Family Child Care

Record-Keeping Guide

Eighth Edition

Being a Family Child Care Professional

Family child care is a special profession for those who love young children. As a professional family child care provider, you must balance the skills required to care for children with those required to operate your business. Here are some tips to help you do this:

- Learn the child care regulations for your area, and follow them.
- Join your local family child care association.
- Sign up with your local child care resource and referral agency.
- Join the Child and Adult Care Food Program (CACFP).
- Find good professional advisors (such as a tax professional, insurance agent, and lawyer).
- Actively participate in training to acquire and improve your professional skills.

Additional Resources

Redleaf Press and Resources for Child Caring are two leading national organizations that share the goal of helping your family child care business succeed. Resources for Child Caring (www.resourcesforchildcare.org) can answer your business questions; its Web site is filled with free handouts, articles, and newsletters. Redleaf Press (www.redleafpress.org; 800-423-8309) publishes resources for family child care and offers the following publications to support your business. For more information, see www.redleafpress.org.

- Starting a family child care business:
  Family Child Care Business Planning Guide

- Promoting your business:
  Family Child Care Marketing Guide

- Creating contracts and policies:
  Family Child Care Contracts and Policies, 3rd Edition
  The Redleaf Complete Forms Kit for Family Child Care Providers

- Keeping accurate records and filing your taxes:
  The Redleaf Calendar-Keeper: A Record-Keeping System for Family Child Care Providers
  Family Child Care Tax Workbook and Organizer
  Family Child Care Tax Companion

- Reducing business risks:
  Family Child Care Legal and Insurance Guide

- Managing your money and planning for retirement:
  Family Child Care Money Management and Retirement Guide

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Redleaf Press and the author are not engaged in rendering legal, accounting, or financial advice or any other professional services, and we are not responsible for the outcome of how the information in this book is interpreted or applied. If you require legal or expert tax assistance, obtain the services of a qualified professional.

This publication is designed to provide accurate information about federal tax record keeping for family child care providers. Despite our attempts to explain the tax laws thoroughly and in a simple manner, errors and omissions may occur in this text. Tax laws are in a constant state of change.

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Part II: Deducting Expenses

Preface

It has been over five years since I wrote the seventh edition of this book. Since that time, Congress and the Internal Revenue Service (IRS) have made many changes to tax rules that affect family child care providers. There have been changes in depreciation rules, adjustments to food and mileage rates, and clarifications on how to calculate the Time-Space percentage. I have been involved in many IRS audits and have represented providers in several Tax Court cases over the past five years that have also clarified numerous rules.

Further necessitating this eighth edition, the IRS published a revised version of the IRS **Child Care Provider Audit Technique Guide** in May of 2009. This online publication helps IRS auditors better understand the issues that arise when auditing family child care providers. I made a series of recommendations to the IRS to clarify particular tax rules, and the revised IRS **Child Care Provider Audit Technique Guide** incorporates many of them in ways that are favorable to providers. Throughout this eighth edition, I have highlighted these new clarifications from the IRS. A copy of the guide is posted on the National Association for Family Child Care (NAFCC) Web site at www.nafcc.org.

As with every edition of the *Family Child Care Record-Keeping Guide,* this book is specifically for those who care for children in their homes and get paid for it. Many child care providers pay more in federal taxes than necessary because they don't keep careful track of their expense deductions—either because they think it's too much work or because they don't know what expenses are deductible. This book addresses both problems by explaining record keeping in a simple manner and by identifying more than one thousand tax deductions.

The information in this book applies to child care providers in every state, regardless of local regulations. If you pay close attention to the recommendations in this book, you will be able to claim the maximum allowable deductions and pay the lowest possible federal taxes. Please be aware that this book only covers federal tax rules; you should consult your state tax laws for additional regulations that may affect your business.

Keeping Up with the Changing Tax Laws

This edition of the *Family Child Care Record-Keeping Guide* is based on tax law as of December 31, 2009. Changing laws may eventually make some of the statements in this edition outdated. Visit the National Association for Family Child Care (NAFCC) Web site at www.nafcc.org for announcements of any tax changes that affect family child care providers and to see an extensive collection of materials on family child care record-keeping and tax issues. I also write a monthly e-newsletter for NAFCC members where I update providers on changes in tax laws and other business issues. Past issues of the e-newsletter are posted on this Web site. I encourage you to join NAFCC.

For updates about IRS auditing procedures, visit my IRS Audit Center on the NAFCC Web site. It includes many articles, Tax Court cases, Revenue Rulings, and other IRS documents that can help you if you are audited. All IRS resources cited in this book can be found on the NAFCC Web site.

Each January, Redleaf Press publishes an annual update of the *Family Child Care Tax Workbook and Organizer*. This book will help you prepare and file your own tax return. It contains the most current and comprehensive tax information, instructions for using specific forms, a special chapter on record-keeping tips, and a family child care tax organizer to make it easier to transfer your records and receipts to the tax forms.

Redleaf Press also publishes the *Family Child Care Tax Companion* annually. This book is for providers who use tax professionals to prepare their tax return. It contains a series of worksheets for you to fill out and give to your tax professional. It will help you and your tax professional avoid mistakes on your tax return. Visit the Redleaf Press Web site at www.redleafpress.org for more information about the *Tax Companion* and the *Tax Workbook and Organizer*.

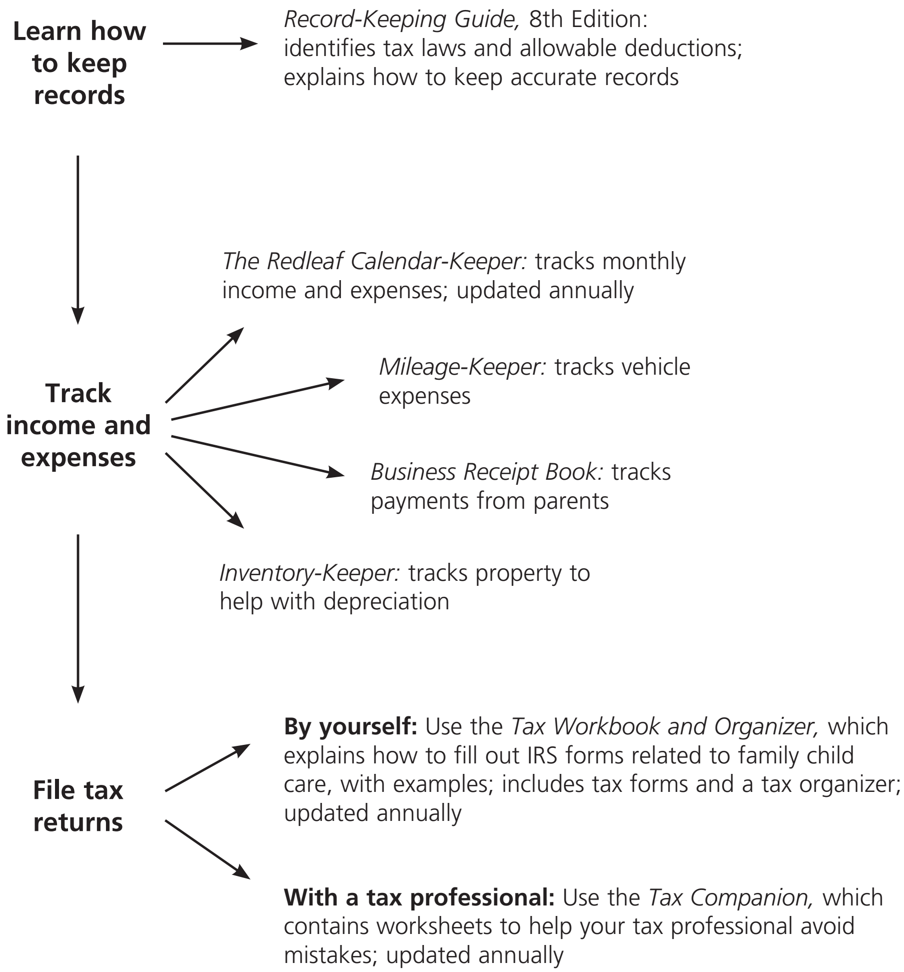
Record-Keeping Resources from Redleaf Press

The *Family Child Care Record-Keeping Guide* is most effective when it is used in combination with the other Redleaf Press publications that have been designed specifically for the business needs of family child care providers. Although all of these items may be purchased and used separately, together they offer the benefits of a complete, customizable record-keeping and tax preparation system. These business resources include the following publications:

- The *Family Child Care Tax Workbook and Organizer* explains how to fill out your tax return each year. Use this book if you are doing your own taxes.
- The *Family Child Care Tax Companion* is designed to help make your tax professional's job easier and to prevent errors on your return. Use this book if you hire a tax professional.
- *The Redleaf Calendar-Keeper* contains monthly income and expense charts that enable you to conveniently organize your records. It also contains special charts to track your meals and snacks.

