PREPARING FOR TAX SEASON: A GUIDE FOR HOME-BASED CHILD CARE PROVIDERS

2023 Edition

By Home Grown Child Care with Civitas Strategies

Contents

Introduction

As a home-based child care provider, you likely have questions about how to prepare for the upcoming tax season. This tax workbook was created and updated to provide timely guidance on how to navigate tax preparation. It is designed to simplify the process of completing your taxes, alleviating some of the stress by guiding you step-by-step. Using this information, you can have your taxes prepared by a professional* or complete them using online software. Information is included here to help you get started either way.

The layout is in a simple question-and-answer format based on the questions frequently posed by other home-based child care providers. To answer the questions, we drew upon official US Internal Revenue Service guidance—including their audit guide for child care providers.

*If you are a tax preparer, see our section with information on how to use this workbook with your clients who are home-based child care business owners. The information should make your job as a preparer easier.

Why care about my taxes?

Taxes are an important consideration for any business. Through taxes, we all contribute to our government at the national, state, and local levels. Paying taxes and following IRS regulations is important. It's also important to take advantage of all the deductions and tax credits for which you are eligible. This will reduce your taxes, maximize your profit, and allow you to continue investing in your business. While you should always heed IRS regulations, you will likely want to reduce any costs to your business, including taxes.

Effective tax preparation can also head off the long-term cost of an audit. Though only a relatively few people are audited every year, if you are audited, the cost in time and money can be great.

PRO TIP Keeping good records throughout the year will make tax preparation easier.

The best way to avoid an audit is to keep in mind common "red flags." That is, the issues that often lead to an audit. The most common red flags for child care providers are:

- Not including all your income on your taxes—such as leaving out a 1099 you received from the Child Care Resource and Referral agency for subsidized care.
- Taking off too many expenses or ones that are high, like a provider who claimed $40,000 in cell phone expenses for themselves each year.
- Taking a very large loss on your business or having losses year after year. Businesses will take a loss from time to time (we'll review that later in this tool), but you want to avoid having losses that are far more than what you earned. After

all, if your business regularly loses more money than it earns, the IRS may be curious about why you continue to operate it!

- Claiming 100% use of your vehicle. You may have a personal van or car you use for transportation for your business—that's allowed. However, reporting that the vehicle is only used for work, and never for personal reasons, can draw attention since it is less common. If you do use your vehicle 100% for business, you'll want to make sure you have all the needed documentation—more on that later.

As you can see, many of the red flags can be easily avoided through proper preparation of your taxes.

What is included on my tax form?

There are different types of business tax forms. Let's go over the most common ones.

A **sole proprietor or self-employed individual** is both the owner and the only employee. Income for a sole proprietorship is reported on a Schedule C as part of your personal 1040 tax return. If you have more than one business activity, you will need more than one Schedule C.

A **Limited Liability Company** is a business structure that offers protections from some liabilities and has tax flexibility. At the time of creation and typically once a year, the LLC owner can declare how they will be taxed. LLCs with a single owner can use the same process as a sole proprietor (this is called a "single member LLC"), but they can also choose to use an S-Corporation or C-Corporation process or, if there is more than one owner, a partnership (all are described below). While you may choose to use an S-Corporation or C-Corporation process, it should be noted that you must continue to use your chosen process for at least 5 years.

An **S-Corporation** is a small business type where any profit is "transferred" directly to your personal tax return so you don't pay corporate taxes on it. An S-corporation uses a Form 1120S (income tax return for S corporation) and will show the "pass through" income to the owner on a Schedule K-1 (individual owner shares). This income goes directly on your personal tax return (the form 1040).

A **C-Corporation** is often called a "regular" corporation. The C-corporation uses Form 1120 (corporation income tax return) and will have profit taxed as a corporation before you can claim it as personal income, where it gets taxed again. Very few home-based providers will benefit from their business being taxed this way.

A **partnership** is formed between one or more business owners who share the costs and profit from the business. Partnerships use a Form 1065 to report their earnings

EIN vs. SSN

In the early stages of running a sole proprietorship, most business owners usually use their own social security number as the tax identification number for the business. This is a quick and simple way to get your business up and running without having to do any additional paperwork.

However, you can also get an Employer Identification Number (EIN) from the IRS. This number functions like a social security number for your business. It is an identification number issued by the IRS specifically for your business.

The advantage of an EIN is that it will limit the number of documents with your social security number on it, which can help you to keep your personal identification number safe and prevent it from being misused. Sole proprietors must get an EIN if they wish to hire employees, and if you want to open a business bank account with most banks.

Though this guide focuses on Sole Proprietors/Self-Employed Individuals who submit a Schedule C, there are three sections of Schedule C that will be similar for those that use other business forms:

- First, your report your revenue—that is all the money you received from your business;
- Then, show all your expenses—the things you paid for to keep your business running; and
- Finally, you calculate the amount that remains—if it is positive, you made a profit; if negative, then a loss.

  Let’s take a closer look at the Schedule C.

Schedule C

SCHEDULE C (Form 1040)
Department of the Treasury
Internal Revenue Service

Profit or Loss From Business
(Sole Proprietorship)
Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, or 1041; partnerships must generally file Form 1065.
Go to *www.irs.gov/ScheduleC* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **09**

Name of proprietor	**Social security number (SSN)**
A Principal business or profession, including product or service (see instructions)	**B Enter code from instructions**
C Business name. If no separate business name, leave blank.	**D Employer ID number (EIN)** (see instr.)

E Business address (including suite or room no.)
City, town or post office, state, and ZIP code
F Accounting method: **(1)** ☐ Cash **(2)** ☐ Accrual **(3)** ☐ Other (specify)
G Did you "materially participate" in the operation of this business during 2023? If "No," see instructions for limit on losses . ☐ **Yes** ☐ **No**
H If you started or acquired this business during 2023, check here . ☐
I Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions . ☐ **Yes** ☐ **No**
J If "Yes," did you or will you file required Form(s) 1099? . ☐ **Yes** ☐ **No**

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . ☐	1	
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	
4	Cost of goods sold (from line 42)	4	
5	**Gross profit.** Subtract line 4 from line 3	5	
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6	
7	**Gross income.** Add lines 5 and 6	7	

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions)	9		19	Pension and profit-sharing plans	19	
				20	Rent or lease (see instructions):		
10	Commissions and fees	10		a	Vehicles, machinery, and equipment	20a	
11	Contract labor (see instructions)	11		b	Other business property	20b	
12	Depletion	12		21	Repairs and maintenance	21	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13		22	Supplies (not included in Part III)	22	
				23	Taxes and licenses	23	
				24	Travel and meals:		
14	Employee benefit programs (other than on line 19)	14		a	Travel	24a	
				b	Deductible meals (see instructions)	24b	
15	Insurance (other than health)	15		25	Utilities	25	
16	Interest (see instructions):			26	Wages (less employment credits)	26	
a	Mortgage (paid to banks, etc.)	16a		27a	Other expenses (from line 48)	27a	
b	Other	16b		b	Energy efficient commercial bldgs deduction (attach Form 7205)	27b	
17	Legal and professional services	17					

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b	28	
29	Tentative profit or (loss). Subtract line 28 from line 7	29	
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: ____ and (b) the part of your home used for business: ____ . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30	
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31	
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	32a ☐ All investment is at risk. 32b ☐ Some investment is not at risk.	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11334P **Schedule C (Form 1040) 2023**

Let's take a closer look at the Schedule C to see where the different sections are for reporting data on your business. It is helpful to know your way around this important document, even if you plan to use a tax prep software that will place the various numbers that you submit onto the form itself.

Part I is where your sales or earned revenue are totaled, and your cost of goods sold or expenses are reported so you can see your gross profit.

Part II is where your business expenses are reported. There are over a dozen categories to help you stay organized, such as advertising, car and truck expenses, legal and professional services, rent, travel and meal expenses, and other costs.

This last section is where your net profit is calculated (Line 31) by subtracting your total expenses (from Part II) from the total revenue (in Part I).

How much money did I make?

The first section of your taxes is all about revenue, or how much money you made. Getting this information may be easy if you have an accounting system. If not, no worries! You can use the revenue worksheet below to calculate it.

Start by **gathering your records**. You are likely to have three types of records for revenue:

PRO TIP You must include your CACFP reimbursement as income. However, you can still deduct your food costs as expenses. This will help ensure your CACFP reimbursements do not increase your taxes.

1099 forms — these are evidence that another business paid you for services. Many home-based child care businesses will receive a 1099-NEC for subsidy care payments and for participation in the Child and Adult Care Food Program (CACFP). As of November 27, 2023, the IRS updated its rules surrounding the 1099-K. You are required to receive a 1099-K if you receive more than $20,000 and over 200 in business payments from apps like Square, Zelle, or PayPal. However, they can send you a Form 1099-K with lower amounts. Keep in mind that this threshold is expected to change yet again for the 2024 tax year. Regardless of the Form 1099-K, you must report all income received through these platforms.

