

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 ECE Community of Practice Team:

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 Kalamazoo, and Vibrant Futures.

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Introduction

- ▶ **Michigan's Child Care Stabilization Grant**
 - ▶ Non-competitive grants to child care providers
 - ▶ January, June, October
- ▶ **Licensed 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.

Presentation Outline

▶ The Big Picture

▶ Details

▶ MAIN TAKEAWAY: How you report your grant spending to the State of Michigan does NOT affect your tax.

- ▶ State of Michigan and IRS reporting are related, but do not affect one another.
- ▶ If you report to the State of Michigan that you spent the grant on salaries, your tax bill will be the same as if you report you spent it on supplies.

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 2021 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 2021 tax return.
- ▶ Tell that tax preparer how much grant income you will receive during calendar year 2022.
- ▶ 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 2021 tax preparer cannot tell you, contact a different tax professional.
- ▶ A 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!
You probably will.

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
 - ▶ \$30,000 in grant income during 2022
- ▶ 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
 $\$50,000 - \$10,000 - (.3 \times \$10,000) = \$37,000$

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

With Grant Income

2022 Gross Income \$80,000
 2022 Child Care Expenses \$40,000
 2022 Shared Expenses \$10,000

Net Profit
 $\$80,000 - \$40,000 - (.3 \times \$10,000) = \$37,000$

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

In this example, the tax on \$30,000 in grant income is \$0 (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 \$80,000
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$40,000

Net Profit
 $\$80,000 - \$10,000 - (.3 \times \$40,000) = \$58,000$

Tax Calculation $\$58,000 \times .33 = \$19,140$

In this example, the tax on \$30,000 in grant income is \$6,930 (23.1%).

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 **\$80,000**
 2022 Child Care Expenses \$10,000
 2022 Shared Expenses \$10,000

Net Profit
 $\$80,000 - \$10,000 - (.3 \times \$10,000) = \$67,000$

Tax Calculation **$\$67,000 \times .33 = \$22,110$**

In this example, the tax on \$30,000 in grant income is \$9,900 (33%).

Extra Income vs. Tax Burden

- ▶ The grant will probably increase your taxes, but you should still apply for it!
- ▶ A grant of \$30,000 could increase your tax bill by \$4,500 - \$12,000.

- ▶ **You'll have at least \$18,000 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 grant or other financial aid
 - ▶ Section 8 housing voucher
 - ▶ Social Security or SSDI benefits before full retirement age
 - ▶ ACA health insurance subsidy (Obamacare / Marketplace health insurance)
 - ▶ SNAP
 - ▶ TANF
 - ▶ Great Start Readiness Preschool
 - ▶ Child care assistance
 - ▶ Free school lunch
 - ▶ Utility bill assistance / home heating credit / Affordable Connectivity Program (internet)

Grants and Government Benefits

- ▶ If you qualify for these or other income-contingent benefits:
 - ▶ First, contact your 2021 tax preparer, explain your 2022 grant income and ask for an estimate for what your total income and AGI will be for 2022.
 - ▶ Then, contact your case manager/insurance agent/financial aid office/school district/etc. to ask how your changed income will affect your eligibility for a government benefit. Do this before applying for the Summer grant so that there are no surprises.
- ▶ 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 much of 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 2021 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 income 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.

Grant Reporting

- ▶ For Spring and Summer Stabilization Grants, MDE recommends that you report using the full amount of the grant as “Salary.”
 - ▶ After receiving your grant, write yourself a check or do an EFT for the full amount of the grant. Write “Salary” in the memo line on the check.
 - ▶ Deposit the check into a personal bank account with your name on it. After the check is deposited there, you can spend the money on any business or personal expense.
 - ▶ Obtain a copy of the canceled check from your online bank account or from a bank teller.
 - ▶ Report to MDE that you used the entire grant for salaries.
 - ▶ Upload a copy of the canceled check to MDE.
 - ▶ You’re done! It’s so easy!
- ▶ If you already spent your Summer Stabilization Grant money before writing checks to yourself, you can still report that you spent it on salaries by using your 2022 Schedule C line 31 or a bank statement showing the original deposit into a bank account with your name on it as proof.

Grant Reporting - Example

- ▶ Jane Doe is a home-based child care provider. She received a Spring grant of \$9,500.
 - ▶ Jane writes a check for \$9,500 made out to “Jane Doe.” She writes “Salary” in the memo line of the check.
 - ▶ Jane deposits this check into her personal savings account. She then transfers \$6,000 to her IRA (Individual Retirement Account), spends \$1,000 on child care supplies, and spends \$2,500 to go on vacation.
 - ▶ Jane downloads a copy of the canceled check from her online bank account.
 - ▶ Jane reports to MDE that she spent \$9,500 of her Spring grant on salaries.
 - ▶ Jane uploads a copy of the canceled check to MDE.
 - ▶ She’s done!

Grant Reporting

- ▶ There are benefits to reporting in this way:
 - ▶ It’s simpler for you. You don’t need to worry about expense categories or to determine whether you should report the full amount or the time/space percentage of that expense.
 - ▶ MDE prefers this reporting method. Because this type of reporting is simpler, you are less likely to be contacted by MDE for correction or clarification.
 - ▶ If you are randomly chosen for monitoring, you don’t need to worry. Your reporting was simple, your expense was allowable, and you’ve already uploaded the perfect proof.
- ▶ Grant reporting is separate from income tax returns. **How you report to MDE that you used your grant will not affect your tax refund or tax due in any way.** You will not pay more tax if you report you used the grant for salaries rather than reporting you used it for supplies.

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.

Thank you!

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