- The *Family Child Care Mileage-Keeper* is a mileage log to help you track your vehicle expenses.
- The *Family Child Care Business Receipt Book* contains a set of carbonless receipts to help you track individual parent payments.
- The *Family Child Care Inventory-Keeper* is a depreciation log to help you track your business and household property.

The diagram that follows illustrates how you can use the publications in this series to keep your records and prepare your taxes. Visit www.redleafpress.org for additional information about books available from Redleaf Press.



About Tom Copeland

Tom Copeland, JD, is a writer, trainer, lawyer, and consultant on family child care business issues nationwide. He has conducted record-keeping, tax preparation, and business workshops for family child care providers across the country since 1981. Tom proposed that the IRS adopt a standard meal allowance rate (see page 38), which the IRS implemented in 2003. He also proposed that the IRS simplify record-keeping requirements for providers who hire part-time employees, which the IRS implemented in 2006. Tom made a number of recommendations to clarify tax rules in the latest version of the **Child Care Provider Audit Technique Guide**, which the IRS adopted in 2009.

Tom has represented numerous providers in IRS audits and has won five U.S. Tax Court cases.

In 2003, Tom received the Friend of NAFCC Award from the National Association for Family Child Care (NAFCC). In 2004, he won the Advocate of the Year Award from NAFCC. He has also won Child Care Advocate of the Year awards from the Minnesota and Nebraska Family Child Care Associations.

Tom is the author of numerous books including *Family Child Care Tax Workbook and Organizer* (updated annually), *Family Child Care Tax Companion* (updated annually), *Family Child Care Contracts and Policies, Family Child Care Marketing Guide, Family Child Care Legal and Insurance Guide* (with Mari Millard), *Family Child Care Money Management and Retirement Guide, Family Child Care Business Planning Guide*, and corresponding business curricula for trainers on many of these family child care topics. All of these resources are available from Redleaf Press; visit www.redleafpress.org for more information.

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The Business of Child Care

Family child care can be both difficult and rewarding. Few people give as much of themselves or accept more responsibility than the family child care provider. And few are more deserving of the satisfaction that comes from helping children learn and grow. As a provider, you know those difficulties and rewards well. However, there are other challenges that are equally important, to which you may not have given as much thought—such as dealing with parents, paying bills, making a profit, doing your taxes, and meeting government requirements.

Taking care of the children is only half your job. The other half is taking care of your business.

It is in your best interest to know as much about taking care of your business as you do about taking care of children. The parents who hire you will appreciate and respect it—and the Internal Revenue Service will demand it.

Since trying to follow all the advice in this book at once would pose a significant challenge for anyone, don't try to read this book from cover to cover. Instead, use it as a guide when you are looking for answers to specific questions about what is deductible and how to keep accurate records. Take your time. If you don't understand something, ask for help. If you try to improve your business skills a little more each year, your success will be assured.

Providing Informal Child Care

As a child care provider, you don't need to have a business name or be registered with your state or Chamber of Commerce in order to be considered a business. All you need to do is open your business and start caring for children. From the standpoint of the IRS, you do not have to be regulated in order to be in business and start claiming expenses.

If the local child care requirements are voluntary, or if you are exempt from them, you may claim all the same business deductions as a licensed or certified provider. For instance, your state may require providers to be licensed if they care for more than four children. If you care for three children, you will be exempt from licensing rules, but you will still be able to deduct the same business expenses as a licensed provider. (You may even claim many expenses if you are operating illegally. See page 88 for further details.)

Top Three Record-Keeping Tips

This book describes many record-keeping suggestions. Here are the three most important points to remember:

- Save your receipts for all the expenses associated with the upkeep of your home (this topic is covered in chapter 1).
- Carefully record the number of meals and snacks that you serve to the children in your care, including all the meals and snacks that are not reimbursed by the Food Program (this topic is covered in chapter 2).
- Track all the hours you work in your home (this topic is covered in chapter 3).

By carefully following these three suggestions, you can ensure that you will claim the most important business deductions that you are entitled to on your tax return. So if all the details in this book feel overwhelming to you, simply focus on these three things.

PART I

Keeping Records

CHAPTER ONE

The Basics of Record Keeping

Chapter Summary
This chapter addresses the importance of good record keeping for your business and summarizes the key rules that you should follow in tracking your business income and expenses.

There are many good reasons to keep complete, accurate, and ongoing records for your child care business:

- You're in business to earn money. Good financial records will tell you at a glance how you're doing. Without them, you may not know.
- Parents are likely to ask you for an account of the payments they have made to you to use in preparing their own income taxes.
- The IRS considers you to be a businessperson selling the service of child care; this means that (except in a few rare cases) you must file a federal income tax return. Good records will help you figure the correct amount of tax that you owe—no more, and no less—and decrease the likelihood that your return will be challenged by the IRS.

Because the information that you need to record is so closely tied to paying your taxes, this book is organized by the tasks that you will need to do to fill out your tax forms. The goal of this book is to explain what you need to know about record keeping in a simple way, not to try to cover every possible detail. If your income and expense situation is unusual or complex, you may need additional information from the IRS or a tax professional.

Record-Keeping Systems

Since the IRS doesn't require you to follow any particular record-keeping system, you can choose to record your business information using *The Redleaf Calendar-Keeper* or any other system that works for you. Here are some of the options for record-keeping systems:

- *The Redleaf Calendar-Keeper* is a wall calendar that allows you to keep all your records in one place. It includes space to record the attendance and payments for each child, as well as your miscellaneous income, deductible business expenses, capital expenditures, and business mileage.
- Minute Menu Kids Pro is a comprehensive record-keeping software program that allows you to track all the records you need for your business: attendance, Food Program, Time-Space percentage, business expenses, mileage, parent receipts, daily reports, and much more. It can generate reports to help you manage your business income and expenses and create the records you need at tax time. For more information, visit www.minutemenu.com.
- The record-keeping methods shown in this book can also be used in an ordinary spiral notebook—simply draw lines to make columns, and then label the columns as shown in the examples.

Other useful record-keeping tools include a calculator, computer, printer, file box or cabinet, manila envelopes to store receipts, file folders, and receipt books. Bear in mind that all the items that you use for record keeping—including pencils and printer ink—are deductible business expenses.

Using a Business Checking Account

Although the IRS doesn't require you to keep a separate business checkbook, doing so can make it easier to track your business income and expenses. Without it, an IRS auditor may take the position that all the expenses paid out of your personal checking account are personal unless you can prove otherwise. Also, if you have only one checkbook, the IRS is more likely to inquire about both business and personal matters than if your business records are separate.

As a family child care provider, you will probably need to write many checks that are only partially deductible for your business (such as utility bills, mortgage payments, and food purchases). Because of this, a separate business account isn't the full solution to keeping your records separate, but it can be a helpful step.

