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ABSTRACT

Women who provide day care in their own homes augment their modest earnings in some cases if they take afvantage of deductions permitted under the Internal Revenue regulations concerning use of private homes for business purposes. Where combined family income is at a level where income tax is payable, it may be profitable to calculate all permissible deductions and to reduce the tax owed, thereby effectively increasing the amount of disposable income. Allowable deductions include both direct expenditures such as cost of food and toys, as well as indirect costs, such as mortgage payments, rent, or utilities. Illustrative examples of various deductions are given to demonstrate the necessary computations and the minimum record keeping procedures required by family day care mothers in order to claim the deductions. The illustrated deductions in the hypothetical example reduce taxable income by almost one half. (Author)

Southeastern Day Care Bulletin No. 1

INCOME TAX DEDUCTIONS FOR FAMILY DAY CARE HOMES

June, 1971

SOUTHEASTERN DAY CARE PROJECT

Southern Regional Education Board
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INTRODUCTION

The Southeastern Day Care Project is a three-year demonstration made possible by grants from the Donner Foundation and Title IV-A of the Social Security Amendments of 1967. The program is being carried on in Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee. The Southern Regional Education Board has responsibility for coordinating the Project, providing training and assistance, and evaluating the program over the three-year period.

From time to time in the course of our activities, we prepare materials for use in our programs or we conduct informal studies to supplement or expand data that we are collecting. Some of these seem to be of general interest and might be helpful either to our own program or to other day care projects. Therefore, we have decided to make such information immediately available rather than wait to incorporate it in a final report.

This is one of a series of bulletins around a variety of topics related to day care.

Nancy E. Travis, Director
Southeastern Day Care Project

INCOME TAX DEDUCTIONS FOR
FAMILY DAY CARE HOMES

Eva C. Galambos, Ph.D.

The modest earnings of women who provide day care in their own homes may be augmented in some cases by these women if they take advantage of deductions permitted under the Internal Revenue regulations concerning the use of private homes for business purposes. The fees or earnings received by family day care mothers constitute income, and as such must be reported on the income tax returns.

In instances where combined family income, including the mother's day care earnings, is so low that no tax is due, it would probably not be worth the effort to calculate the permissible deduction. However, where combined family income is at a level where income tax is payable, it may be profitable to calculate all permissible deductions and to thereby reduce the tax owed (which increases the amount of disposable income). These include direct expenditures on child care, such as cost of food and toys, as well as indirect expenditures related to the use of the house, such as mortgage payments, rent, or utilities. Examples of the type of income deductions which are permitted are discussed below.

Direct Expenditures

For a self-employed person, such as a family day care mother, the calculation of profit or loss derived from the fees she received would be made for tax purposes on the Internal Revenue Form 1040 Schedule C. Gross receipts represent the total fees she has received for the year.

Deductible direct expenses include the amount she spent for food for the children other than her own, toys and supplies for their play and care, or cost of advertisements she may have placed in local papers. Although she need not maintain a record of all food expenses incurred during the year, she should have some type of record to justify the amount claimed. An example of such evidence would be purchases made in one week required for the meals of the children in her care (other than her own).

For instance: Items bought for feeding three children breakfast and lunch week of September 5, 1970:

3 loaves of bread @ .31	.93
1 box of cereal	.55
1 package of bologna	.41
2 packages of cheese @ .35	.70
3 cans of soup @ .23	.69
3 cans of juice @ .39	1.17
$1\frac{1}{2}$ gallons of milk @ .36/qt.	2.16
3 cans of applesauce @ .21	.63
3 pounds of bananas @ .15	.45
1 box of cookies	.49
1 carton of eggs	.51
1 jar of mayonnaise	.59
	$ 9.28
Cost per child per week ($9.28 divided by 3)	$ 3.10
Number of child-weeks = 129 (sum of number of weeks each child was in care during year)	
Total food cost ($3.10 x 129)	$ 399.90

The family day care mother should keep receipts for expenditures on items such as cribs, toys, or newspaper advertisements to facilitate the claiming of these deductions.