Bank records — showing additional funds you may have received from other sources.

CCMS, Bookkeeping, and other software – Most CCMS and bookkeeping software includes easy reports to export and use in the preparation of your return.

Your own documents — such as year-end or weekly receipts that show parents paid for care.

Then, fill out the revenue worksheets. Include each 1099 and revenue for each child you served during 2023. Also, list other income such as grants, that may not already be accounted for on a 1099.

If you received reimbursement for food costs through the Child and Adult Care Food Program as a home-based provider, you could report all the reimbursements under the income section of Part I of the Schedule C using the 1099 you received. You can then deduct your food expenses in full in the next section.

Revenue Worksheets

Click the to access the [digital version]() of this worksheet.

1099 INCOME	
1099 Payer Name	Amount
Total (add all of the 1099s)	

PRO TIP Make sure all your revenue records match. That is, the amount of a bill to a family should match the amount paid per your bank records and the amount you report to the IRS.

PARENT PAYMENTS & FEES (INCLUDING CASH)	
Parent	Total Amount Paid
Total (add all of the parent payments)	

OTHER INCOME (SUCH AS GRANTS NOT ASSOCIATED WITH A 1099)		
Payer Name	Purpose	Amount
Total (add all of them together)		

TOTAL REVENUE	
Total Payment	Amount
Total 1099 Payments	
Total Parent Payments	
Total Other Payments	
Total Revenue (add them all up)	

How much money did I spend?

Now that you have your business income, you need to collect your expenses, or what you spent money on for your business. You will need records of your costs—ideally receipts showing payment for expenses—but in most cases, you can also use canceled checks, invoices, or credit card and bank records. It is critical that any proof of an expense show:

- That you paid the expense.
- The amount you paid.
- The date you paid it.
- A description of the item purchased, or service received.

PRO TIP The IRS understands you may not have a receipt for every expense, so look closely at one or more documents that show the information they need: That you paid the expense; the amount you paid; the date you paid it, and a description of the item purchased, or service received.

When considering Vehicle Costs you can use The Mileage Log at the end of this tool to track your vehicle mileage and meet the above recording requirements.

To collect your expenses, begin by collecting all your receipts. Next, go month by month in your records to:

- Review your credit card bills.
- Check app-based system payments (such as Venmo, Zelle, PayPal, and Square Cash).
- Look at your bank statements and checks.

With your accumulated expenses you can now fill out the expense worksheet. The worksheet uses the expense categories for a Schedule C that are most relevant to home-based child care providers, but they can also be used for any corporate or partnership tax return as well.

PRO TIP Each year, create a folder for each of the expense categories above. Throughout the year, place receipts in the correct folder and update your expense sheet.

The full amount of home expenses that are directly related to your business can be included in the expense worksheet. The IRS defines a direct expense as one that is "incurred exclusively for the business and provide no personal benefit." Some examples of direct expenses in your home are fixing the bathroom used by the children, getting a new carpet for the play area, or light bulbs for fixtures in a play area. Indirect or shared costs associated with your home, such as homeowner's insurance or your electric costs, will be covered under the section on the business use of your home below.

You should hold on to all proof of payment through the tax season and at least four years after. It's great to have paper copies as well as electronic ones, even if that is just snapping a picture of each with your phone.

Expense Worksheet

Click the link to access the digital version of this worksheet.

CATEGORY	DESCRIPTION	TOTAL EXPENSES
Advertising	Costs to promote your business including online and print ad costs, brochures, mailers, and flyers.	
Car & Truck	Expenses related to use of your vehicle for your business. You will most likely use the total mileage calculation in the Mileage Log resource in this document.	
Contract Labor	This is for any contractors you use (workers you pay using a 1099). If you paid a contractor $600 or more in a year, you will need to send them a 1099 form to document the expense (ask your tax preparer about this process).	
Employee Benefit Programs	Do you have a company health or accident insurance program? This includes programs associated with your business (not your personal expense) like group-term life insurance and dependent care assistance programs.	
Insurance (other than health)	Include your general liability insurance and workers compensation insurance if you have employees. Don't include your health insurance (put that in the section above) or homeowner's insurance (that will be in the section on deducting the business use of your home).	
Interest Paid	Includes interest you paid directly related to your business (we'll talk about mortgage interest later in the section on the business use of your home). Deductible interest can include interest on business credit cards (not personal ones) and business loans such as the Economic Injury Disaster Loan or an SBA 7a loan.	
Legal Fees & Professional Services	Should include any fees paid to a lawyer, accountant, or tax preparer as well as membership fees for professional associations like the National Association for Family Child Care or the National Association for the Education of Young Children.	
Office Expenses	All office supplies, postage, cleaning supplies and personal protective equipment, apps and software that cost less than $200 (those that are more than $200 will be under Other Expenses). Also add in larger purchases, like computers, telephones, copiers, and furniture that cost less than $2,500. If any single purchase of equipment or furniture is **more than** $2,500 you will need to consult current depreciation rules in the What is Depreciation? resource.	
Pension & Profit Sharing	Do you have a company retirement program? If so, include the employer contributions you made for the benefit of your employees to a pension, profit-sharing, or annuity plan (including SEP, SIMPLE, and SARSEP plans).	
Repairs & Maintenance	Includes any repairs and maintenance of the space or equipment you used exclusively (100%) for your business. For example, if you need a plumber to fix the bathroom used only by the children or if you need your work computer fixed. If this is a repair or maintenance for areas with shared use between home and business, time/space percentage will apply, and the amount will be entered on line 20 of	

	form 8829	
Rent or Lease (see instructions)	For equipment rented or leased only. Costs for renting your home will be included in the section on deducting the business use of your home.	
Supplies	Includes items you use with the children (such as art supplies), diapers and wipes, toys, and food for snacks and meals that you serve your children. For meals, you can use the actual expenses or can use a standard meal and snack rate set by the USDA. Rates can be found here. Note that this applies to home-based child care only and is equal to the Tier 1 CACFP reimbursement rates.	
Taxes & Licenses	Such as a business registration fee or fee for licensure.	
Travel & Meals	For you as part of your business, such as going to a conference or an off-site meeting. Food for the children in your care should be in Supplies.	
Wages	For all W-2 employees (not contractors). Note that paying yourself is not included as wages here. As a sole proprietor, paying yourself is not deductible, so you will not report that as an expense on your tax return. The IRS considers all income that you receive from your business as a self-employed individual as your pay, as noted in Part I, Revenue, of the Schedule C.	
Other Expenses	Covers anything else that is deductible but not listed, the most common will be software or apps that cost more than $200 (otherwise they can be listed as an office expense). This is where you will also include accessibility and financing expenses such as screen readers, online service fees, ramps you're your business, bank and merchant fees, and credit card processing fees.	
Total (add up all expenses)		

How do I include vehicle costs?

Many home-based child care providers use their own car or van to conduct their business. This could be as simple as the personal car you also use to purchase supplies for your business or a van you purchased to transport children to and from school as part of your business. Vehicle costs can add up, so keeping records of costs and knowing how to deduct them is important.

There are two ways to deduct your vehicle expenses:

> The **Standard Mileage Rate** provides a simple cost per mile that is used to calculate your deduction.

> The **Actual Expense** method uses all the costs of your car.

Here are the pros and cons of each option:

Pros/Cons	Standard Mileage Rate	Regular (Actual Cost) Method
Pros	Easy to do, Fewer records to collect and keep, Only need to track miles driven for business purposes.	May result in a higher deduction, especially if you use your car for work a great deal.
Cons	Limited to a set rate per mile.	Takes time to collect all the expenses and you need to hold onto the receipts. Must log miles driven for business and personal purposes.

Regardless of the method you use, you need a simple log recording the number of miles you drove your car for business purposes with:

- The date,
- The distance you traveled,
- Where you went, and
- The purpose (business or personal) as specifically as possible.

An example Mileage Log can be found in the resource section of this guide. There are also apps such Mile IQ and Everlance which can automatically track your trips and make them easier to log. The costs of these apps can also be deducted under Other Expenses.

If you use the **Standard Rate**, you take the total miles you drove in the year and multiply it by the IRS rate. In 2023, the standard rate is 65.5 cents per mile.

For example, if you logged 500 **business miles** from January 1 to December 31, 2023, your deduction would be:

Time	Miles	Rate	Deduction
January 1 to December 31, 2023	500	65.5 cents a mile	$327.50

Keep in mind, when you use the standard mileage rate, you **can** still deduct parking fees and tolls accumulated when driving for business purposes.

If you use your car a lot for your work, you may want to use the **Actual Expense** method. It requires more record keeping but could result in a larger deduction. With the actual expense method, you will collect receipts or other proof of payments for all expenses related to your car. The **Vehicle Expense Worksheet** included below can help you collect the total amount of your actual vehicle expenses.

