It is recommended that you talk to your tax advisor and the social service worker or case worker who administers each of your benefits if you are concerned about this. With some advance planning, you can figure out if the benefit of the grant income will outweigh the cost.*

**9. If I think the grant income will make my taxes go up, what should I do?**

*If you think your taxes might go up because of the grant, you should first ask your tax advisor for an estimate of how much your taxes would increase. When you receive the grant, you should set aside the money for taxes before spending anything. If you don't have a tax advisor, set aside 40% of the grant money you receive until after you file your tax return. When you file, you can use as much of this saved money as necessary to pay your tax obligations and keep the rest.*

*Alternatively, you could make or increase federal, state, and/or local estimated tax payments in advance of filing your tax return. Consult your tax advisor on how to make these estimated payments.*

## QUESTIONS ABOUT DETAILS

### 10. How will the state document the grant for tax purposes?

Form 1099-NEC reports non-employee compensation paid to you during the tax year. You will receive a Form 1099-NEC from the State of Michigan reporting your grant income. A copy of the Form 1099-NEC will also be sent to the IRS. If you receive payment from the State of Michigan for CDC subsidies, you may receive only one Form 1099-NEC from the state showing the combined amount of the grant and subsidy money you received during the tax year. Since you will receive the grant in January of 2022, you should receive Form 1099-NEC in late January or early February of 2023. You may receive it in the mail or need to download it from an online account. If you do not receive it, you will have to contact the state to request one.

### 11. What should I do if I think the Form 1099-NEC I received was wrong?

If you think the Form 1099-NEC you received was wrong, you should first check your bank records to see how much you actually received. Next, you should contact the state to request an explanation or corrected Form 1099-NEC.

### 12. Are my reporting requirements for the IRS the same as my reporting requirements for the grant?

No. You should report your grant expenses to the state in the method required by the Michigan Department of Education. For the IRS, you should report your grant expenses according to logical categories (supplies, repairs, insurance, etc.) in the same way you would report any other expenses. You do not need to report grant expenses separately from other expenses on your tax return. For example, if you use \$2,000 in grant money for supplies and \$500 in other money for supplies, you would simply report a \$2,500 supplies expense on your tax return.

### 13. What happens if I receive the grant money in one tax year and spend it in the next tax year?

Almost all child care providers are cash-basis taxpayers. This means that you must report the grant income in the year you receive it. You must report the grant expenses in the year you make those purchases.

If you receive the grant income in a different tax year than you spend it, your tax rate in the year the income was received could be higher than it otherwise would be. To counteract this, you could consider changing the timing of some purchases or setting aside extra for taxes. Talk to your tax advisor about your individual circumstances and what you can do to smooth out your annual income from year to year.

### 14. I have to use part of my grant to pay a bonus to my employee. Will I be taxed on that?

No. Because the bonus paid to an employee (not yourself) is an expense that you would not have otherwise incurred, the expense will cancel out the grant income to result in no taxable income. You will report an extra \$1,000 as income on your tax return and an extra \$1,000 as a wage expense.

$\$1,000 \text{ income} - \$1,000 \text{ expense} = \$0 \text{ taxable income and } \$0 \text{ in tax}$

## **15. The grant money can be used to pay personnel costs. Can I pay myself?**

*Your net profit (see Appendix B) is the equivalent to your salary or wages and the grant can be used to increase your net profit. Schedule C on your tax return reports this to the IRS. Please contact the Michigan Department of Education with any logistical questions about grant reporting for personnel costs.*

## **16. What's the best way to lower my taxes?**

*Good recordkeeping is the best way to lower your taxes!*

- *Keep track of all of your business income and expenses.*
- *Keep track of your child care hours, including hours that you are doing child care work when children are not present. This includes the time you spend on bookkeeping for your business.*
- *Categorize your expenses correctly so that you get the most tax benefit possible for each dollar you spend.*
- *Don't forget about small expenses like extra meals served or business miles driven. These small expenses add up.*
- *Do your bookkeeping on a daily, weekly, or monthly basis instead of waiting until the end of the year. You won't remember everything after so much time has passed and could miss valuable deductions.*
- *Attend a [webinar](#) on tax preparation for child care providers or read any of [Tom Copeland's](#) excellent materials on this topic.*
- *Hire a tax preparer who understands the child care business and prepares tax returns for other child care providers. Ask lots of questions during the tax preparation process.*