Indirect Expenditures

The calculation of indirect or other business deductions includes a determination of the amount to cover the use of the house where the house is regularly used to care for other children.

A pro rata portion of expenses such as mortgage interest, property taxes, rent and utility payments is deductible as a business expense. There are various ways of determining the pro rata portion. If the entire house is available for and used in child care, and the children are in the home half of the day; then one-half of the rental, utility bills, or mortgage payments would be deductible. If only some rooms of the house (one bedroom, kitchen, and den) are used in child care, then the square footage of those rooms should be calculated as a percentage of the entire house to determine the pro rata deductible portion. For example, where three rooms used for child care represent a total of 540 square feet, and the entire house is 1620 square feet, then one-third of the monthly rent or mortgage payment of $250 may be allocated for business purposes. If these rooms are used for child care one-half of the day, one-sixth (or 1/3 x 1/2) of the rent or mortgage payment of $250 a month (or $41.67) is deductible. This represents an annual deduction of $500. The monthly utility bills may be pro rated in similar fashion:

Average monthly water and sewer fee	$ 4.00
Average monthly electricity bill	12.00
Average monthly gas bill	8.00
	$ 24.00

Multiplying $24 by one-sixth (or 1/3 of house space x 1/2 of total day) nets $4 monthly for a total $48 annual deduction.

The amount that may be deducted from the telephone bill is not related to the portion of the house used for business, but rather to the time the telephone is available and needed for business use. If day care is provided for 12 hours per day, one-half of the monthly telephone bill (approximately $60 per year) would be deductible.

If the home is owned by the family day care mother, depreciation may also be deducted. In order to calculate depreciation it is necessary to determine the current value of the house, less land which does not depreciate. A recent property tax statement may be used as evidence. If assessments are on a 50 percent rate, and the assessment for tax purposes is $8,000 on the house and $2,000 on the land, the current value of the house is $16,000. Applying the one-sixth pro rata share, the current base for depreciation of the home allocated for business use is $2,667. The next step is to estimate the property's useful life and salvage value. The useful life is the number of years one expects to continue the child care business in one's home. If a mother plans to continue 10 years until her own children are finished with high school, the useful life is 10 years. The salvage value is the estimate of the value of the portion of the house used for business at the end of 10 years. The basis for this estimate may be the current prices of similar homes that are approximately 10 years older, adjusted for an inflation factor.

Assuming a 10-year estimate of the time day care will be provided in the home, and a $12,000 estimate for the value of the home in 10 years, the salvage value is $12,000 x1/6 or $2,000.

The basis for depreciation	$ 2,667
less the salvage value	2,000
nets a depreciation amount of	$ 667 for 10 years, or 66.70 depreciation deduction per year.

The cost of major renovations made to the home, such as roof repairs or new kitchen floors, may be depreciated in the same manner as shown for the value of the home.

The cost of major equipment such as a washing machine, if necessary for child care, could also be distributed and depreciated for deductions. For instance, if a larger refrigerator is purchased for use in the day care business, and approximately one-half of the weekly total food expenses are made for the children in the day care program, then one-half of the refrigerator is used for business. If it costs $300, with a useful life of 10 years and a salvage value at the end of $30, then the base for depreciation is $300 x 1/2 business use, or $150 less $30, or $12 per year.

The deductions described above total $1,087.60. If a day care mother has had 129 child care weeks in a year at $20 per child week, her gross receipts would be $2,580. However, the deduction of $1,087.60 described above reduces her taxable income by almost one-half to $1,492.40, which could produce considerable tax saving, depending on the amount of total family income.

As a safeguard, it is advisable that receipts, canceled checks or similar evidence relative to any of the expenses described above be kept by the family day care mother for three years from the date of the tax return to which the expenses pertain.

Family day care mothers, as self-employed persons, are liable for self-employed social security payments. The computation of this payment is made on Form 1040, Schedule E at the time the income tax return is filed. On the net profit shown in the above hypothetical example, the social security tax owed in 1970 would be $1,492.40 x .069, or $102.98.