If you do set up a business checkbook, you should deposit all your child care income into this account, and pay as many of your business expenses as possible from it. You may also wish to get a business credit card that is separate from your personal credit cards.

There will also probably be items that you will have to pay for with cash. I suggest that you keep receipts for these cash business expenses, total the amount that you spend each month, and then write a check for that amount from your business account to your family account.

Try not to pay for any personal expenses out of your business checking account. When you need money from your business account for personal use, make out a check to your personal checking account, and record it as a "transfer of income." Checks that you make out to yourself are not business expenses, and cannot be deducted. (This is how you pay yourself from your business.)

Operating Under a Business Name

You may wish to work under a business name—such as "Dee's Day Care" or "Tender Care for Kids"—and have it printed on your checks, advertising, parent contracts, and so forth. Not only can a business name help you set a professional tone with parents and the IRS, it can also help you keep track of your business expenses. For more information about obtaining a business name and using it to market your program, see the *Family Child Care Marketing Guide*.

Once you select your business name, you should register it with your state, which you can usually do through the secretary of state's office. If you don't register your business name, another child care provider could register that name for their business and stop you from using it. Consult your state, county, or city licensing office to see if there are any regulations about using a business name or if you will be required to get a business license (in addition to a child care license). See page 114 for a discussion of deducting the fees that may be involved in this process.

Tracking Your Income and Expenses

Keeping good records is not as difficult as it may appear. Essentially, all you have to do is track all the money that comes in and goes out of your business—specifically, your child care income and your business expenses. Your goal is to have a receipt for every penny of income and expense that is associated with your business.

Your net income (or profit), the money you've worked long and hard to earn, will be the amount that's left after you subtract your business expenses from your business income. This is also the amount that Uncle Sam wants to tax.

Tracking Income

What Is Business Income?

Business income is all the money that you receive in exchange for providing family child care. It includes the following:

- Payments from parents (whether for child care services during the day or for evening babysitting while the parents enjoy a night out)
- Reimbursements for your food expenses from the Child and Adult Care Food Program. Save all your monthly claim forms for the Food Program; this will show the yearly total of your Food Program reimbursements. The reimbursements for the children in your care are taxable income; the reimbursements for your own children are not. See chapter 2 for more information.
- Any payments from a state or private agency for caring for low-income children. Any co-payments that you receive from low-income parents are also taxable income to you. (If you offer a scholarship or reduce your fees for a low-income parent, you can't claim the discount as a tax deduction.)

- Fees for family child care–related services (for example, conducting a workshop for other child care providers)
- Grants from state or local organizations for the purchase of equipment, home improvements, or other business expenses (even if the organization gives you the equipment directly)

Your major source of income will probably be payments from parents for the care of their children. Since you may have some parents who pay hourly, some who pay based on a part-time daily rate, and others who pay based on a full-time flat rate, it is imperative that you keep accurate attendance and payment records for each child. The parents will also need this information for their tax records.

Tracking Attendance and Payments

There isn't one right way to track attendance and payments. However, for each payment you should always record the following:

- the name of the child(ren)
- the date of each payment
- the period of time covered by each payment
- the amount paid and the check number (if paid by check) or the receipt number (if paid with cash)

One way to do this would be to set up a notebook so that you can check off the children's attendance and record the payments that you receive for those days in the same place. Here's an example:

January

	4th	5th	6th	7th	8th	
Louisa	X	X	X	X	X	paid $175 on the 4th √ # 4286
Terri	X	X	X	X	X	paid $175 on the 4th √ # 6912
Michael	X	X				paid $75 on the 4th cash receipt #1

You might also consider using the record-keeping system provided in *The Redleaf Calendar-Keeper* (see next page), which was designed specifically for family child care providers.

Whether you use a notebook or *The Redleaf Calendar-Keeper*, you should keep a monthly total of all your income, as well as a year-to-date total. (Keeping a running year-to-date total will help you avoid the errors that may be caused by adding up long columns of figures.) To calculate your total monthly income, add the total amounts that were paid by all the parents each month, as well as any other child care income that you may have received, as shown in the following example:

MARCH ATTENDANCE AND PAYMENT LOG

CHILD'S NAME	S	M 1	T 2	W 3	T 4	F 5	S 6	TOTAL	S 7	M 8	T 9	W 10	T 11	F 12	S 13	TOTAL	S 14	M 15	T 16	W 17	T 18	F 19	S 20	TOTAL	S 21	M 22	T 23	W 24	T 25	F 26	S 27	TOTAL	S 28	M 29	T 30	W 31	T	F	S	TOTAL	S	M	
Maria		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔							$700
Lupe		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔	✔	✔		$175		✔	✔	✔							$700
Albert		✔		✔		✔		$100		✔		✔		✔		$100		✔		✔		✔		$100		✔		✔		✔		$100		✔		✔							$400
Carol					✔	✔		$75					✔	✔		$75					✔	✔		$75					✔	✔		$75											$300

WEEKLY PAYMENT TOTALS $525 $525 $525 $525 $2,100 total for March

	FOOD PROGRAM INCOME RECVD	PARENT FEE INCOME RECVD	OTHER INCOME RECVD			
MARCH INCOME	$301.32	$2,100		=	MAR TOTAL	$2401.32
BALANCE FORWARD	$425.80	$2,410		=	BALANCE FWD TOTAL	$2835.80
TOTAL Y-T-D INCOME	$727.12	$4,510		=	TOTAL Y-T-D	$5,237.12

Food Program Claim

Date Claim Sent 4/2

Date Check Received 4/30

MEAL COUNT TALLY

BREAKFASTS	
LUNCHES	
DINNERS	2
SNACKS	64

To get your total yearly income, add up all your monthly totals of parent payments and any other child care income. You will record your total yearly income on Part I of **Schedule C Profit or Loss from Business**. (For more complete instructions for recording your business income on **Schedule C**, see the latest edition of the *Family Child Care Tax Workbook and Organizer*.)

Income Report for the Year 20__

Sally Jones	$4,230
Frank King	$2,950
Marie Pirez	$5,600
Elizabeth Dalton	$5,450
Franklin Peters	$1,300
Emmy Washington	$1,500
William Mitchell	$2,560
Lucy Stone	$4,600
Alexander Berkman	$3,800
Total Parent Income	$31,990
Food Program Income	+ $9,000
Total Income	**$40,990**

Recording Income

Almost all family child care providers use the cash accounting method of record keeping. This is a method in which you record your income when you receive it and record your expenses when you pay for them. If a parent pays you in January for care that you provided in December, you report the income for the January year. (This is also true for any Food Program reimbursements that you receive in January for December meals.) However, if you receive a check from a parent in December, and don't cash it until January, you must still count it as December income.

If you buy something on credit in December, but don't pay the bill until January, that is a December expense, because you were legally responsible for it when you signed the credit card receipt in December. If a parent leaves without paying you for care that you have provided, you don't deduct the money that she owes you as a bad debt; you simply don't report it as income (see page 97).

It is a good business practice to make sure that you get paid in advance for the child care that you are providing. Most child care centers make parents pay at the beginning of the week or month, and you should do the same. This will protect you from parents who don't pay on time, or at all, and will help set the proper business tone for your relationship with the parents.

If a parent can't pay the entire bill in advance, ask her to pay a little extra each week until she has paid a week ahead. For example: You charge $180 a week and regularly collect fees on Friday for the next week. Give her a month's notice that you would like her to pay an extra $20 each Friday for nine weeks until you have an extra week of payment in your hands. After that, her payment will go back to the regular $180 every Friday.

Some family child care providers try to avoid paying taxes by not reporting their income. They ask parents to pay in cash and not claim the child care tax credit for their children. In turn, the provider often agrees to charge the parents less for taking care of the children. However, these providers are breaking the law, and if they are caught they will have to pay back taxes, interest, and penalties.

