NOTE TO TAX RETURN PREPARERS ASSISTING FAMILY CHILD CARE PROVIDERS

Assisting family child care providers (“FCCPs”) with their tax returns generally raises the same issues as for all other home-based businesses, like proper proof of income and expense, separation of business and personal expenses, etc. The IRS and Congress have provided special rules for FCCPs, thereby recognizing the difficulty of separating personal expenses from business expenses in a family child care setting. When assisting FCCPs, tax return preparers should bear in mind that there are special rules (1) for the business use of the home and (2) related to food expenses. This handout is intended to provide tax return preparers with general information on tax issues that affect FCCPs.

FOOD EXPENSES

FCCPs may claim a deduction for food costs related to child care. There are two particular issues related to food expenses for providers to bear in mind. First, the IRS has promulgated rules, under Rev. Proc. 2003-22, to permit FCCPs to use standard meal and snack rates, instead of actual costs. The new rules are particularly beneficial to FCCPs since deducting the actual cost of meals can be a difficult task. This is because in order to prove the actual cost of meals, it is necessary to separate child care expenses from personal expenses, keep child care food in a separate area of their fridge and pantry, and get separate receipts for the food purchased. Instead, the cost of each meal (i.e. breakfast, lunch, dinner or snack) can be deducted at standard rates, provided that the FCCP has sufficient documentation (as outlined below).

In order to use the standard meal and snack rates, an FCCP must (1) provide child care in their home, (2) the care must be non-medical, (3) the care must not involve a transfer of custody, (4) and the care must generally last less than 24 hours. Additionally, the standard meal and snack rates can only be used for meals provided to “eligible children.” Eligible children are children who (1) receive care in the home of the FCCP, (2) do not live with the FCCP, (3) are not children of the FCCP or another resident of the home, and (4) do not receive child care for personal reasons of the FCCP.

The standard meal and snack rates are published each year in IRS Publication 587. The rates are derived from the Child and Adult Care Food Program (“CACFP”), which is a subsidized food program to

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reimburse eligible FCCPs for food provided to enrolled children, funded by the federal government and administered by State agencies (who in turn can contract with independent centers and sponsoring organizations). The standard meal and snack rates for 2014 are $0.71 for each snack provided, $1.28 for each breakfast provided and $2.40 for each lunch and each dinner provided. FCCPs can deduct up to one breakfast, one lunch, one dinner, and three snacks per eligible child per day. The standard rates include beverages, but do not include non-food supplies such as containers, paper products, or utensils.

In order to use the standard rates, FCCPs must maintain records to substantiate their computation of the total amount deductible. The records must include:

- the name of each eligible child;
- dates and hours of attendance in the family day care; and
- the type (breakfast, lunch, dinner, or snack) and quantity of meals and snacks served.

Exhibit A on page 32 of IRS Publication 587 provides a Meal and Snack Log which can be used to keep these records.

Reimbursements that FCCPs receive under CACFP are taxable only to the extent they exceed expenses for food for eligible children. If the FCCP’s reimbursements are more than expenses for food, the difference is taxable income and must be reported in Part I of Schedule C (Form 1040). If the FCCP’s food expenses are greater than the reimbursements, the difference should be shown as an expense in Part V of Schedule C (Form 1040). Do not include payments or expenses for the FCCP’s own children even if they are eligible for the program. This procedure should be followed even if the FCCP receives a Form 1099-MISC reporting a food payment.

OTHER ORDINARY AND NECESSARY BUSINESS EXPENSES

Other than food costs related to the child care, FCCPs can deduct two other business expenses in the year that these expenses are paid: (1) business insurance premiums (provided the insurance covers a period of one year or less), (2) supplies and other consumables used in the FCCP’s business, and (3) gifts to clients as a gesture of goodwill up to $25 per client per year.

CAR EXPENSES

FCCPs, like other sole proprietors, can deduct car expenses attributable to the business use of their car. There are two alternatives for claiming a car expense deduction: (1) the Standard Mileage Rate Deduction, or (2) Actual Car Expense Deduction.

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2 Id.
Standard Mileage Rate Deduction

The Standard Mileage Rate deduction must be elected in the first year the car is available for use in the FCCP’s business. If the FCCP has used his or her car for business purposes in prior tax years without electing the Standard Mileage Rate deduction, this deduction cannot be claimed.

