

Getting Ready for Michigan's Child Care Stabilization Grant and Taxes

A Webinar for Home-Based Child Care Providers

This webinar was made possible thanks to the Michigan Early Childhood Collaborative.

Members include representatives from BC Pulse, BUILD Initiative, Detroit Hispanic Development Corporation, Early Childhood Investment Corporation, Early Learning Neighborhood Collaborative, First Steps Kent, Grand Rapids Chamber, Hope Starts Here, KC Ready 4's, M.A.C. Tax Service, Michigan's Children, Refugee Education Center, Southeast Michigan Early Funders Collaborative, The Grand Rapids Early Discovery Center, YWCA, and Vibrant Futures.

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Introduction

- ▶ **Michigan's Child Care Stabilization Grant**
 - ▶ \$700 million in federal funding
 - ▶ Non-competitive grants to child care providers
- ▶ **Home-Based Child Care Providers**
 - ▶ Sole Proprietors
 - ▶ Schedule C

Introduction

- ▶ **Informational Only**
 - ▶ This webinar has been prepared for informational purposes only.
 - ▶ The impact of the funding will vary from provider to provider, and this webinar is not intended to provide, and should not be relied on for tax, legal, or accounting advice.
 - ▶ You should consult your own tax, legal, and accounting advisors before engaging in any financial transaction.
- ▶ **Questions?**
 - ▶ Please put questions in the chat.
 - ▶ Answers will be provided throughout the presentation and at the end.
 - ▶ FAQ will be sent out after presentation to answer additional questions.

Presentation Outline

- ▶ The Big Picture
- ▶ Details

The Big Picture

Are grants taxable income?

- ▶ Child Care Stabilization Grants are taxable income.
- ▶ Taxable on federal, state, and local levels.

How much tax will I pay?

- ▶ It depends!
- ▶ This presentation should help you figure that out.
- ▶ **Contact your 2020 tax preparer for the most accurate answer.**
- ▶ Most child care providers pay between 15% and 40% of their net profit in federal, state, and local taxes.

Consulting your tax advisor

- ▶ Call the person who prepared your 2020 tax return.
- ▶ Tell that tax preparer how much grant income you will receive.
- ▶ Answer the tax preparer's questions.
- ▶ That tax preparer will give you the most accurate answer about how much tax will be due.
- ▶ If your 2020 tax preparer cannot tell you, contact a different tax professional.
- ▶ Tax preparer may or may not charge for time spent giving you advice.
- ▶ Cost of business tax preparation is tax deductible and good tax advice will likely save you money on taxes.

Allowable Expenses and Taxable Income

If I spend all of the grant money on allowable expenses, will I have taxable income?

It depends!

Allowable Expenses and Taxable Income

- ▶ **Gross Income:** All business income for the year
- ▶ **Child care Expenses:** Child care-only expenses
- ▶ **Shared Expenses:** Expenses with both child care and personal use
- ▶ **Time-Space Percentage:** Your business-use-of-home percentage which is calculated based on your square footage and child care hours
- ▶ **Net Profit:** Gross Income – Child care Expenses - (Time-Space Percentage x Shared Expenses) = Net Profit

Net Profit = Taxable Income

As a business owner, you are taxed on your net profit!

Allowable Expenses and Taxable Income

- ▶ For tax purposes, grant income is treated the same as any other type of income.
- ▶ For tax purposes, allowable grant expenses are treated the same as any other type of expenses.
- ▶ **Normal Expenses:** Expenses you pay for every year for your child care business
 - ▶ Supplies, food, business insurance, business miles, utilities, mortgage, etc.
- ▶ **Extra Expenses:** Expenses you would not incur without the grant
 - ▶ Bonuses paid to employees (not yourself), shared expenses you would not purchase unless you received the grant income, etc.

Allowable Expenses and Taxable Income

- ▶ All of the examples that follow assume:
 - ▶ 30% time/space percentage
 - ▶ 33% total tax rate
 - ▶ Social Security + Medicare + federal income tax + state income tax + local income tax
- ▶ Your time/space and tax rate are different than these examples!
- ▶ Your tax advisor can help you determine these.

Extra Child Care-Only Expenses and Taxable Income

Without Grant Income

2022 Gross Income	\$50,000
2022 Child Care Expenses	\$10,000
2022 Shared Expenses	\$10,000
Net Profit	\$50,000 - \$10,000 - (.3 x \$10,000) = \$37,000
Tax Calculation	\$37,000 x .33 = \$12,210

With Grant Income

2022 Gross Income	\$60,000
2022 Child Care Expenses	\$20,000
2022 Shared Expenses	\$10,000
Net Profit	\$60,000 - \$20,000 - (.3 x \$10,000) = \$37,000
Tax Calculation	\$37,000 x .33 = \$12,210

In this example, the tax on \$10,000 in grant income is \$0.

Extra Shared Expenses and Taxable Income

Without Grant Income

2022 Gross Income \$50,000
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$10,000

Net Profit
 $\$50,000 - \$10,000 - (.3 \times \$10,000) = \$37,000$

Tax Calculation $\$37,000 \times .33 = \$12,210$

With Grant Income

2022 Gross Income \$60,000
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$20,000

Net Profit
 $\$60,000 - \$10,000 - (.3 \times \$20,000) = \$44,000$

Tax Calculation $\$44,000 \times .33 = \$14,520$

In this example, the tax on \$10,000 in grant income is \$2,310.