In addition, because they aren't reporting their income, many of these providers probably aren't keeping receipts and records of business expenses. So if they are caught by the IRS, they will have few expenses to claim, and thus will have to pay even more back taxes than they actually owe.

Furthermore, the parents may decide at the end of the year to claim the child care tax credit anyway, despite promising not to do so. The parent is always entitled to claim this credit, regardless of any agreement with you. After reading this book you will understand that there are hundreds of business deductions that you can claim to reduce your taxes. We hope that all child care providers who read this book will report all of their income, claim all of their allowable deductions, and encourage others to do so too.

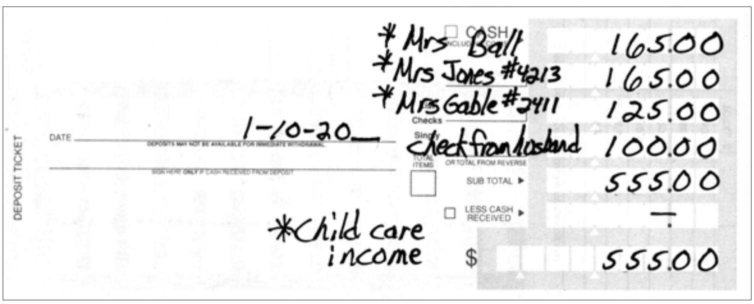
IRS Child Care Provider Audit Technique Guide on Income

The revised IRS **Child Care Provider Audit Technique Guide** recommends that auditors ask providers a lot of questions about their income. This is a reflection of how important the IRS considers the reporting of income in family child care. In other words, the IRS will be initially suspicious that a provider has not properly reported all her income on her tax return and will ask many probing questions in an attempt to uncover unreported taxable income.

The IRS **Child Care Provider Audit Technique Guide** recommends that auditors look carefully for the many different rate terms that may be listed in a provider's contract or policies, such as charges for illnesses, vacations, late pickups, overnight care, transportation, diapers, and so on. The auditor will look to see if you got paid any additional amounts beyond your regular child care rate. Because parent fees are your main source of income, you should take steps to keep careful records that back up the income reported on your tax return.

Here are some suggestions for how to do this:

- Report all income from parents, the Food Program, subsidy programs, and grants on your tax return.
- Keep records showing the source of all deposits to your checking and savings accounts, both business and personal. Indicate on deposit slips (see image below), check registers, a software program, or other record-keeping system where the money for each deposit came from (for example, from your husband's paycheck, a business deposit, or a transfer from your savings account). The IRS might look at your bank deposits and compare them to what you reported as income. If you cannot identify where all the money came from for each deposit, the IRS will assume any unidentified deposits are business income.


DEPOSIT TICKET
DATE 1-10-20
CASH
*Mrs Ball 165.00
*Mrs Jones #4213 165.00
*Mrs Gable #2411 125.00
Check from husband 100.00
SUB TOTAL 555.00
LESS CASH RECEIVED —
*Child care income
$ 555.00

- Make a note on a ledger or calendar if you receive cash from parents but do not deposit all of it into a bank account. Make sure to indicate how much of these cash payments you did deposit.
- Keep attendance records that show when a child is not present (due to sickness, a vacation, or a holiday, for example) and whether a child is enrolled part-time for all or part

of the year. The IRS will initially assume that a child is enrolled in your program for 52 weeks a year at your full-time rate. They will look at your contract to identify your rates. If your rate is $150 a week, the IRS will assume you earned $7,800 a year to care for each child. Your records will need to show if this is not the case.

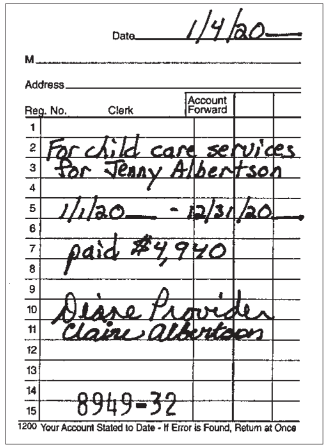
- Keep records that show when you do not receive your full-time rate for a child for part or all of the year (because of a family layoff or other special circumstance). Let's say, for example, that you care for a child for 52 weeks and the child is on the Food Program. Because of a layoff in the child's family, you decide to charge the family half your regular rate for three months. If you are audited, the IRS will look at your Food Program and attendance records and see that the child was present for the entire year. They will assume that you were paid your full rate for the year unless you can show with your payment records that the parent paid a reduced rate for those three months.
- Keep records that show when you choose *not* to charge a fee (for a late pickup, overnight care, early drop-off, or transporting a child, for example). In other words, if your attendance records show that the child was picked up at 7 PM and your contract says the pickup time is 6:30 PM with a $1 per minute late fee, the IRS will assume that you earned an extra $30 each day that this happened. If you are not charging parents for these late pickups, put a note in your attendance records (for example, "No late fee charged").
- Check your sign-in and sign-out sheets for accuracy. The IRS **Child Care Provider Audit Technique Guide** gives an example of a how an auditor might try to verify income using sign-in and sign-out sheets and rate schedules. The example involves a provider who reported $38,400 in income based on her bank deposit records. When the auditor looked at her attendance records and multiplied the days the children were in care with the stated contract rate of $250 a week, the income totaled $61,250. This provider is in trouble because it looks like she underreported her income. How would a provider respond to this situation? The provider might make the case that parents didn't actually pay the stated rate consistently throughout the year for a variety of reasons. To support her position, the provider would need to ask parents to write letters indicating how much they did pay that was less than $250 a week for part or all of the year.

Obtain Parent Receipts

The amount that you report on your tax forms as parent income should be the total of the amounts that your client parents report as child care payments to you on **Form 2441 Child and Dependent Care Expenses**. Parents can claim several thousand dollars in child care expenses on their tax returns—and in claiming those deductions they must also report the total that they paid for child care to each provider.

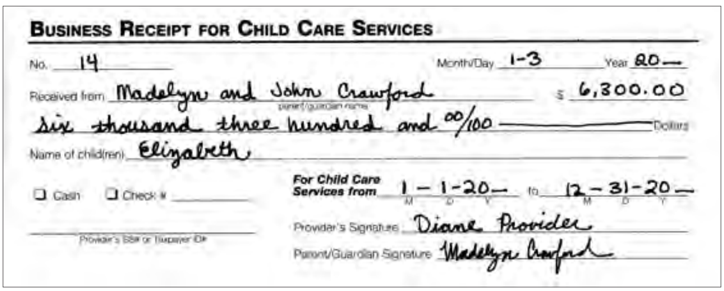
However, the parents may not file the correct total for their payments to you. They may not be able to track down one of their other child care providers, and so may just decide to put all their payments under your number; they may put down more than they paid by mistake; or they may inflate the amount that they paid in order to claim a higher deduction than they are entitled to.

How can you protect yourself from a parent who reports spending more on child care than you received? Your best protection is to prepare a receipt for each client family at the end of the year that shows the name of the child(ren), the amount paid for the year, the months covered by the payment, the date the receipt was signed, your signature, and—most important—the parent's signature.


Date 1/4/20—
M
Address
Reg. No. Clerk Account Forward
1
2 For child care services
3 for Jenny Albertson
4
5 1/1/20— - 12/31/20—
6
7 paid $4,940
8
9
10 Diane Provider
11 Claire Albertson
12
13
14
15 8949-32
1200 Your Account Stated to Date - If Error is Found, Return at Once

Keep a copy of this signed receipt and give the parent a copy. Without the parent's signature, the parent could argue later that the amount is incorrect. If the parent refuses to sign the receipt, mark that on the receipt, and save it.

You can use any of the following forms for these receipts: **Form W-10 Dependent Care Provider's Identification and Certification**, a form from a sales receipt book, or a form from the *Family Child Care Business Receipt Book* published by Redleaf Press. See the illustrations above and below for examples of filled-out receipts using these three methods.