PRO TIP Parking tickets and other violation fees are not deductible.

If you have a dedicated work vehicle, all expenses will be business expenses.

If you use your vehicle for work *and* personal expenses, you will need to multiply the total of your actual expenses by the percentage of miles driven for work. To determine this, you take your mileage log and divide the miles driven for work by the total miles driven in the year. You then multiply your total expenses by this percentage.

Here's an example: A home-based child care provider logged 3,000 miles for business-related purposes. Overall, she drove her car for work and personal reasons for 10,000 miles over the year. She had $6,000 in actual car expenses. First, the provider will divide their miles driven for work, 3,000, by the total miles driven, 10,000, to come up with 0.30 or 30%. She will then multiply her total vehicle expenses of $6,000 by 30% to determine her business use of vehicle deduction, which would be $1,800.

Here is a worksheet that you can use to log your actual vehicle expenses, which will help you complete this portion of your Schedule C.

Vehicle Expense Worksheet

Click the link to access a digital version of this worksheet.

CATEGORY	DESCRIPTION	TOTAL EXPENSES
Licenses & Registration Fees	The cost of getting and renewing a license, inspections, and registration costs.	
Gas & Oil	The costs of gas or diesel fuel, as well as oil and oil changes for the car. This can also include charging costs for electric vehicles.	
Tolls	Payments for accessing toll roads, highways, and bridges.	
Lease Payments	Payments for a leased vehicle used for work.	
Repairs & Maintenance	For the vehicle including preventative "checkups."	
Garage Fees and Parking	To keep the vehicle on a regular basis (like an off-street parking garage in a city) or temporarily (such as waiting for pick up).	
Insurance	For the vehicle even if not required by your state.	
Total (add up all expenses)		

Depreciation of my vehicle

Another consideration if you are using the Actual Expense method is depreciation. If you use a vehicle for your work 50% or more of the time, you may want to also deduct part of the overall wear and tear on the car. You can learn more about this in the What is Depreciation? resource.

How do I Include the Cost of My Home?

As a home-based child care provider, if you are licensed and regularly use your home for your business, you can deduct the cost of your home and other related expenses.

To prepare for claiming these deductions on your return, regardless of whether you rent or own your home, there are three steps you need to take: 1) determining the space used for care, 2) determining the time spent on your business (both caring for children and maintaining the business), and 3) determining the allowable expenses related to providing care in your home.

Let's go through each one. Know that there is a table to record your information below:

There are two elements that determine how much of your home expenses can be deducted: (1) the space regularly used for care and (2) the amount of time it is used form the business on average. Calculating space and time for the percentage of your home expenses that are deductible is done by multiplying the percentage of space used in your home by the time it is used.

We are going to go through the calculation here, but there is also a spreadsheet you can use to make it even easier.

Step 1: Calculating the space used in your home.

Typically, space is measured in the square feet of your home that is used for care and the total square footage of your home. Exclusive use is space that is only used for child care and has no personal use. Regular use space includes areas that may be used all day for care, such as a play area, but also ones that are regularly used for only part of the day. To give an idea of an area that is only used part of the day, the IRS guide to auditing child care providers uses the example of a provider with three children enrolled in her program who each nap in different rooms at quiet time so they can rest better.

Though the other rooms are just used at nap time, it is a regular use and can be included in your calculation. As a rule of thumb "regular use" means you use the space regularly for your child care business. "Regularly" doesn't have to be every day, it just needs to be a part of the schedule or way you operate. For example, let's assume you normally don't use a bedroom. However, you have one child who comes weekly and needs to have a separate space to sleep, so you use that bedroom. This would be considered regular use of the bedroom.

You then take the total space used in your home for care and divide it by the total square footage of your home to get a percentage:

Space used for care ÷ total square footage of your home x 100 = percentage of your home that you use for child care

For example: a provider uses 500 square feet of her 1,100 square foot home regularly for care. If she divides 500 by 1,100, she gets .454. By multiplying 0.454 by 100, she calculates that 45.4% of her home is used regularly for care.

Step 2: Calculating the time spent on your business.
Time is the total number of hours you used your facility on average. This includes not only the time that you are caring for children, but also the time you used the space for cleaning, cooking, attending business related Zoom meetings, banking, or shopping for your business online, entering data into your child care management system, and other tasks that revolve around preparing for the care of children and the upkeep of your business. You can also include the time when your business was closed but you were preparing to open.

12 hours a day x 5 days a week x 48 weeks +10 hours when you were closed = 2,890 hours

You can create a percentage of the business use of your home by dividing your total hours used for care by 8,760 (the total hours in a year).

For example, our provider above uses her home for care 2,890 hours a year. When you divide 2,890 by 8,760 you find that her home is used for business 0.329 or 32.9% of the time.

For example, let's say your business is open and providing care for children 10 hours a day. During the hours that you are closed, you clean and set up for two hours a day. Combined, this would give you 12 hours a day that you were using your facility. Then, let's say you were closed for four weeks but did 10 hours of work in this time to maintain the space and prepare for re-opening. Your total hours would be:

DESCRIPTION	EXAMPLE	YOUR HOME
Square feet **exclusively** used for care. Exclusive use areas are only used for childcare business purposes and no personal purposes whatsoever. If no exclusive use, enter 0.	0	
Square feet **regularly** used for care. Regular use areas are shared for both personal and child care business purposes.	500	
Total square feet of your home. Include square footage of your basement, garage, porch, and deck in addition to the interior of your home. Do not count patios or yard space—even outdoor play areas.	1, 100	
Exclusively used space percentage. Divide spaced used exclusively by the total square feet in your home for a percentage.	0%	
Regularly used space percentage. Divide spaced used regularly by the total square feet in your home for a percentage.	45.4%	
Total time, in hours, spent a year for care. This can include activities such as bookkeeping and paying bills, planning lessons/activities, purchasing supplies online, communicating with families, any online trainings, and cleaning. Keep track of these other non-direct childcare tasks for your records. The best way to figure out your total time is to multiply the average number of hours you work each week and multiply it by the number of weeks you provide care during the year.	2,890	
Total hours in a year.	8,760	8,760
Divide the time spent for care by the total number of hours in a year to create a percentage.	32.9%	

Multiply your **regularly used space percentage** by the time percentage. If you have no exclusively used space, this is your Time-Space Percentage. You'll use this percentage to deduct your business use of home expenses for your in-home child care services.	45.4% * 32.9% = 14.9%	
If you have exclusively used spaces: Add to your **regularly used Time-Space Percentage to** your **exclusively used space percentage.** If you don't have exclusively used spaces, skip this step. It will be: Space percentage (%) of exclusive use area + (regular use space percentage (%) * time percentage (%)). This will weigh your exclusively use areas higher in your Time-Space Percentage. This is your Time-Space Percentage. You'll use this percentage to deduct your business use of home expenses for your in-home child care services.	N/A in example	

Calculation
To calculate how much of your home expenses you can deduct, multiply the Space of your home you use for your business by the Time you use your home for the business. Then multiply the result by the costs of your home.

In our examples above, the provider is using 45.4% of her home (Space) for care that is provided 32.9% (Time) of the year. If she multiplies 45.4% times 32.9% she gets 14.9% (0.454 x 0.329 = 0.149). So, she can deduct 14.9% of her home expenses.

We also have a spreadsheet that can make these calculations easier.

PRO TIP Make sure you have records of indirect or shared expenses for your home, just like your other expenses.

Step 2: Collecting allowable expenses for your home
The full amount of expenses that are for your home but are directly related to your business can go under your expenses, under the applicable Schedule C lines—as we mentioned under the section on expenses.

Now you want to focus on collecting indirect expenses related to your home, such as electricity usage, which is partially for your business, but also partially for your own use.

The table below includes many of the indirect home-based business expenses you can collect by looking at your receipts, bank accounts, credit card bills, checks, invoices, and app pay services (like Zelle and Venmo)

Indirect Home-Based Business Expenses (subject to time-space percentage)

INDIRECT EXPENSE	NOTES	TOTAL AMOUNT	DEDUCTIBLE AMOUNT (TOTAL AMOUNT X TIME-SPACE %)
Rent	The full amount you paid over the year.		
Mortgage Interest & Mortgage Insurance Payments	Not mortgage principal		
Real Estate Property Taxes			
Electricity			
Gas			
Oil			
Water			
Home Phone, Internet, & Cable			
Common Area Repairs	Such as repairing the front steps of your home if they are used by families when they drop off and pick up their children.		
Cleaning & Lawn Care Services			
Homeowner's or Renter's Insurance			
Other			
Total			

How do I handle stimulus program funds?

Many child care providers benefited from federal and state stimulus programs in 2023. The funding programs do have different tax implications, so it is helpful to review some of the most common ones.