Normal Expenses and Taxable Income

Without Grant Income

2022 Gross Income \$50,000
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$10,000

Net Profit
 $\$50,000 - \$10,000 - (.3 \times \$10,000) = \$37,000$

Tax Calculation $\$37,000 \times .33 = \$12,210$

With Grant Income

2022 Gross Income \$60,000
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$10,000

Net Profit
 $\$60,000 - \$10,000 - (.3 \times \$10,000) = \$47,000$

Tax Calculation $\$47,000 \times .33 = \$15,510$

In this example, the tax on \$10,000 in grant income is \$3,300.

Benefits vs. Tax Burden

- ▶ The grant will probably increase your taxes, but you should still apply for it!
 - ▶ A grant of \$10,000 could increase your tax bill by \$1,500 - \$4,000.
-
- ▶ You'll have at least \$6,000 more in your pocket with the grant than without!

Grants and Government Benefits

- ▶ Eligibility for some government benefits may be income-based
 - ▶ Medicaid, CHIP, Pell Grants, SNAP benefits, etc.
- ▶ Talk to your tax advisor and social services case worker if you are worried about how the grant will affect your income and benefits.
- ▶ You can then determine if the benefit of the grant income will outweigh the cost.
- ▶ With advance planning, you may be able find ways to spend the grant income to improve your child care without increasing your net income and government benefit eligibility.

Preparing for Taxes

- ▶ Not sure if your expenses are normal or extra? Assume they are normal and that your tax burden will increase.
- ▶ You can *plan ahead* so the tax increase does not cause hardship.
- ▶ CHOICE 1: SAVE
 - ▶ Ask your 2020 tax preparer how much to save and set that amount aside for taxes.
 - ▶ OR set aside 40% of the grant money for taxes.
 - ▶ When you file your return, you can use this saved money as necessary to pay your tax obligation and keep the rest.
- ▶ CHOICE 2: ESTIMATED TAX PAYMENTS
 - ▶ Make or increase your quarterly estimated tax payments in advance of filing your return.
 - ▶ Consult your tax preparer about how to do this.

Details

Form 1099-NEC

- ▶ Form 1099-NEC reports non-employee compensation.
- ▶ You will receive Form 1099-NEC from the State of Michigan in January or February of 2023.
- ▶ Form 1099-NEC will be delivered to you either by mail or online.
- ▶ SOM will also send a copy to the IRS.
- ▶ Form 1099-NEC may combine your grant income with any CDC subsidies you received.
- ▶ If you think the 1099-NEC you received was wrong:
 - ▶ First, check your bank records to confirm.
 - ▶ Next, contact the State of Michigan to request an explanation or correction.

Grant Reporting vs. Tax Reporting

Grant Reporting

- ▶ Use the method and categories required by the State of Michigan.

Tax Reporting

- ▶ Report grant expenses in the same way as any other expenses.
- ▶ Do not separate expenses paid for with grant income from expenses paid for with other income.
- ▶ For example, if you use \$2,000 in grant income for supplies and \$500 in other money for supplies, you would simply report \$2,500 in supplies expense on your tax return.

When to Report Income and Expenses

- ▶ Most child care providers are cash-basis taxpayers.
- ▶ Cash-basis taxpayers report:
 - ▶ Income in the year they receive it
 - ▶ Expenses in the year they pay for those expenses
- ▶ Keep this in mind if you will spend your grant income in a different year than you receive it.

Employee Bonuses

- ▶ You will not pay income tax on grant money that you use to pay a bonus to an employee (not yourself).
- ▶ The extra expense (the bonus) will cancel out the extra income from the grant.
- ▶ \$1,000 income (grant) - \$1000 extra expense (employee bonus) =
 - ▶ \$0 taxable income
 - ▶ \$0 tax

Paying Yourself

- ▶ Grant can be used for personnel costs, including paying yourself as a sole proprietor.
- ▶ Your net profit is the equivalent to your salary or wages.
- ▶ Net profit can be found on line 31 of your Schedule C.
- ▶ Grant income can be used to increase your net profit.
- ▶ Money that you pay to yourself is not deductible on your tax return.
- ▶ Contact Great Start to Quality with questions about how to document amounts you pay to yourself for your grant reporting.

How to lower your taxes

Good recordkeeping is the best way to lower your taxes!

- ▶ Keep track of all business income and expenses.
- ▶ Record your child care hours including hours spent doing child care work when children are not present.
- ▶ Categorize your expenses correctly to get the most tax benefit possible.
- ▶ Don't forget small expenses like business miles and extra meals.
- ▶ Don't wait until the end of the year to do your bookkeeping.
- ▶ Attend a webinar on tax preparation for child care providers or read any of Tom Copeland's 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.

Questions?

- ▶ Please put any questions in the chat.
- ▶ A FAQ will be sent later with answers to any questions that we can't get to during this webinar.

Thank you!

Please complete the evaluation that follows this webinar.

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