BUSINESS RECEIPT FOR CHILD CARE SERVICES

No. 14 Month/Day 1-3 Year 20—

Received from Madelyn and John Crawford (parent/guardian name) $ 6,300.00

Six thousand three hundred and 00/100 Dollars

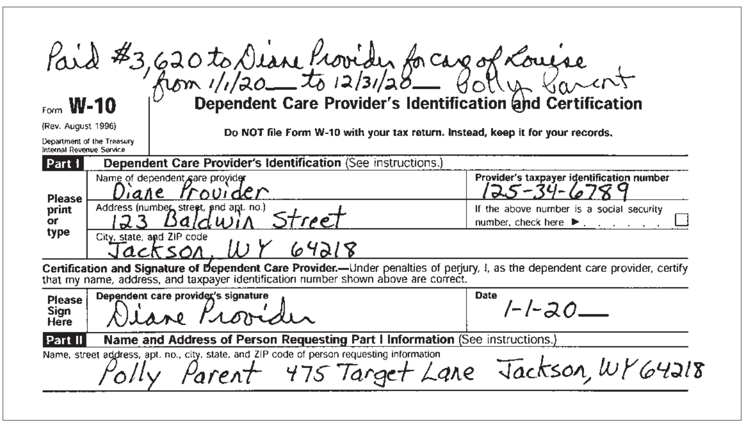
Name of child(ren) Elizabeth

☐ Cash ☐ Check # ______ **For Child Care Services from** 1 - 1 - 20— (M D Y) to 12 - 31 - 20— (M D Y)

Provider's SS# or Taxpayer ID#

Provider's Signature Diane Provider

Parent/Guardian Signature Madelyn Crawford


Paid $3,620 to Diane Provider for care of Louise from 1/1/20— to 12/31/20— Polly Parent

Form **W-10** (Rev. August 1996) Department of the Treasury Internal Revenue Service

Dependent Care Provider's Identification and Certification

Do NOT file Form W-10 with your tax return. Instead, keep it for your records.

Part I **Dependent Care Provider's Identification** (See instructions.)

Please print or type

Name of dependent care provider: Diane Provider

Provider's taxpayer identification number: 125-34-6789

Address (number, street, and apt. no.): 123 Baldwin Street

If the above number is a social security number, check here ▶ ☐

City, state, and ZIP code: Jackson, WY 64218

Certification and Signature of Dependent Care Provider.—Under penalties of perjury, I, as the dependent care provider, certify that my name, address, and taxpayer identification number shown above are correct.

Please Sign Here — Dependent care provider's signature: Diane Provider — Date: 1-1-20—

Part II **Name and Address of Person Requesting Part I Information** (See instructions.)

Name, street address, apt. no., city, state, and ZIP code of person requesting information: Polly Parent 475 Target Lane Jackson, WY 64218

If a client family leaves in the middle of the year, require the parent to sign a receipt for the child care fees that they have paid you for that part of the year. If the parents of a child are separated or divorced, and both parents are paying you for a portion of the child care fees, give each parent a receipt for the amount that they paid you. Never give out receipts that total more than what a parent has actually paid you. If the father gave money to the mother to pay you for child care expenses, give the receipt to the mother for the amount that she paid you, even if she received some or all of this money from the father. If the father asks you for another receipt for the amount he paid her so that he can claim the child care tax credit, don't give it to him. He should claim the credit by working out an arrangement with the mother.

Signed receipts make it less likely that parents will claim an incorrect amount on their child care tax credit forms, since the parent will have to explain why the amount on his tax form is different from the amount on your signed receipt. You can help keep your client parents honest by explaining that they are likely to be audited if the amount they claim toward their child care tax credits does not equal the amount on your receipt.

Gifts and Grants

You must report as income any gifts of cash or gift certificates to you from the parents of the children in your care. This is true even if the parent calls it a "bonus," "birthday present," or "gift." Small gifts of food or merchandise (such as holiday or birthday presents) are not income to you. If a parent gives you a toy, used furniture, or bicycle for your business, don't report it as income unless the item is given partly in payment for your services. However, you may depreciate these items as expenses (see chapter 4). If you are given $500 to attend a family child care conference by a public or private agency or a parent, you must report this payment as business income. If you then spend $500 on conference expenses (travel, hotel, and so on), you may deduct it as a business expense.

Many providers participate in grant programs run by their state or child care resource and referral agency. If you receive cash or equipment from one of these grant programs, you must report it as income, even if you don't receive a **Form 1099G Certain Government Payments** from the agency. The only exception is if you are entitled to the grant only because you have a low income, and the source of the funds indicates to you that this money is not taxable. (Contact your granting agency for further information.)

If you receive cash, and then spend the money on items for your business, or if you receive a large item, such as a swing set, you can deduct the cost of these items as a business expense. Use the regular rules for deducting business expenses described in chapter 4. If you are given an item, base your deduction on the fair market value of the item at the time you received it, and depreciate it. If you received a used sofa that is worth $200, you can depreciate this amount over seven years.

Sometimes child care providers are given a grant with a stipulation that they must return the item if they go out of business within a set period of time. If this is the case, you can treat the item as if you owned it from day one, and you may begin depreciating it in the first year. If you go out of business within the stipulated time frame, you can take the rest of the depreciation in the year that you quit.

Sometimes receiving a grant can create an unplanned tax burden in the year that you receive it. For example, if you receive a $2,000 grant and use it to purchase an egress window, you must depreciate it as a home improvement over 39 years, which means that you will be entitled to about a $50 deduction each year for 39 years. However, you will have to pay tax on the entire $2,000 in the first year. If you go out of business after ten years, you will lose the depreciation for the additional 29 years.

Grants are a great way to get educational items, play equipment, or other resources to help improve the quality of your business—don't pass up these opportunities. While you may end up paying more in taxes, the grant will provide you and the children in your care with worthwhile benefits.

Loans

A loan you receive for any personal or business purpose is not taxable income to you. You may deduct any items that you purchase with loaned funds if you use them in your business, using the normal rules of deductions (see chapter 4). Some loans to family child care providers to buy business equipment are structured so that if you stay in business for two years, the loan is forgiven and you don't have to pay it back. When a loan is forgiven, it becomes a grant, and you will need to report it as income in that tax year.

Military Housing Allowances

There are many child care providers across the country whose spouses work for the U.S. military, and the military offers housing allowances to its personnel based on rank and location—the BAQ (Basic Allowance for Quarters) and VHA (Variable Housing Allowance). These housing allowances are not taxable income to a military family. However, if your family is in the military and you are operating a family child care business, you will need to understand how these allowances affect your business and your business deductions.

1. If Your Family Is Living on a Military Base

The military has its own set of licensing standards that you must meet before you can operate a family child care business on a military base, and these standards supersede any local or state rules and regulations. If you live on base, the housing allowances will be applied toward your living quarters, and your family will pay nothing for housing except telephone costs. Because of this, you aren't allowed to claim as a business expense any house expenses that are covered by the housing allowance, such as rent, utilities, insurance, repairs, depreciation, property tax, or mortgage interest. You can claim part of certain other expenses as business deductions if they aren't covered by the housing allowance: insurance or local taxes on personal property, house repairs, home improvements, and any other business expenses that you pay directly.

2. If Your Family Is Not Living on a Military Base

If you aren't living on a military base, your business won't have to meet any military licensing standards; instead, you'll be regulated under the local and state regulations. In this case, your housing allowance is not taxable income and does not need to be spent entirely on housing costs (regardless of whether your family rents or owns your home).

The IRS Child Care Provider Audit Technique Guide and Military Housing Allowances

The IRS **Child Care Provider Audit Technique Guide** clearly spells out how you can deduct your housing expenses if you are receiving a military housing allowance.