Stabilization Grants

Many state and local governments used stimulus funding to provide one-time grants to providers, often referred to as "stabilization grants" for personal protective equipment or other needs. Typically, you will receive a Form 1099-NEC displaying the income received. Even if you do not receive a Form 1099-NEC, this revenue should be noted as income for your business and will be treated as any other source of income. Many business purchases that you made with grant funds will be subject to usual tax deduction guidelines and will be claimed as expenses that may offset tax liability.

Each state administers its own stabilization grant on its own terms and timeline. To find Stabilization Grant Applications for your State or Territory, visit the Child Care Technical Assistance Network.

Additional Subsidy Funding

Many home-based childcare providers received additional subsidy funds (for example, based on pre-COVID enrollment or at a higher rate). This helped to make up for gaps in revenue due to drastic decreases in enrollment. These funds need to be recorded as revenue for your business and are likely already included in a 1099-NEC you received from the Child Care Resource and Referral agency or other entity that paid you.

Before I submit, are there ways I can mitigate my tax obligations?

There are proactive steps you can take to effectively manage your tax obligations. The window for retirement contributions closes by April 15th, 2024 so it's important to act promptly.

Here are some key strategies to consider:

1. Contribute to a Retirement Plan

Investing in a retirement plan is not only a wise long-term financial move but also a practical way to reduce your taxable income for the current year. Contributions to traditional IRAs or other eligible retirement accounts can be made until April 15th and may reduce your taxable income.

First, you should choose the most appropriate retirement account type, which could be a SIMPLE IRA, SEP IRA (Simplified Employee Pension), or a Solo 401(k). Each of these options offers unique benefits that vary based on the number of employees you have, income level and retirement goals.

Review this IRS Guide to select the best plan for you: https://www.irs.gov/pub/irs-pdf/p3998.pdf

For SIMPLE IRAs, you can put all your net earnings from self-employment in the plan, up to $15,500 in 2023. In the case of SEP IRAs (Simplified Employee Pension), self-employed individuals can contribute up to 25% of their net earnings from self-employment, with a cap of $61,000 for the year.

For a Solo 401(k) plan, you can defer up to $22,500 of your salary ($7,500 extra if you're 50 or older) and contribute an additional 25% of your net self-employment earnings, with total contributions capped at $66,000. This plan, tailored specifically for businesses with no employees other than a spouse, offers flexibility through loans and hardship distributions, helping you save for retirement while managing your business's unique needs.

It's crucial to note that while these retirement plans offer tax advantages and growth opportunities, they also come with specific regulations, particularly concerning withdrawals. Withdrawing funds from these retirement accounts before reaching age 59½ typically incurs a 10% early withdrawal penalty in addition to the income tax due on the amount withdrawn. This rule is designed to encourage long-term savings and ensure that these funds are used for retirement purposes.

2. Maximize Your Home Business Deduction

This deduction allows you to allocate a portion of your home expenses (like utilities, mortgage interest, property taxes, repairs, and maintenance) to your business use of the home. It's important to accurately calculate the percentage of your home used for business purposes and apply this to your eligible expenses. (If you are a home based provider, this will most likely be your largest deduction and is often not fully utilized.) Home business expenses need to be incurred in 2023 to be applicable for the 2023 tax year.

3. Diligently Review All Possible Deductions

Carefully review all your business expenses, including those paid through business accounts and any inadvertently charged to personal accounts. Be diligent in identifying and deducting these expenses. For instance, if you have bought business supplies using your personal card, make sure to include these costs in your deductions. Always keep your receipts for everything you buy for your business. Expenses need to be incurred in 2023 in order to be applicable for the 2023 tax year.

4. Pay Your Taxes on time (April 15) to avoid penalties and fees

It's crucial to remember the fundamental obligation: Pay your taxes on time! (April 15th at the latest!) Not only is it a legal requirement, but failing to do so can result in substantial penalties and interest charges.

Great! I am ready to file my taxes. How do I get started?

Do I want to file My own taxes or do I need a paid tax preparer?

The information in this guide is intended to support your tax preparation activities and make your life easier, whether you decide to take everything to a professional tax preparer or utilize additional resources and tools to complete your taxes on your own.

Choosing an Online Tax Program

Some people choose to use an online tax program in place of a tax preparer- the feedback from child care business owners is that it can be less expensive, easier, and provide a greater feeling of "control" over the business. There are many programs available that are easy to use, accessible, and often less expensive than hiring a tax preparer. Just as you would when choosing a tax preparer to hire, you will want to do a little of your own research to find the program that is best for you. Two main factors to consider are your comfort level with technology and your overall tax knowledge as some programs are better for beginners than others.

Below are three popular options for online tax preparation. While we do not endorse any particular online tax program, we understand that preparing your own taxes can be intimidating. We have developed reference guides for self-employed child care business owners that guide you through each of the three main tax software programs. These guides will support you in preparing for and completing your tax filing if you decide to do it yourself.

- Turbo Tax is easy to use and provides many tips and tools for beginners. See "TurboTax Self-Employed Online Tax Preparation Guide for Child Care Businesses."
- H&R Block covers a variety of filing options and is great for simple filing. See "H&R Block Self-Employed Online Tax Preparation Guide for Child Care Businesses."
- TaxAct is a great option for self-employed but tends to be less user-friendly than the other options. See "TaxAct Self-Employed Online Tax Preparation Guide for Child Care Businesses."

PRO TIP Around half of all individual tax returns are filed without the use of a professional tax preparer. If you're comfortable using email and online banking services, we think there is a good chance you can comfortably prepare your own return using our online guides.

Note that our tax software guides are not tax advice, financial advice, or an endorsement of any platform. In addition, if your tax situation is especially complicated and you choose to use professional tax preparation services instead of doing your taxes yourself, it is important to find a service that is right for you.

However, you may want to have your taxes done by a professional preparer. Here are some things to consider if you make the choice to pay for tax preparation service:

Make sure your tax preparation service is qualified.
All tax preparers should have an IRS Preparer Tax Identification Number (PTIN). Paid tax preparers are required to register with the IRS, so be sure to ask for this in advance as they are not allowed to prepare your tax return without one. You can use this IRS directory to verify a preparer's PTIN and credentials.

Ask if your tax preparer has any professional credentials. Enrolled agents (licensed by the IRS), certified public accountants, or attorneys all work as tax preparers. Other qualified preparers may be participants in the Annual Filing Season Program, bookkeepers, or certified financial planners.

You can search for qualified tax preparers in your area on the IRS Directory of Federal Tax Return Preparers.

Look at your tax preparation service's history and experience.
- Experience counts when looking for a qualified tax preparation service. In addition to checking for length of previous experience, make sure your tax preparation service has knowledge that is relevant to your specific circumstances.
- Ask if your tax preparer is part of any professional organizations or takes any continuing education classes to keep up to date.
- Make sure your tax preparer knows your state and local tax requirements in addition to federal return requirements.

Evaluate your tax preparation service's costs.
It is important to properly evaluate the cost of your paid tax preparation options, as many paid tax preparation services may cost more than you realize. Here is some information that can help you ensure you don't pay more than you intend:

- If you have a typical home-based child care business and choose to use paid online software to file your return, you may pay $60-$250 depending on the features you choose (e.g., audit protection).

- If you have a typical home-based child care business and choose to hire a paid tax preparer to file your return for you, you may pay $400 on average for the Form 1040 and Schedule C. This amount increases if you add itemized deductions and any other forms, such as quarterly estimated tax forms.

Remember, the initial cost is just the cost to file your forms, and the price may be higher if you elect to add on additional services and features.

PRO TIP Make sure your tax preparer reviews all the documents in your tax return filing with you and explains what each form is and why it is used. Also make sure that you review how to make changes to your tax return in case there is a mistake. Remember, a good tax preparer will want to make sure that you feel comfortable and satisfied with the information you receive so do not hesitate to ask them questions.

Do not leave your original tax documents with the tax preparer.
Have the preparer scan or photocopy your documents if they need to work on your return while you are not there. You want to avoid leaving your important original tax documents with a preparer as you may have trouble getting them back. You may need your original documents later if you need to amend or resubmit your return or if you get audited.

Get a copy of your completed return as soon as it has been submitted.
You should keep a copy of your completed return for your own records. You may need a copy of your tax return to prove your income when applying for a loan or other financial product and the easiest time to obtain a copy of your return is immediately after your preparer completes it.

Other questions to ask:
- Is my tax preparer available after tax season?
- Do they have a clear, upfront fee schedule?
- Do they know how to deal with an audit?
- Exactly how much time do they require to prepare and deliver a tax return?
- How do you get a copy of your tax return?

If you have utilized the information in this workbook, you can take it to your tax preparer, along with your tax documents. Child care business taxes are unique, and this resource, along with the IRS's Child Care Provider Audit Technique Guide can be helpful information, even for professional preparers.

Once my taxes are completed, what do I do next?

Once your taxes are finished, there are a few more things that you should do. First, make sure that you get written confirmation that your state and federal taxes were submitted, either from your online tax program or from your tax preparer if you used one.