The Standard Mileage Rate allows for a deduction of 56 cents per mile driven for business purposes, 23.5 cents per mile driven for medical or moving purposes, and 14 cents per mile driven for charitable service. If the Standard Mileage Rate deduction is used, the FCCP cannot deduct actual car expenses explained below (including depreciation) except for parking fees and tolls.

If the FCCP uses the Standard Mileage Rate in a prior year, and then elects to use actual car expenses to determine the car expense deduction, the FCCP must use the straight-line method to calculate depreciation on the car.

Actual Car Expenses

The deduction for actual car expenses is the amount of such expenses multiplied by the “business percentage,” which equals the number of miles driven for business purposes divided by the total number of miles driven. Car expenses include repairs, registration, tolls, lease payments, license fees, insurance, parking fees and gas.

A car is “listed property,” therefore it must be depreciated using the straight line method and it does not qualify for a Section 179 deduction or Special Depreciation Allowance unless it is used more than 50% of the time for business purposes. The total depreciation deduction that can be taken on a car in a given year is limited. For 2014, that amount is $11,160. If the FCCP does not qualify for the Special Depreciation Allowance or elects not to take it, the deduction is limited to $3,160. Use Table 4-1 in IRS Publication 463 to determine the amount of the depreciation deduction on a car.4

Car Loan Interest Payments; State & Local Property Tax

Provided the FCCP is self-employed, the provider can take a deduction for the interest paid on a car loan and the state and local property taxes paid on the car. The amount of the deduction is equal to these expenses multiplied by the “business percentage” used for determining the deduction for actual car expenses. An FCCP can take this deduction whether they use the Standard Mileage Rate Deduction or the Actual Car Expense Deduction.

BUSINESS EXPENSES RELATING TO THE USE OF THE HOME

Regular and Exclusive Use of Home

FCCPs may claim a business deduction for the regular and exclusive use of their home for child care purposes. The use of the home is exclusive if an area is used solely for child care, the area is the principal

place of business or the child care is operated in a separate structure. It can be very difficult to prove the exclusive use of an FCCP home for child care, especially if there is no separate structure to run the business. The amount of the deduction for regular and exclusive use of the home depends on whether the expenses are “direct” or “indirect,” and the “area percentage” of the house used for child care.

**Direct and Indirect Expenses:** Direct expenses are expenses for improvements made to the areas in which the FCCP operates the child care, including, but not limited to, painting, repairs, and installation of new equipment in these areas. Indirect expenses are expenses that relate to the use of the entire house including, but not limited to, rent and utility payments, insurance and security system payments, house-wide repairs, including roof damage, and outside painting.

**Area Percentage:** The “area percentage” is the square footage used exclusively for child care purposes divided by the total square footage of the house.

Under the Regular and Exclusive Use of Home deduction, FCCPs can deduct the total cost of direct expenses. Also, FCCPs can take a deduction equal to their indirect expenses multiplied by the “area percentage.”

**Day Care Exception**

When dealing with business expenses related to the use of an FCCP’s home, Congress has provided an exception to the exclusive use requirement under IRC 280A(c), which is set forth in IRC 280A(c)(4). This is called the “day care exception.” Under IRC 280A(c)(4), “day care” providers (i.e., FCCPs) that use their home regularly for child care purposes can deduct expenses relating to the use of their home, even if the use is not exclusive.

Only a provider who has applied for, been granted, or is exempt from having, a license may claim expenses for the business use of their home under the “day care exception.” The amount of the deduction that the FCCP may claim under this exception will depend on (1) whether the expenses incurred are direct or indirect; (2) the area percentage of the house used for child care; and (3) the “time percentage” that the house is used for child care in a year.

**Direct and Indirect Expenses:** The definition of direct and indirect expenses is provided above in the *Regular and Exclusive Use of Home* section.

**Area Percentage:** The area percentage is the square footage used regularly for child care purposes divided by the total square footage of the house. The square footage that is regularly used for child care purposes may include the kitchen, bathrooms and rooms that are used for child care during business hours, and for personal use at other times. FCCPs may also have a laundry room, a storage area or a car in the basement or garage. These areas should also be taken into account when calculating the “area percentage.”