If you own your home, you may deduct the Time-Space percentage of your property tax and mortgage interest as business expenses on **Form 8829 Expenses for Business Use of Your Home** if you meet or are exempt from your local licensing or registration regulations. If you itemize, you can claim the remaining amount on **Schedule A Itemized Deductions**. This is true even if your housing allowance pays for the full cost of these expenses. If you spend less on your housing expenses than your housing allowance, you can still claim the business portion of your property tax and mortgage interest, but you can't claim a portion of any additional housing expenses (utilities, house depreciation, house insurance, and so on).

If your housing allowance doesn't cover the full cost of your housing expenses, you can claim the remaining house expenses by using the following formula: Divide your housing allowance by your total house expenses, and then multiply this number by the business portion of your remaining house expenses. This is the amount that you can't claim; subtract it from the business portion of your remaining house expenses. You can deduct the result as a business expense on **Form 8829**.

Here's an example taken from the IRS **Child Care Provider Audit Technique Guide**. Diane gets a $6,000 housing allowance. She spends $4,000 on property taxes and mortgage interest. Her other home expenses (utilities, home repairs, and home insurance) total $2,500. The home depreciation for her business totals an additional $500. Her Time-Space percentage (the business-use percentage of her home) is 30%. Diane will claim $1,200 as a business expense for her property tax and mortgage interest on **Form 8829** ($4,000 x 30%), and use the following formula for her remaining $3,000 of home expenses:

> Divide the housing allowance by total house expenses:
>
> $6,000 ÷ $7,000 = 85.7%
>
> Multiply the result by the business portion of the remaining house expenses:
>
> 85.7% x $1,250 ($750 [$2,500 x 30%] + $500) = $1,071.25
>
> Subtract the result from the business portion of the remaining house expenses:
>
> $1,250 – $1,071.25 = $178.75
>
> Diane can claim $178.75 as a business expense on **Form 8829**.

If you are living in on-base housing, you can't claim any home expenses except those that you pay out of your own pocket. For example, since you will have no property tax or mortgage interest expenses, no deductions for these expenses are allowed. But if you spend your own money on a home repair, fence, or home improvement, you can deduct the business portion (usually using the Time-Space percentage) of these expenses on **Form 8829** or **Form 4562 Depreciation and Amortization**.

If your family is renting an apartment or home off-base, you are not incurring any mortgage interest or property tax costs, and therefore may not claim these business deductions. If your housing allowance covers all housing expenses, you may not claim any other housing expenses as business deductions. If the allowance is not enough to cover rent and other housing expenses (utilities, renter's insurance, and repairs), you may deduct a portion of your out-of-pocket expenses using the formula as described above.

If you have additional questions about housing allowances and deducting housing expenses, consult a representative from the military, the IRS, or a tax professional. To see the more detailed description of the housing allowance in the IRS **Child Care Provider Audit Technique Guide**, see the NAFCC Web site (www.nafcc.org).

Clergy

Some family child care providers have spouses who are members of the clergy and receive housing or rental allowances. With a few exceptions, the tax consequences of these allowances are similar to those of military housing allowances. For more information, see IRS **Publication 517 Social Security and Other Information for Members of the Clergy and Religious Workers**.

Foster Care Payments

If you care for foster children in addition to running a child care business, the payments that you receive for child or adult foster care under an arrangement with a qualified charitable organization or government agency are not taxable income to you. In addition, you can't claim any expenses for caring for these persons.

If a foster child or adult pays you directly, the payments are taxable income and you must report them on **Schedule E Supplemental Income and Loss**. You may also deduct the expenses that you incur in caring for these foster clients on **Schedule E** (see the instructions for **Schedule E**). However, you can't claim these expenses on **Schedule C** as a day care expense, and then claim them again on **Schedule E**.

For more information, contact your local foster placement agency or see IRS **Publication 525 Taxable and Nontaxable Income**. Also check your state tax rules, since they may be different from the federal tax rules.

Bartering Child Care

Some providers (or providers and parents) exchange child care services; one person will care for the children one day, in exchange for the other person taking the children another day, and no money changes hands. This is known as *bartering*. From a tax standpoint, whenever one person provides services to another person in exchange for something, a taxable transaction has occurred, and both parties must report the value of the service that they received as income or expense, even if no money was exchanged. How would you determine the value of the services exchanged? You would probably look at what you normally charge for such care.

Let's say that you and a parent exchange child care services for three children for one day each. If the amount that you would normally charge for a day of care for three children is $100, the value of the care would be $100, and you should report this amount as taxable income on your tax return, even though you never received any cash. You would also count the $100 that you "paid" the parent as a business expense on your **Schedule C**, under "Other Expenses," as "Outside Labor." Since the care was provided at the parent's home, and the parent is not operating under your direction, the parent is not considered your employee, and this payment would not be subject to any withholding taxes. (For a full explanation of the difference between employees and independent contractors, see chapter 8.)

In addition, if the parent is caring for your child while you are doing an activity that is related to your business, you could count the amount that the parent would normally charge you to care for one child for one day (maybe $35) as a payment toward your personal child care tax credit. The parent would also have to report the $100 that she "received" as income on her tax return. She cannot count the $100 that she "paid" you as a business expense unless she is also in the business of providing child care.

You don't have to report as income any services you receive that are given to you without the expectation that something will be offered in return. This is not considered a bartering arrangement, but a gift.

Increasing Your Income

There are basically four ways that you can increase your income in a family child care business: care for more children, raise your rates, increase your fees, or lower your taxes. Caring for more children and raising rates and fees may be difficult. (For more information about how to set your rates and attract more parents to your program, see the *Family Child Care Marketing Guide.* For more information about increasing your income, see the *Family Child Care Money Management and Retirement Guide.* Both books are available from Redleaf Press.)

Here are some tips to lower your taxes, especially if you are an experienced provider who has been in business for a number of years:

- Open a SIMPLE IRA to build up your retirement fund. The contributions to a SIMPLE IRA and the interest earned on this investment are not subject to income taxes until you withdraw the funds when you retire. See chapter 8.
- Hire your spouse or children to work for your business and set up a health reimbursement arrangement (previously known as a medical reimbursement plan) in which you can deduct 100% of your family's uninsured medical expenses as a business deduction. See pages 159–61.

- Look for ways to cut your business expenses. Use discount or co-op food stores. Ask parents to give you their old toys. Exchange ideas for reducing expenses with other family child care providers.

Tracking Expenses

The Importance of Keeping Good Records

Do you love record keeping? Probably not. But you should look at it as your friend, because it will always help you—and the more you know about your friend, the more it will be able to help you. In fact, from a financial standpoint, the time that you spend on record keeping is probably worth a lot more to you than the time you spend caring for children. Let's see how this works: You'll be paying both federal income tax and Social Security tax on your business profit. In many states you will also owe state income taxes. Your combined tax rate is probably between 30% and 40%, which means that for every $10 of business receipts you record and claim on your tax return, you will save between $3 and $4 in taxes. If it takes you five minutes to record a $100 deduction in your records, you will be "earning" between $36 and $48 an hour for your record-keeping work.

Although for most people record keeping isn't fun, it doesn't have to be a great burden, either. Try to set up a comfortable, convenient method for collecting your receipts and records. Put a box in your kitchen or entryway to remind you to deposit your receipts when you come home from the store. Set up a specific time each week to do your record keeping. Hire an accountant to help you set up a good record-keeping system. Make it your goal to do a better job this year than you did last year. However, also remember that you are just trying to reduce your taxes, not become an expert accountant. You will have three years to correct any mistakes by filing an amended tax return (see page 177).

Save All Your Receipts

Family child care is the business of caring for children in a home. Therefore, the cost of maintaining, cleaning, and repairing your home and the cost of all the household items you use in your business are at least partially deductible as business expenses. This means that you should save receipts for everything that is associated with your home, as well as for your business expenses.

For example, your hammer, floor polish, lightbulbs, garage door opener, and broom are all probably used at some time in your business, so you need to save receipts for these items. You also need to keep complete records of any home improvements (new light fixtures, a new deck, remodeling, and so forth) that you make, since these expenses can also help reduce your taxes.