Also, make sure you have a hard copy of your filed tax return and all documents included in your filing. Aside from the fact that it's good to have a copy for your records, you never know when you might need a copy quickly. While several of the online tax programs allow you to login at any time and print or download a copy of your return, tax preparers may or may not be easy to reach outside of tax season. In addition to the hard copy of all the documents in your tax return, it is recommended to have electronic copies as well. Digital copies could be made by scanning hard copies and converting them to PDF files, or by taking photos of the documents with your phone and saving the files on a secure device.

PRO TIP You can use the **IRS Get Transcript Tool** to access your tax records online. Here, you can see your prior year adjusted gross income (AGI) and access all transcript types such as a **Tax Return Transcript** and **a Wage & Income Transcript**.

Finally, make sure all the original documents submitted to your tax preparer are returned to you. Keep all receipts, proof of payments, 1099s, and all other tax-related documentation for at least four years.

How can my business benefit from filing my taxes?

Taxes are often associated with confusing and overwhelming forms, anxiety about future audits, and fears of a large tax bill. But tax season can also be an opportunity for small business owners to save money, prevent future issues, and provide the documentation you need to access financial products, like loans and financing to grow your business. When you are self-employed, you do not have paystubs to show a bank when you are seeking a loan. Giving them your bank records will also not be helpful. What most lenders look for are financial statements to show your business's income and your tax returns to show your personal income history. Often, lenders will use Line 31 (Net Income) on your tax return to prove your income for a mortgage or business loan.

PRO TIP You can use **Google Drive** to store your tax return and related documents digitally!

Year-Round Tax and General Business Resources

Now that you've filed your tax return this year, consider changes you might make to help the process go even smoother next year! The following pages include additional resources that may help you learn more about certain tax topics and business practices that can improve your business operations and your tax filing experience.

Resource 1: Mileage Log

Click to access the digital version of this worksheet.

DATE	DISTANCE	LOCATION	PURPOSE
e.g. 11/2/2023	e.g. 5.5 miles	e.g Burbank Wal-Mart	e.g. Picking up supplies

TOTAL DISTANCE (ADD UP ALL YOUR ENTRIES)	MULTIPLY BY THE IRS PER MILE RATE	TOTAL EXPENSE AMOUNT
	0 .655	

The IRS standard mileage rates for 2023 are available here.

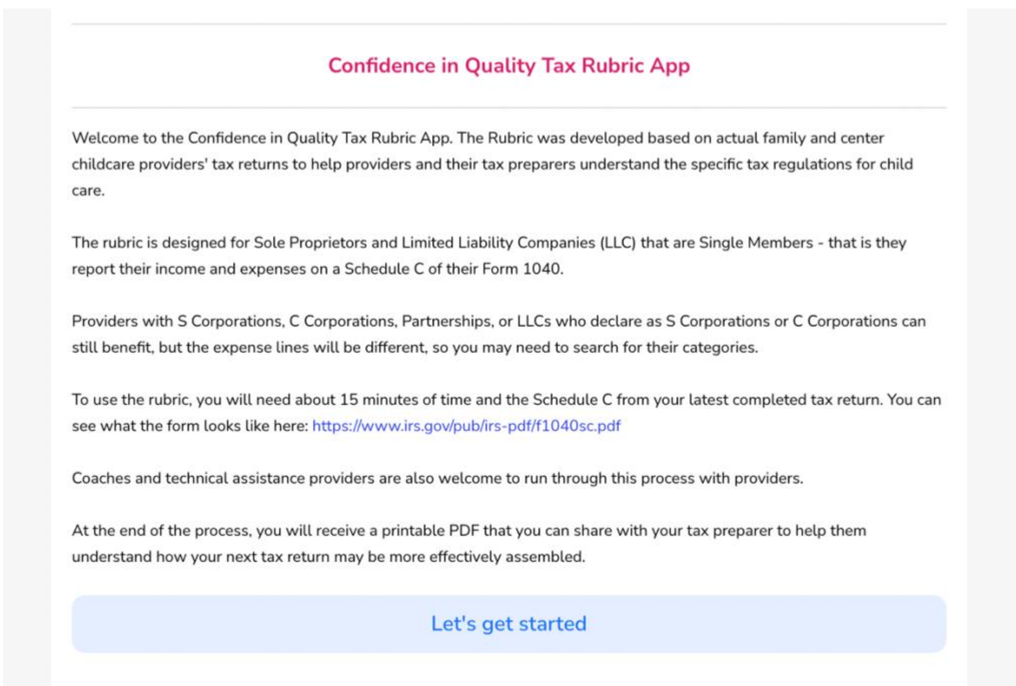
Resource 2: Assess My Taxes

Better understand your taxes by using the *Confidence in Quality Tax Rubric App* ©.

Civitas Strategies developed a digital app to assist child care providers to assess their federal tax returns are consistent with the best practices for their program type. The *Confidence in Quality Tax Rubric App*© was informed by an analysis of a set of child care provider tax returns. It can be used widely, especially by organizations who offer business technical assistance to childcare providers, to ensure they are applying these practices. Providers can also use this assessment with their paid preparer to guide tax preparation or feel empowered to submit their own returns and save several hundred dollars on fees. The tool can also be used to retroactively review past submitted tax returns.

Through this opportunity for the assessment of past taxes, you can search for errors and amend returns for up to three years, receiving back money they overpaid in already submitted returns.

Click on the image below to access the website or scan the QR code with your smart phone to install.



Resource 3: Payroll Taxes (for Businesses with Employees)

Learn how to understand your payroll tax obligations as an employer.

What are Payroll Taxes?

Payroll taxes are taxes that employees and employers must pay on wages, salaries, and tips. The employee pays their portion of these taxes through a payroll deduction and the employer pays the rest directly to the IRS. Typically, the employer will report payroll taxes using Form 941, Employer's Quarterly Federal Tax Return.

There are different types of payroll taxes:

1. Federal income tax
2. Social Security and Medicare (also known as FICA)
3. Federal Unemployment (also known as FUTA)

How much are Payroll Taxes and when are they due?

Some payroll taxes are a fixed percentage of wages, and some are dependent on the employee’s tax bracket. There are also various due dates for these taxes. Below is a helpful chart that describes the tax, the amount, who is responsible for paying it, and when it’s due:

What forms must be completed?

- **Form W-4:** completed by employee to let the employer know how much payroll tax to withhold. The amount withheld will be calculated based on their marital status, number of dependents, and any additional withholding they may choose. This is completed once an employee is hired, prior to their first paycheck and can be updated by the employee if their tax situation changes.
- **Form W-2:** you must file Forms W-2 to report wages paid to employees. This must be issued by January 31 to any employee with wages withheld during the previous tax year.

Tax Type	Amount	Due Date	Responsible Party
Federal income tax	Varies, based on individual withholding status.	Withheld from each paycheck issued; paid to the IRS from employer **monthly** if you reported $50,000 or less in taxes July 1 – June 30 of the previous tax year and **semi-weekly** (twice a week) if total taxes reported were more than $50,000.	Employee, but employer must withhold based on W-4 received.
FICA	Social Security – 12.4%		Employer and employee each pay 6.2%
	Medicare – 2.9%		Employer and employee each pay 1.45%
FUTA	6% on the first $7,000 in wages paid per employee, each year.	Quarterly	Employer

- **Form 941:** used to report income taxes, Social Security tax, or Medicare tax withheld from employee's paychecks and can be used to pay the employer's portion of Social Security or Medicare tax. This is due quarterly by the last day of the month that follows the end of the quarter:

Quarter	Months in the Quarter	Form 941 Due Date
1	January, February, March	April 30
2	April, May, June	July 31
3	July, August, September	October 31
4	October, November, December	January 31

- **Form 940:** used to report any FUTA tax. The due date for filing the Form 940 is January 31.

What about Part-time workers?
Part-time workers and workers hired for short periods of time are treated the same as full-time employees for federal income tax withholding and social security, Medicare, and FUTA tax purposes.

What about family employees?
One of the advantages of operating your own business is hiring family members. However, employment tax requirements for family employees may vary from those that apply to other employees. View the Family Help resource to learn about the tax requirements for family employees.

For more information, review IRS Publication 15, Employer's Tax Guide.

How do I determine if someone is an employee or 1099 contractor?
Employees and contractors are treated very differently under federal and state law. Contractors are considered independent business people. They pay their own employment taxes, and the employer usually has fewer legal obligations to the individual, such as providing paid time off. Employees, on the other hand, come with greater costs, like employment taxes and benefits.

There are rules that determine if a person should be considered an employee or a contractor and there can be harsh fines if you misclassify an employee as a contractor. When determining if you have a contractor or employee, you should look at the three essential elements of the definition of employment: service, wages, and direction and control.

