



# How do I prepare for tax season?

Learn how to better prepare for taxes in 2021 and beyond.

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**Office of Early  
Childhood and Out-  
of-School Learning**

# Introduction

Taxes are often associated with confusing and overwhelming forms, anxiety about future audits, and fears of a large tax bill. But tax season can be an opportunity for small business owners to save money and head off the risk of future issues.

In this guide we will discuss:

- The importance of taking the time to prepare for your taxes.
- How to analyze your past return for opportunities to do better this year.
- A free resource that shares information to help you prepare for your annual tax filing.

This guide will be most useful to **family child care** and **small center providers** who typically file as a sole proprietorship under Schedule C. That being the case, there will still be useful information for child care providers of all sizes.

## So, how does this work?

While it is our responsibility to pay our fair share in taxes, proper tax preparation can be a vehicle for recapturing your hard-earned profit, thus keeping more money in your pockets, all while reducing costly liabilities for your child care business.

Self-employed small business owners are subject to a 15.3% self-employment tax of their net earnings, or profit remaining after all your expenses have been subtracted from all revenue. Additionally, you are still subject to your general income tax rate on your profit. When you claim all of your expenses correctly, you are creating deductions, which essentially reducing your profit. Your profit is the number you get when you take your revenue, or money coming in, and subtract your expenses, or money going out.

Your business expenses can be claimed as deductions on your taxes, which ultimately impact the amount of money that gets taxed and potentially the rate at which you are taxed. Properly recorded deductions are an area of tax preparation that can help you to increase the amount of profit that you get to keep and mitigate audit risks associated with your business.

For example, if you bring in \$40,000 in revenue and claim no deductions, you will be subject to self-employment tax on \$40,000 and taxed at your general income tax rate on \$40,000. If you bring in \$40,000 in revenue and claim \$10,000 in deductions, your profit is reduced to \$30,000 and you will only be taxed on that \$30,000 profit.

REVENUES	DEDUCTIONS CLAIMED	NET PROFIT SUBJECT TO TAX	TAX LIABILITY (TAXES OWED)
\$40,000	\$0	\$40,000	Higher
\$40,000	\$10,000	\$30,000	Lower

As you can see, deductions help to show all the expenses that you must cover as a small business owner. The higher this number is, the lower your profit and the less you get taxed. Now, this does not mean you can inflate this amount to avoid paying what you owe in taxes because this will increase your chances of getting selected for an audit by the IRS, which can be costly. We will talk more about audit risk in a moment.

## Start by looking backward

Many providers don't realize the missed opportunities they had for deductions to reduce their costs and the audit risks they may have taken.

To help you assess last year's taxes we suggest using the [Confidence in Quality Tax Prep Rubric](#)® developed by Luminary Evaluation Group. The rubric is based on a review of 60 tax returns filed by actual child care providers.

Some of the key findings from the study are:

- 83% of child care providers operating out of their own homes did not claim the business use of their home at all.
- In some cases, providers did not claim any expenses on their tax returns at all.
- Many providers were claiming certain business expenses, which can drastically increase chances of an expensive and time-consuming audit by the IRS.
- Several common deductions were often miscategorized or improperly calculated that when present on your taxes can raise an automated audit alert.

## What are some commonly missed child care program deductions?

When preparing your taxes, it is important to know there are some deductions that are common for child care programs to claim that are often overlooked. Here are the ones many providers miss:

- **Business Use of Home:** Home-based child care providers can claim the business use of their home on their taxes. To determine the business use of your home, you will use the time/space calculation to find the percentage of time and space that your home is used for business purposes. This percentage can then be applied to expenses associated with your home such as rent, utilities, or mortgage.
- **Insurance:** Business-related insurance costs, such as liability insurance, can be claimed on your taxes but this cannot include personal or health insurance.

- **Mortgage Interest:** For child care programs that are not home-based, mortgage interest for a business property that you own can be claimed as a deduction. For home-based providers, this would already be captured in your business use of home calculation.
- **Supplies:** Supplies are another commonly overlooked deduction. This can include classroom supplies, learning materials, toys, diapers and wipes, cleaning supplies, etc.
- **Wages:** Total salaries and wages for the year for W-2 employees and yourself, if you pay yourself through payroll, can be deducted on your taxes. Do note that 1099 employees cannot be claimed in this line, only W-2 employee wages.

## What are some things that I should be careful of?

Small businesses are being targeted for auditing by the IRS now more than ever. Many audit triggers are automated formulas that flag certain line items or amounts for certain types of businesses, which can then lead to everything being reviewed with a fine-tooth comb by the IRS. This is time-consuming and often comes with potential costs associated with representation. Here are some frequently misused deductions that providers should be mindful of:

- **Cost of goods sold:** Use of this line could trigger an audit alert since it would be extremely uncommon (if ever used) in child care. Generally, this line is referring to inventory that a business has on hand that they were not able to sell or get rid of.
- **Deductible meals:** Based on what we have seen in the amounts and frequency with these claims, providers may be entering costs into this line when they are referring to meals they are serving children though it is intended for business-related meals. A high dollar amount in this line for a child care program can appear like you are trying to deduct all of your personal meals in your business expenses.
- **Car and truck expenses:** Car and truck expenses are a great deduction, as long as you are only claiming the amount of your vehicle and associated expenses that are used for your business. Also, you will need to make sure that you are following [IRS guidelines](#) for these expenses.

## Assessing last year's taxes

You can easily assess your taxes by using the *Confidence in Quality Tax Prep Rubric*® for Child Care Providers.

Here's how to do it:

- 1 Get your tax return from last year. We are going to focus on the Schedule C (profit and loss from a business) in your 1040 return since that is most commonly used by child care providers.
- 2 Go item by item using **Confidence in Quality Tax Prep Rubric**®.
- 3 Note where you can do better and share it with your tax preparer.

It is also important to know that you can revise your taxes for up to three years after they are submitted. So, if you find opportunities for deductions or ways to head off a potential audit when you review last year's taxes, share your concerns with your preparer or use your online software to make appropriate changes.

## Preparing for next year

Now that you have an idea of how you can more effectively report your revenue and costs for your taxes, you need to collect the numbers for this year and find the best preparer you can. Whether you choose to prepare your taxes yourself or use a qualified professional, be sure to refer to the *Confidence in Quality Tax Prep Rubric*® to make sure you are maximizing your deductions and minimizing your risks.

We recommend using **this tax prep guide** from Home Grown Child Care. The guide is designed for family child care providers, but will work with almost any provider who reports their business taxes on a Schedule C.

Remember to fill the rubric out fully and capture all of your deductions!