If you're not sure whether an item is deductible, always save the receipt anyway; you can sort out your deductible expenses at the end of the year. Some family child care providers just assume that they are using about 50% of their toilet paper purchases for their business every year, and so they only save their receipts every other time they purchase it. This isn't a good idea. It's better to save all of your receipts, since this will allow you to prove how much you spent in total, and then you can claim 50% of that amount for your business. If you don't have all business and personal receipts, the IRS may argue that some of your business receipts are actually for personal use.

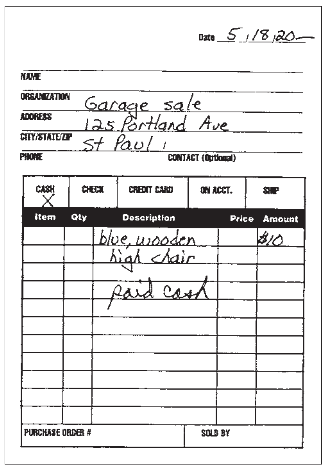
Develop the habit of saving receipts every time you make a purchase—don't skip a week here and there. If you're afraid that a receipt will fade and be illegible by the end of the year, photocopy it. (The cost of copying your receipts is 100% deductible.) If you need to submit your receipts for any other purpose—such as helping your local school buy a computer—make copies of your receipts before you submit them to the school, and get a receipt from the school for the receipts that you submitted.

If you are audited by the IRS, the more receipts you have that show your personal expenses, the easier it will be to claim your business deductions. The reason for this is that there are hundreds of common expenses that may or may not be business deductions. Although personal expenses are not deductible, if you can prove your personal expenses it will be easier to claim that your business expenses really are for business.

For example, if you spent $100 on paper towels for the year, and your Time-Space percentage is 40%, you are entitled to deduct $40 as a business expense. (For more about the Time-Space percentage, see chapter 3.) However, if you only save $40 worth of receipts, the IRS may suspect that this was your total expenditure for paper towels, and demand that you prove that you also purchased paper towels for personal reasons. Although there is no IRS rule that says you must save your personal receipts, you should make a point of saving as many as you can, in case you are ever audited.

Always Get a Receipt

There's no law that requires you to have a receipt for an expense before you can claim it as a business deduction. The IRS regulations simply state that you need to support your claims for business deductions by showing "adequate records" or other "sufficient evidence."



Date 5/18/20—

NAME

ORGANIZATION Garage sale

ADDRESS 125 Portland Ave

CITY/STATE/ZIP St Paul

PHONE CONTACT (Optional)

CASH	CHECK	CREDIT CARD	ON ACCT.	SHIP
X				

Item	Qty	Description	Price	Amount
		blue, wooden		$10
		high chair		
		paid cash		

PURCHASE ORDER # SOLD BY

However, if you're ever audited, the burden will be on you to prove that your deductions are proper, and in that case the best evidence you can have is a complete folder of business receipts. After a receipt, the next best form of evidence would be a canceled check. But a canceled check isn't as convincing as a receipt, because it doesn't provide a record of exactly what you purchased—a check that you wrote to Leonardo's Hardware could have been for a house lock or a watch battery.

Other types of records that are occasionally useful for tax purposes include credit card statements, written records, photographs, or notations in a calendar or notebook. But it is most important to have receipts to back up all your expenses.

So what should you do if a seller doesn't give you a receipt—for example, at a garage sale? The answer is to buy a receipt book and take it with you when you shop. Ask the seller to fill out and sign one of your receipts to record the purchase. If you forget to bring your receipt book, record your purchase in your receipt book as soon as you get home. Write down all the particulars of the purchase, as shown on page 20 for a garage sale item.

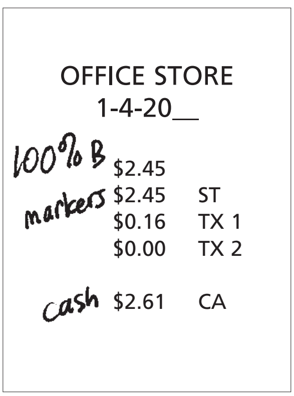
You can also do this if you lose an original receipt and need to reconstruct it. Record the item, the cost of the item, the date and place of purchase, and how you paid for it. The closer to the time of purchase you fill this out, the better. Don't wait until December 31 to try to reconstruct 100 receipts. Also, remember that it's never acceptable to backdate a receipt; that's clearly against the law.

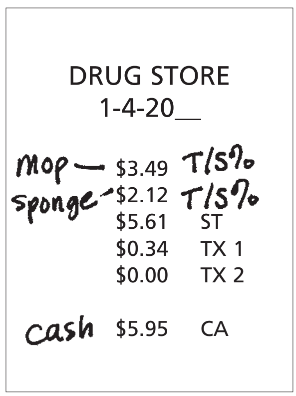
Mark Your Receipts

It isn't enough to just have a receipt, if it doesn't indicate what you purchased, or where or when you made the purchase. All of your receipts need to clearly show the following information:

- the name of the store
- the date of purchase
- the amount paid for each item
- the business portion of each item
- a description of each item
- the method of payment (cash or check)

If a receipt is missing any of the above information, write it on the receipt as soon as you get home. For example, if a receipt doesn't identify the items that you purchased, make those notes on the receipt—"plastic bucket," "mop," and so forth—next to each price. Here are some examples:


OFFICE STORE
1-4-20__
100% B $2.45
markers $2.45 ST
$0.16 TX 1
$0.00 TX 2
cash $2.61 CA


DRUG STORE
1-4-20__
mop — $3.49 T/S%
sponge - $2.12 T/S%
$5.61 ST
$0.34 TX 1
$0.00 TX 2
cash $5.95 CA

If you know that an item on a receipt is strictly for business use, indicate that on the receipt by marking the item "100% B" (or a similar notation). Most deductible items that are used for both personal and business purposes will be multiplied by your Time-Space percentage; indicate those items on the receipt by marking them "T/S%" (or a similar notation). If you know that a particular item will be used more heavily for your business, you can mark your actual business-use percentage next to it. (For information on how to calculate your Time-Space and actual business-use percentage, see chapter 3.)

It's important to mark your receipts promptly after making each purchase, because it will be difficult to remember these details at the end of the year. Marking your receipts like this will make it much easier to identify and claim all your allowable deductions at the end of the year. Here are some example receipts, showing the notations for the deductible portion of each item:

GROCERY STORE
1-4-20__

APPLES	100%	1.49
MILK	80%	1.99
EGGS	75%	1.79
TOTAL	cash	5.27

HARDWARE STORE
1-4-20__

BATTERIES	100%	1.29
LIGHTBULBS	T/S%	2.49
SANDPAPER		.59
TOTAL	check #4721	4.37

Sales Tax

When you claim expenses for your business, you can include any sales tax in the cost of your purchases; you don't need to add up the sales taxes separately and claim them under "Taxes" on **Schedule C**. If a receipt is for items that are used 100% for your business, include the sales tax in the expense. If you are using your Time-Space percentage to claim part of the cost of an item, use the same percentage for the sales tax and include it as part of the expense.

On the sample receipt at right, the first three items, totaling $37.30, are all shared business and personal expenses. Here's how you would calculate how much to deduct for these items: Let's say that your Time-Space percentage is 40%. First you would multiply the $37.30 total by the sales tax percentage (6.5%) to get $2.42 ($37.30 x .065). You would add this to the total of the shared expenses ($37.30 + $2.42 = $39.72). Then you would multiply that total by 40% ($39.72 x .40 = $15.89). The result ($15.89) is the amount that you would deduct.

DISCOUNT STORE
1-4-20__

$12.95	game
$9.40	CD
$14.95	sprinkler
$1.90	hairbrush
$1.90	hairbrush
$41.10	
$2.67	tax 6.5%
$43.77	

Rebates

Sometimes you may receive a rebate for items that you purchase for your business. For example, you might use a newspaper coupon that reduces the price of the item by 10%, or a rebate coupon that is redeemed by mail. In either case, your business deduction must be based on the price of the item after the rebate is taken into account.