1. **Service (Type of Relationship)**: Does the person work on a project-by-project basis (like a contractor)? Does the person work for other businesses or just for you?

2. **Wages (Financial)**: How is the person paid? For example, is the person paid every week for a set number of hours (which indicates an employee), or does the work vary (like a contractor)? Do they have regular expenses that are reimbursed (like an employee)?

> **PRO TIP** Don't use Forms 1099 to report wages and other compensation you paid to employees; report these on Form W-2.

3. **Direction (Behavioral):** How much control do you have over their day-to-day work? For example, do you set the requirements around their work hours, the equipment or tools to be used, or the training needed? (If yes, then this person is likely an employee.)

For more guidance, run through the IRS list of 20 factors that indicate if someone is a contractor or an employee.

Resource 4: Quarterly Estimated Tax Payments (for Self-Employed Individuals)

What are quarterly estimated taxes?

Quarterly estimated taxes are estimated self-employment (SE) tax payments you may need to make to the IRS four times a year. Self-employment taxes are taxes that freelancers, independent contractors, and other business owners pay towards Medicare and Social Security. W-2 employees have these taxes taken out of their paychecks by their employer however, self-employed people need to pay these taxes to the IRS themselves. Typically, the deadlines for these payments are on the 15th of April, June, and September of the current year, and January of the following year:

Payment Period	Due Date
January 1 – March 31	April 15
April 1 – May 31	June 15
June 1 – August 31	September 15
September 1 – December 31	January 15 of the following year

Making quarterly estimated self-employment tax payments during the year means that you pay most of your tax during the year as you receive income, rather than owing one large amount at the end of the year. These payments are based on your estimated income for the current year.

View When to Pay Estimated Tax for more information.

Do I have to pay quarterly estimated taxes?
Self-employed individuals generally have to make estimated tax payments if they expect to owe tax of $1,000 or more when their income tax return is filed.

If your net earnings for the year are greater than $15,000, you will likely owe at least $1,000 in self-employment taxes and therefore will be required to make quarterly

Key Terms

Self-employment tax - a Social Security and Medicare tax primarily for individuals who work for themselves. The SE tax rate is 15.3% (12.4% for social security tax and 2.9% for Medicare tax) and it is applied to 92.35% of your net earnings from self-employment.

Quarterly estimated tax - Estimated tax is the method used to pay your self-employed Social Security and Medicare taxes and income tax. Those who are not self-employed will have an employer withholding these taxes for them and paying these taxes at regular intervals to the IRS. Because you do not have an employer doing that for you, you need to pay them yourself, quarterly.

Income tax - self-employed individuals generally must pay self-employment tax as well as income tax. Income tax is tax on personal income. For a self-employed person, their personal income is their net profit (Line 31 of the Schedule C). Income tax is also paid on all other types of income you may have (for example, capital gains). Your income tax rate will depend on a number of things such as your filing status, household income, and whether you have any dependents.

estimated self-employment tax payments. This figure is if you have no dependents and no other personal credits on your tax return. If you do, then you may be able to have a higher net earnings before you're subject to making quarterly payments.

Find more information on whether you will need to pay quarterly estimated taxes in the IRS FAQ.

To avoid making quarterly payments, you can also have your spouse withhold enough in taxes to cover your Social Security/Medicare and income taxes. If you are single or have a spouse who is unemployed or self-employed, you will most likely need to file quarterly estimated taxes.

You can also make monthly estimated tax payments which may be easier to budget than paying a larger amount quarterly.

How much do I pay each quarter?
Any self-employed business must pay a 15.3% self-employment tax that is made up of both the employee and employer portions of the Medicare and Social Security taxes, and the amount is calculated with the 1040 estimated tax form. You must pay at least 90% of the taxes you owe for the quarter to avoid paying a penalty.

To get a rough estimate of how much you owe each quarter, add up all your income and multiply it by 20%. If you pay that 20% and it's more than you actually owe, you will get a refund at the end of the year. If it's too little, you will owe some additional taxes when you file your tax return. It's unlikely that you will face a penalty if you pay greater than 20% of your income in taxes each quarter.

Illustrative Example

DESCRIPTION	EXAMPLE AMOUNT	YOUR AMOUNT
Self-Employed Net Income (Schedule C, Line 31) This is your profit after deducting business expenses from your revenue.	$15,000	
Self-Employed Income Subject to Self-Employment Tax This is 92.35% of your net income	$13,853 ($15,000*0.9235)	
CREDITS		
Self-Employment Tax Credit Self-employed individuals receive a 50% credit on their SE tax	$1,060 ($2,120*0.5)	
Other credits	$0	

Enter any additional credits that you are expecting to receive when you file your tax return, this can be the Earned Income Tax Credit, Child Tax Credit, Child and Dependent Care Tax Credit, American Opportunity Tax Credit		
TAX OWED & QUARTERLY ESTIMATED TAX		
Tax Owed This is the amount you get when you subtract all expected credits from all anticipated tax owed (this is SE tax plus any other personal tax liability). **If this amount is over $1,000 you must make quarterly estimated payments. If it's below $1,000 you do not have to make quarterly estimated payments.**	$1,060 ($2,120-$1,060)	
Quarterly Estimated Payments This is the amount you may be required to pay to the IRS quarterly.	$265.00 ($1,060/4)	

Resource 5: What to Look for in a Business Bank Account

Learn about opening a business bank account.

Setting up a business account isn't difficult and is the best first step to ensuring that you're clearly separating your personal and business revenue and expenses. Once set up, you will easily "see" what money is in your business versus your own pocket, and it will be easier for you to do your bookkeeping and taxes.

This resource, along with Resource 6, *How Can I Create a Simple Financial System for My Business?*, will walk you through the basics of developing a financial system for your business. The basics consist of only two big steps—getting a business bank account and adopting a bookkeeping system.

Getting a business bank account can be quite simple. As a sole proprietor, you have multiple options. You are not required to have a traditional business bank account; however the best practice is that you at least have separate accounts for your personal and business finances. You may want to use the bank that holds your personal accounts already, or you may want to look for the best deal for your business. We recommend you look at 2-3 account options to be sure you are making the right choice.

What are the features of a Business Bank Account?

Typically, a business bank account requires you to have an Employer Identification Number (EIN) and offer features that do not come with a standard personal account. Some of those features include:

- Protection services for you and your customers
- Allows for credit card payments to you directly, not through a payment processor
- Credit options that will allow your business to grow or use in emergencies
- Helps establish your business credit

For more features and details on business bank accounts, view Open a Business Bank Account by the U.S. Small Business Administration.

Choosing a Bank

In selecting a bank for your business account, first and foremost, relationships are important. You want to make sure that the bank will be responsive to your needs and your questions and provide the opportunity to grow over time. Once you've established a relationship with your bank, you may be eligible for financial supports such as a business loan or a line of credit that could help you to grow your business. Look for a bank that offers these services.

Think about how the bank treats you from the moment you first walk in the door. Do they seem eager to talk? Does the employee appear to want your business? If the bank isn't excited to see you when you are a prospective customer, they are not very likely to be there when there's an issue and you need them the most.

If a bank appears friendly and welcoming, you should consider four other points:

1. **Does the bank require you to deposit a certain amount of money to open the account?**
   Understanding how much money may be tied up in the account is important. If the bank requires you to keep a minimum balance, it will then be money that you cannot access easily if you have bills to pay or want to pay yourself.
2. **Are there fees associated with the account? What are they?**
   Banks make money by charging fees for their services and these seemingly small fees can add up quickly. You will need to factor them into your routine expenses.
3. **How many checks can you write a month? How many deposits can you make?**
   Some banks place limits on the number of checks, transactions, and deposits that can be made during each billing period. After you reach your thresholds, the bank will charge a fee for each transaction. Again, this is going to erode how much money you're making, so it's imperative that you know what the fees are and if your business will be able to operate without incurring these fees.
4. **Will you need a debit or credit card for your business? Do you want the ability to use a credit card that is issued by your bank?**
   These are important services, and again, going to the earlier point, may also come with fees, so you want to look very closely at these.

Decision Time
Review the account options, services, and fees at two, three, or four banks, setting aside any that have passed the "relationship" test. Then consider what is the best deal? Think about how much money you are willing to have tied up (i.e., the minimum balance) and how high the fees will be per month, based on your current banking.

For example, Marta is considering two banks that passed her "relationship test: Bank A and Bank B. Bank A has a higher minimum deposit—$500—but their fees are lower. Based on the number of checks Marta writes a month and that she doesn't need a debit card, Marta calculates that the fees for Bank A would only be $5 a month. Bank B has higher fees, totaling $8 a month, but no minimum deposit.

The account Marta chooses will depend on her personal and business needs, finances, and preferences.

If you don't already have a bank account, we recommend opening an account that meets the Bank On National Account Standards. These accounts take the stress out of banking by charging only $5 or less per month with no overdraft or insufficient fund fees and include convenient features like Bill Pay or free checks you can use to help pay rent and other bills without using expensive money orders. These accounts are also great options for anyone with a limited or challenging banking history.