## **17. I still have questions. Whom should I contact?**

*You should contact the person who prepared your 2020 tax return. If that person cannot answer your questions, you should consult another tax preparer.*

# Appendix A

The following examples assume a 30% time-space percentage and a 33% total tax rate (Social Security + Medicare + federal income tax + state income tax + local income tax). Your time-space percentage and total tax rate are unique to you, and your tax advisor can help to determine those. Marital status, spouse's income, and children all affect your tax rate dramatically, so your tax rate may be significantly different than these examples.

**Example 1:** If you spend all of the grant money on business-only child care expenses that **you would not otherwise incur** (e.g., bonuses for staff members or playground equipment that you would not otherwise purchase), those additional expenses will offset the additional income and you will have no taxable income.

*\$10,000 grant - \$10,000 in staff bonuses that would not otherwise be paid = \$0 taxable income and \$0 in tax*

**Example 2:** If you spend the grant money on business-use-of-home expenses that **you would not otherwise incur** (e.g., home repairs that you wouldn't do without the grant income), you can only deduct the time-space percentage of those expenses and you will have taxable net income.

*\$10,000 grant - (\$10,000 in home repairs that you would not otherwise pay for x 30% time-space) = \$7,000 in taxable income and \$2,310 in tax*

# Appendix B

When you're self-employed, you own a business. You are taxed on the net profit for that business. First some definitions:

**Gross Income:** All business income for the year, including income from parents, food program, grants, CDC subsidy payments, etc.

**Child care Expenses:** Child care-only expenses, including toys, business insurance, food for child care kids, etc.

**Shared Expenses:** Expenses with both child care and personal use, often home expenses, including utilities, home repairs, shared paper goods, etc.

**Time-Space Percentage:** Your business-use-of-home percentage which is calculated based on your square footage and child care hours

To determine net profit, use the following formula:

**Gross Income – Child care Expenses - (Time-Space Percentage x Shared Expenses) = Net Profit**

The following examples assume a 30% time-space percentage and 33% total tax rate (Social Security + Medicare + federal income tax + state income tax + local income tax). Your time-space percentage and total tax rate are different, and you tax advisor can tell you those. Marital status, spouse's income, and children all affect your tax rate dramatically, so your tax rate may be significantly different than these examples.

## Example 1 – without grant income:

2022 Gross Income	\$50,000 (\$45,000 parents + \$5,000 food program)
2022 Child care Expenses	\$10,000 (supplies, child care insurance, child care meals, etc.)
2022 Shared Expenses	\$10,000 (utilities, mortgage interest, depreciation, etc.)
<b>Net Profit Calculation</b>	<b>\$50,000 - \$10,000 - (.3 x \$10,000) = \$37,000</b>
2022 Net Profit	\$37,000
<b>Tax Calculation</b>	<b>\$37,000 x .33 = \$12,210</b>
2022 Tax	\$12,210

**Example 2 – with grant income:**

2022 Gross Income	\$60,000 (\$45,000 parents + \$5,000 food program + \$10,000 grant)
2022 Child care Expenses	\$10,000 (supplies, child care insurance, child care meals, etc.)
2022 Shared Expenses	\$10,000 (utilities, mortgage interest, depreciation, etc.)
<b>Net Profit Calculation</b>	<b>\$60,000 - \$10,000 - (.3 x \$10,000) = \$47,000</b>
2022 Net Profit	\$47,000
<b>Tax Calculation</b>	<b>\$47,000 x .33 = \$15,510</b>
2022 Tax	\$15,510

*As you can see, even though you spent more than \$10,000 on allowable grant expenses, your taxable income increased by the amount of the grant. The tax on that increased taxable income is \$3,300.*

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