**Time Percentage:** The “time percentage” is the total number of hours used for child care per year, divided by the total number of hours in a year. See IRC 280A(c)(4)(C). In order to calculate the “time percentage,” include regular hours of operation during which the FCCP provided child care (or was paid to provide child care), as well as any time spent on record keeping, accounting, cooking, cleaning and preparing activities for the day care.
Calculating FCCP’s Deduction under the Day Care Exception

To calculate the FCCP’s allowable deduction for direct expenses, direct expenses must be multiplied by the “time percentage.” The resulting amount is the FCCP’s allowable deduction for direct expenses. To calculate the allowable deduction for indirect expenses, the FCCP must first multiply the “time percentage” by the “area percentage.” The resulting number is the “business percentage” of the house. Indirect expenses must be then multiplied by the “business percentage.” The resulting amount is the FCCP’s allowable deduction for indirect expenses.

The deduction calculations under the “day care exception” are made on Form 8829. When dealing with a FCCP who has both “exclusive use” areas of the home and “day care exception” uses of the home, there is no place on Part I of Form 8829 to combine the two. Instead this calculation must be done on an attachment to Form 8829. For more information, please read IRS Publication 587.5

Simplified Method for Business Use of Home

Instead of using actual expenses to calculate the deductions above, FCCPs can use the Simplified Method. The amount of the deduction under the Simplified Method depends on whether the FCCP has an area used exclusively and regularly for child care purposes or whether the FCCP qualifies for the Day Care Exception.

If the FCCP has an area used exclusively for child care purposes, the deduction is $5.00 multiplied by the number of square feet used exclusively for child care purposes up to 300 feet. If the FCCP has an area used regularly but not exclusively for child care purposes, the deduction is $5.00 multiplied by the “time percentage” described above. Then this number is multiplied by the number of square feet used regularly for child care up to 300 feet.

CREDITS

FCCPs often qualify for the Earned Income Credit and the Child Tax Credit. These credits are available regardless of the trade or business of the taxpayer.

Earned Income Credit

The Earned Income Credit is available if the FCCP has a “qualifying child” or meets the following three requirements: (1) the FCCP’s principal place of abode is in the U.S. for more than ½ of the year, (2) the FCCP is over age 34 and under age 65, and (3) the FCCP cannot be claimed as a dependent on someone else’s tax return.

A “qualifying child” for purposes of the Earned Income Credit is someone who (1) has the same principal place of abode as the FCCP, (2) is the child, descendant, sibling, or descendant of a sibling of the FCCP, and (3) is younger than the FCCP, is under age 19, or is still in school and is under age 24.

The amount of the credit is the “credit percentage” times the FCCP’s “earned income” up to a limit. “Earned income” includes net income from self-employment, wages, salary and tips. The credit percentage depends on the number of qualifying children the FCCP can claim. For 2014, the credit percentage is 7.56% for no qualifying children, 34% for one qualifying child, 40% for two qualifying children and 45% for three or more qualifying children. The maximum amount of earned income that can be used to calculate the amount of the credit is $6,580 for no qualifying children, $9,880 for one qualifying child and $13,870 for two or more qualifying children. The Earned Income Credit is phased out if the FCCP has too much earned income. The “phase out amount” depends on how many qualifying children the FCCP has and whether the FCCP is filing separately, or jointly with his or her spouse.

To calculate the amount of the Earned Income Credit, use Worksheet B of Form 1040. To have the IRS figure out the amount of the Earned Income Credit, write “EIC” on the dotted line next to line 66a of Form 1040, and do not fill out lines 74, 75, 76a and 78 of Form 1040.

**Child Tax Credit**

FCCPs can take a $1,000 credit for each “qualifying child.” For purposes of the Child Tax Credit, a qualifying child is someone who (1) is a citizen or resident of the U.S., (2) has the same principal place of abode as the FCCP for more than ½ of the year, (3) has not provided more than 50% of his or her support for the year, (4) is the child, descendant, sibling, or a descendant of the sibling of the FCCP, and (5) is under age 19, or is still in school and under age 24.

**ADDITIONAL RESOURCES**

For additional information on tax issues that affect child care providers, please consult the following publications:


This document was prepared by Public Counsel’s Early Care & Education Law Unit in April 2015 and is meant to provide general information. This document is not all-inclusive and is not intended to provide any individual or entity with specific legal advice. Receiving this document does not create any lawyer-client relationship. For questions or comments, please call the ECE Law Project Intake line at 213/385 2977 ext. 300.

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