You can review the full list of available Bank On certified accounts you can open online here.

Resource 6: How Can I Create a Simple Financial System for My Business?

Learn about basic bookkeeping.

At the heart of any successful business, from a one-person operation to a *Fortune 500* company, is a financial accounting system.

An accounting system is critical because it lets you know where your money is, where it is going, and how much you're making. Having this information readily available will let you pay yourself without putting your company at risk, manage cash flow so that you always have enough money to pay your bills, and know when it's time to expand your business.

Developing a bookkeeping system

Once you have your business bank account, you can start to think about a basic system for bookkeeping. Bookkeeping is very important because it will help you understand where your money is coming from (tracking revenues), where it is going (monitoring expenses), and how much profit you're making (managing cash flow). Profit is just a fancy way of saying how much money is left after you pay all your bills.

Step 1

Determine how you will account for funds coming in and going out.

There are two basic methods in accounting—one is an **accrual method**, which is more complex and is based on when an expense or a revenue is taken on or *accrued*. For example, if using the accrual method, the moment you receive your credit card bill, the amount owed would be taken from your assets (versus when you actually pay the bill). If using the **cash method**, this amount would be taken from your assets when the bill is paid. The cash method is more common for businesses and is less challenging, as it is based on when things are paid or received.

Let's look at revenues. Let's say a client owes you $300. Under the accrual method, that $300 is considered income at that time. Under the cash method, the $300 wouldn't be considered income until the client gave you the check and you deposited it. For most small businesses, the cash method is both simpler and more helpful because it's going to let you know exactly *when* money is coming in and out of your account. This method is more comfortable because it matches the act of balancing your checkbook—just in a bigger way.

Step 2

Determine how you will record your transactions.

Now that you've determined how you will account for funds, you need to determine how you're going to record your transactions. For many small businesses, it is easiest to record transactions on a sheet of paper or on a spreadsheet, such as Microsoft Excel or Google Sheets. You want to set up some simple categories to start.

Begin with your income. Determine what the key revenue streams are for your business—that is, the sources from which you primarily receive your money. Parent fees will likely be one source; another might be a child care subsidy or payments from a food service program. Perhaps there are additional funds that you receive for after-school students or grant funds. Each one of these will be a separate revenue stream to account for.

Next, list your expenses. This may include items like payroll, cleaning, rent, repairs, supplies, and other categories that match your business. Try to limit the number of categories—you don't need to detail every category that might occur. Focus on the categories you have right now; you can always add more later. With too many categories, the list could become overwhelming, making it difficult to account for spending or revenue.

You can use this example list to categorize your income sources:

Revenue Categories
Income category #1
Income category #2
Income category #3
Fees
Other

You can use this example list to categorize your expenses:

Expenses Categories
Personnel
Taxes
Mortgage/Rent
Utilities
Car lease
Phone
Supplies
Inventory
Cleaning
Insurance
Loan payments
Bank fees
Other

Step 3
Set a schedule to record and review your transactions.

You should set a time to update your books, at least every month. Start by looking at all your revenue sources: cash, credit cards, app payment systems like Venmo or Zelle, and checks written to you. Enter each one into your income on your spreadsheet. Next, record your expenses. Look through your receipts, bank and credit card statements, and invoices from people you have paid. Any of these proofs of payment can help you to not only record these costs, but more importantly, ensure that you're recording the correct amount for each one.

Though it may seem tedious to record each transaction, it is important in terms of understanding your profitability by tracking exactly where your money is coming and going. Once you have recorded your revenue and expenses for the month, you will then total each category. Subtracting your revenue from your expenses will give you an idea of how much profit you made that month. You may want to consider holding onto some of that profit, leaving it in the business for a rainy day or to help pay your bills.

You can use this helpful template to record and track your monthly revenue:

What revenue did I receive?			
Date	**Description of what I was paid**	**Amount Received**	**Category**
Total			

You can use this helpful template to record and track your monthly expenses:

What did I pay for?			
Date	**Description of what I paid for**	**Amount Paid**	**Category**
Total			

Bookkeeping Pro Tip:

Label your receipts so that you remember which category they belong in.

Accounting Pro Tips:

Stick to a regular schedule! Make sure you regularly update your records, whether monthly, every other week, or every week. This will save time and headaches in the future. Leaving your expenses and revenue to pile up will not help you. You can't understand how your business is doing on a moment's notice, nor will you be able to keep up with your accounting system if it involves an intimidating pile of receipts and statements.

Consider an electronic system. It can be tedious to do accounting by hand. So, you may want to create a simple spreadsheet or even get an online system. When looking for online systems like QuickBooks, FreshBooks, or Xero, consider their ease of use, cost, and complexity. Many of you with a small business may not need QuickBooks or other more complicated systems. Perhaps a simpler, less expensive system that is easier to use would be preferred and work better for your goals. Make sure you keep all your records, whether you take photos or scan each receipt and statement and save them electronically, or just store everything in a box. It is important to save these documents in case you are audited by the IRS. It also allows you to go back and check your information, if needed.

Resource 7: What is Depreciation?

Understand depreciation and how it impacts your financials.

Depreciation can be confusing, but if you make any single asset purchases or property improvements over $2,500 for your home-based child care business, such as cars, furniture, computers, or a new roof, you need to understand depreciation and how it can impact your business.

Depreciation impacts the timing of revenue and expenses which may increase your taxes when you make a large purchase or improvement but lowers your taxes in future years. Typically, when you have an expense, it is fully deducted in that year "offsetting" the same amount of revenue earnings. For example, let's say you buy a $100 table. You made $100 and you get to deduct $100, so the impact on your taxes is $0—since the $100 was spent on a deductible expense.

Depreciation changes this offset. Let's say you used $20,000 in revenue to purchase a new van. In this case, your taxes would reflect the $20,000 in revenue, but you would only be able to deduct $4,000 in the first year (we'll explain why later). As a result, you would have $16,000 in taxable revenue (that is, the $20,000 - $4,000 in depreciation leaves $16,000 in revenue).

In this resource, we'll review the basics of depreciation and how it works so you can understand when you need to prepare for higher taxes and when you don't.

This document should not be considered tax advice. Please consult with an or accounting professional for specific guidance and information regarding depreciation for your business.

What is depreciation?

Key Terms

Asset - property you acquire to help produce income for your business. Assets are subject to depreciation. An asset is a single item, not a group of items. For example, an office sofa that costs $3,000 rather than 10 chairs that were $300 each.

Basis – the full cost of an asset to you, includes purchase price, sales tax, freight, and other costs.

Depreciation - an annual income tax deduction that allows you to recover the cost or other basis of certain property over the time you use the property. Usually, you must depreciate single item purchases over $2,500.

Improvement – a renovation that enhances the value of or improves the life of property.

Repair – fixing the normal "wear and tear" of an item, such as replacing shingles that fell off, but not the whole roof.

Time-Space – a calculation that allows home-based child care businesses to determine their business use of certain property. Providers must first apply time-space to the item or property before calculating allowable depreciation.

Whenever you make a business purchase that you will use for more than one year, the Internal Revenue Service (IRS) requires it to be depreciated. This means that you will deduct the cost on your business taxes over time, rather than only the year when you purchase it. Instead of getting all the deduction in one year, you get it slowly, over a number of years. Depreciation can apply to many things in your business including:

- Furniture
- Appliances such as dishwashers
- Computers
- Buildings that you own and renovations
- Vehicles

What is subject to depreciation? To determine if a purchase that you make for your business is subject to depreciation you need to ask the following questions.

1. **Is the item "ordinary and necessary" for your business**? – that is, do you need this to run your business? This is an interesting opportunity for home-based child care business owners since it may make home improvements eligible for deductions (more on that later in this resource).

   If it is, then move to the next question. If the item is not "ordinary and necessary" for your business, then it is a personal expense that is not deductible on your business taxes at all.

2. **Can the item last more than one year? –** For example, paper towels will likely be used up in a year, so they would not be eligible. However, a desk or a newly installed deck (for a home-based child care provider) would be items that will last more than one year.

   If the item can last more than a year, then move to the next question. If the item cannot last more than one year, then treat it as a typical business expense that would not be subject to depreciation.

3. **Is the value more than $2,500?** – Any item, even one that could last for years, that has a value of less than $2,500 is considered a "safe harbor" and can be deducted all in one year and without being subject to depreciation. Keep in mind, that this is a per-item limit. For example, if you purchased 50 chairs for $100 each, even though the total bill was $5,000, each chair is less than $2,500 so depreciation will not need to be applied.

   If the value is more than $2,500, then move to the next question. If it is less than $2,500, then treat it as a typical business expense.

4. **Is this a repair or maintenance cost?** – Costs to repair or maintain items for your business, including your home for child care providers, can be expensed in one year and will not be subject to depreciation. For example, let's say you have your roof shingles repaired and it cost $3,500. As a repair, you would still be able to deduct it in one year and depreciation will not be applied.

   If it is not a repair or maintenance cost, you'll need to depreciate the item. If it is a repair or maintenance cost, report it as an expense on your tax return.

Additional Information for Home-Based Child Care Providers
There are two other considerations in determining if an item is subject to depreciation for home-based child care providers. First, if an item is exclusively used for your business (for example, a business computer), 100% of the depreciation can be applied to your business. However, if an item is mixed with personal and business use, like a new cooling system, you will need to determine the amount of business use (and deductible amount) using the time/space calculation.

Second, home-based child care providers can deduct the depreciation on their homes. Home depreciation is based on the value of the home and any renovations (improvements to the home that increase its value, such as a new deck), but not the value of the land itself. The best way to determine the land value is through your local assessor's office and then subtract that amount from the total value of your home. For example, if you purchased your home for $400,000 and the assessor valued the land at $75,000, then your total depreciable amount would be $325,000.

Pro Tip: Note that when you sell a home where you operated a business, you will need to pay a tax on the depreciation that was allowed or allowable. That means that even if you did not utilize the deduction during the years you operated the business, you will still be liable to factor in allowable depreciation expenses when determining your basis and gain on the sale. This is called depreciation recapture. While a certain amount of the sale of your home will be excluded and not counted as a capital gain, the recaptured depreciation amount will be taxable at a rate of up to 25%. The tax rate will be based on your ordinary tax rate for the given year. Accordingly, it is a good45 practice to deduct your home when you can to get the benefit of value that will be eventually taxed. More information on this topic can be found in the IRS Q&A.

How do I depreciate an item?
Once you have identified a depreciable item, you need to determine how you can expense it.

The most basic way to figure out how much you can expense in a given year is called **straight line depreciation**—though there are some other methods your tax professional may use.

In this calculation, you take the total cost of the item and divide it by the total number of years that the IRS says is the life of the item. Here are some common useful life values from the IRS:

- Office furniture, fixtures, and equipment – 7 years
- Automobiles – 5 years
- Land improvements – 15 years
- A building (or house) used in part or whole for business – 39 years

You can find the current list of all life values in IRS Publication 946, here.

For example, a land improvement such as a new driveway is considered by the IRS to have a 15-year life. So, if you paid $15,000 for the new driveway, you could deduct $1,000 a year in depreciation for it, for 15 years ($15,000 divided by 15).

Accelerating depreciation

Another option in addition to straight line depreciation is to accelerate your depreciation faster which allows you to expense your purchase quicker. Namely, you can accelerate your depreciation through three special rules:

1. **Section 179 depreciation** is allowable for physical property used for your business more than 50% of the time. Examples of allowable property are office equipment, furniture, vehicles, and most other assets **that are not buildings, or improvements to your building** (including a home used for business.) If you are a home-based child care provider who wants to use this depreciation method for an improvement to your home, you will need to show 50% or greater business use. As another example, for a vehicle, such as a van for transporting children, you will need to show that the miles driven for business purposes are at least 50% or of the total miles driven for a year if you are using this method (alternatively, you can depreciate the car based on the percentage of use for business versus personal driving using straight line depreciation).

   For the 2023 tax year, you can write off up to $1.16 million in eligible Section 179 expenses. This maximum amount gets smaller if the cost of all the Section 179 property you put to use in the year goes over $2,890,000. The one exception is cars that have a limit to a single-year deduction based on weight. Information on maximum deduction based on weight can be found in Publication 946. You also need to make sure you prorate your costs based on the percentage of business use. For example, if you take the total miles driven in the year for your car and 65% of the miles are for your business, you can only depreciate 65% of the purchase price.

2. **Bonus Depreciation** allows you to deduct 80% of certain assets in one year without an upper limit on the total amount you can deduct. To qualify for Bonus Depreciation, the item needs to have a useful life of 20 years or less (so it does not apply to your home) and only the business use cost is allowable.

   One exception, like Section 179 depreciation, is there are separate rules for vehicles. For vehicles under 6,000 pounds, you can expense $19,200. For vehicles over 6,000 pounds, but less than 14,000 pounds, they do not have a limit. Just like Section 179 depreciation, you need to use the vehicle for your business at least 50% of the time based on the total miles driven and the amount of depreciation must be adjusted by the business use.

   Bonus depreciation will be 80% in 2023 and will continue to decrease until it ends completely in December 2026.

3. The **Safe Harbor for Small Taxpayers** can provide another way to accelerate depreciation. This rule comes out of the IRS Tangible Property Regulations and allows providers to deduct repairs or improvements to the home (for home-based child care providers) or a facility that total the lessor of $10,000 or 2% of the unadjusted basis (that is the value of the property less the value of the land).

   For example, let's say you owned a restaurant building that was worth $350,000 and the land is worth $50,000. The unadjusted basis would be $300,000. Two percent of the unadjusted basis would be $6,000. So, an improvement, like adding an awning that was $5,500, could be deducted in one year since the cost of the awning was less than $6,000.

   For home-based child care providers, you need to also include the time/space calculation. So, let's say a provider's home is valued at $400,000 and the land is $65,000. Their unadjusted basis would be $335,000. Further, let's assume the time/space calculation shows the provider is using the home for business 35% of the time. Now, the unadjusted basis would be $117,250 (that is 35% of $335,000). Two percent of $117,250 is $2,345. So, costs under $2,345 related to repair or renovation could be deducted in one year rather than depreciated over time.

If you use this rule, make sure you or your preparer include a statement with your tax return reading:

> *"Section 1.263(a)-3(h) De Minimis Safe Harbor Election*
>
> *Your name ________________*
>
> *Your address __________*
>
> *EIN or Social Security Number __________*

For the year ending December 31, 20__ I am electing the safe harbor election for small taxpayers under Treas. Reg. Section 1.263(a)-3(h) for the following: (list your improvements).”

It is important to note that state limitations can vary, so depreciation, as described above, may only apply to your federal tax return.

Record Keeping

It is critical to have clear records of your purchases for the depreciation that include what you purchased, when, the total cost, and any indication of the amount of business use (for example, was it 100% for business or a mix of business and personal use?).

It is also important to keep records of your remaining depreciation so that your tax preparer knows to apply it to future years.

Resource 8: Information for My Tax Preparer

Share this with your preparer to provide additional information about this guide.

We have developed this guide to help child care business owners prepare for tax season, but also to make your job as a preparer easier. The guide was developed by expert preparers at Civitas Strategies, who know the child care business and the special tax law around it.

How can I use this workbook?

This guide provides an opportunity for home-based child care business owners to collect critical information, some of it unique to their line of business. You can use the information in this guide and their original receipts and other documentation as you would a "tax organizer" or similar document where you have clients start the preparation process by pulling their revenue and expenses. It should accelerate your process, but, of course, does not supersede the IRS requirement that you check documentation.

What else do I have to know?

Throughout the guide we reference particular IRS rules and regulations for home-based child care businesses. So you have them for your reference, the key IRS and other federal document guides are:

- The Child Care Provider Audit Technique Guide, which focuses on family child care providers, but informs other child care businesses.
- Topic No. 509 Business Use of Home includes information on deducting expenses for the business use of home for home-based child care business owners.
- Publication 463 (2021), Travel, Gift, and Car Expenses which reviews the use of vehicles by a business.
- The Child and Adult Food Program reimbursement rates which can be used by home-based child care providers to simplify the calculation of food costs, regardless of whether they are participating or not participating in the program.

What if I have questions?

Civitas Strategies runs a free platform for helping home-based child care business called *Taking Care of Business*. This site is a useful collection of information on the child care business generally but also specifically on taxation. There's also a link to "ask the experts" where a specialized member of our team will respond to your questions, free of charge.

About the Organizations

The mission of **Home Grown** is to increase access to and the quality of home-based child care. Home Grown envisions a country in which all children have the care they need to reach their full potential (cognitive, social, emotional, health and wellness). Providers offer quality child care and parents have equitable access to quality child care for their children. To achieve this vision, Home Grown will remove policy barriers, strengthen home-based child care practices and business models, and support the growth and recognition of the sector so that all providers offer quality care and parents choose quality care.

To learn more about Home Grown, visit homegrownchildcare.org.

Civitas Strategies is a national management consultancy that has helped mission-driven organizations increase their impact for over 14 years. Founded in 2009 with a vision that no child grow up in poverty, Civitas Strategies' work has impacted over one million children and families collectively served by its clients. The firm's mission is to provide high-value support to help organizations become more efficient, effective, and sustainable. Today, Civitas Strategies specializes in providing training and technical assistance for the child care industry and has conducted more direct coaching and technical assistance for providers than any other organization in the US.

To learn more about Civitas Strategies' services and work, visit www.civstrat.com.