For example, let's say that you spend $80 to buy a toy that is used by both your business and your family. After purchasing the toy, you send in a manufacturer's rebate coupon that is worth $10, so the final cost to you is actually $70. If your Time-Space percentage is 40%, your business deduction for this item would be $28 ($70 x .40).

Organize Your Receipts

There are many different ways to organize your records, and it's important to find the method that works best for you and makes it easiest to keep your records up-to-date. Here are some suggestions that other family child care providers have found to be helpful.

Many people like to file their records by month. However, if you put all your January receipts in one file, and all your February receipts in another file, and so on, you'll have to search through 12 files in order to find out how much you spent on utilities for the year. So it's usually better to organize your receipts by category rather than by month—put all your utility bills in one file, all your receipts for supplies in another file, and so on. If you want, you can organize your receipts by month within the file for each category.

You have a lot of leeway in deciding how to organize your records into categories. *The Redleaf Calendar-Keeper* identifies certain categories on its expense pages each month, and also leaves room for you to create your own categories. Chapter 5 divides business expenses into the categories that are listed on **Schedule C**. You can use this as a guide, or you can arrange your items into almost any categories that you wish. But in the end, all your business expenses will eventually appear somewhere on **Schedule C**.

Another idea is that whenever you come home after shopping, mark all the receipts and put them into a "holding" envelope or file folder. Then at the end of the week or month, transfer all the receipts you have collected there into the appropriate file folders according to the category of expense.

You may wonder how to file a receipt that contains more than one expense category. In the end it doesn't matter what category you label an expense, since all your expenses will eventually be added together on **Schedule C**. There is no penalty for not putting your expenses on the proper line of the tax return. The only exception to this rule are the expenses associated with your home (property tax, mortgage interest, house insurance, house repairs, house depreciation, casualty losses, and home improvements), which you need to first list on **Form 8829**, and then transfer to **Schedule C**. (For more information, see the latest edition of the *Family Child Care Tax Workbook and Organizer*.)

Some providers put these "mixed" receipts into the business category that is associated with the majority of the items on the receipt. For example, let's say that you go shopping at a discount store, and when you get home, you see that the receipt contains three items of supplies and six items of toys. In this case, you would put the receipt into the "toys" category. At the end of the year you can break out the expenses for supplies and move them into that category, or you can just include them with the toy expenses. It really doesn't matter. The easiest method would be to simply include them in your toy expenses.

Most family child care providers use the standard meal allowance rate (see page 38) to calculate their food expenses, and if you do this, you won't need to save your food receipts to calculate your food expenses any more. However, be sure to save all your receipts for nonfood items, such as paper products and kitchen supplies, that you purchased when grocery shopping. If you get a receipt from a grocery store that shows both food and nonfood items, save the receipt and put it in the nonfood category.

There is a way to organize your receipts by month and still be able to easily track the category totals. Begin by marking the total for each expense category on each receipt, and then store the receipts in folders or envelopes by month. (If you have more than one category of expense on a receipt, mark the total amount for each category.) At the end of the month, add up the totals for each category and enter them on a calendar or ledger. At the end of the year, total your monthly expense amounts for each category. If an IRS auditor asks to look at your receipts for a particular month, you will have your monthly receipts stored together for easy retrieval.

Some tax professionals recommend other methods of record keeping, and you may want to follow your professional's suggestions. However, if you already have a method that you are comfortable with, don't hesitate to tell your tax professional that you don't want to switch.

Conduct a Regular Review of Your Records

Don't throw all your receipts into a box and wait until the end of the year to sort them out. If you do this, you'll be likely to misplace your receipts and forget to record some expenses, and it will be much more difficult to organize your records at tax time.

In an audit, the appearance of your records can sometimes be as important as the records themselves, so try to keep them in a clear, well-organized fashion. It will be easier to do this if you spend a little time on it each week. It's best to conduct a monthly review of your records to make sure that everything is in order. At the end of each month, ask yourself:

- Have I recorded all payments from parents?
- Do I have complete attendance records?
- Have I recorded all the hours that I used my home for my business?
- Have I kept a record of all my business trips in my calendar or notebook?
- Have I saved all my business receipts?
- Do my receipts clearly identify what I bought? (If not, mark the items on the receipts.)

Reconstructing Your Records

What if you're reaching the end of the year and suddenly realize that you haven't been keeping careful track of all your records and receipts? Is it too late to claim deductions for your expenses? No! There are some ways that you may be able to reconstruct your records:

- Review your credit card statements. They may remind you of additional expenses or help you reconstruct your records.
- Take photographs of any items that you purchased without a written record. Return to the store where you bought the item, and record the price. The combination of a photograph and a credit card statement or other written record can be effective.
- Check how many business trips you made by reviewing your receipts, bank deposit slips, check register, field trip permission forms, and *The Redleaf Calendar-Keeper* or *Mileage-Keeper* notes. Drive to each location, record the distance, and then figure your business mileage.
- If you have forgotten to save your business receipts, try to keep enough records to show a pattern of spending. If you carefully save all your business and personal receipts for two months, you may be able to use that to show a pattern of business and personal spending, and base your business deductions on that. (This will only work if your expenses were about the same for the other months of the year.) Although the IRS may not accept this, it's worth trying if you have no other choice.

If none of these methods work, as a last resort, you can try to back up your deductions with your own testimony and that of other witnesses. For example, although you have no record of parking meter expenses, you and your children can testify that you regularly spend 50 cents on a parking meter every time you take them to the library. This approach may work. I once helped a provider win an audit by presenting her testimony about buying her furniture, photographs of the furniture, and her estimate of what it was worth.

Although a receipt is always the best kind of record, don't give up just because your records aren't perfect. If you can make a reasonable case with "sufficient evidence," you should be able to prevail.

How Long Should You Save Your Records?

The IRS requires you to save your business records for three years from the date that you file your tax return. If you receive an extension and file your tax return after April 15, you must keep your records for three years after the extension deadline. If you amend a tax return from an earlier year, you must keep your records for three years after the date that you filed the amended return. The IRS will not audit you more than three tax years back unless they believe that you may have committed fraud or substantially underreported your income.

The following are some guidelines for how long you should keep various kinds of records. However, we recommend saving records for a few years longer than is officially required, just to be on the safe side.

- Keep all your canceled checks and bank deposit slips for at least three years.
- Save for four years any payroll records associated with hiring employees.
- Keep records of all depreciated items (such as furniture, appliances, computers, large play equipment, and so on) for the life of the item, plus three years. (For more information, see the *Family Child Care Tax Workbook and Organizer*.)
- Save copies of all the forms that you have filed with your tax returns for your lifetime.
- Save any records that are associated with your home (purchase and sale agreements, improvements, repairs, landscaping, and so on) for your lifetime, since they may affect the taxes on your estate.

Finally, check with your state department of revenue to see if you must save your state income tax records for a longer period than described above. Some states, for example, require you to save your tax records for four years. If this is true for your state, you will also need to keep copies of your federal tax forms and business records for the same period.

CHAPTER TWO

Claiming Your Food Expenses and Reimbursements

Chapter Summary

This chapter covers the Child and Adult Care Food Program, how to calculate your food expenses, and how to report food expenses and Food Program reimbursements.

The U.S. Department of Agriculture's Child and Adult Care Food Program (CACFP) is designed to improve the nutrition of children. The Food Program reimburses family child care providers for serving nutritious food. It also offers training about nutrition and meal planning and offers other forms of support. If you participate in the Food Program, you are required to file monthly reports, keep track of the meals you serve and your menus, and allow a Food Program monitor to observe the meals in your home four times a year.

The Food Program is administered through local nonprofit sponsors in each state. Although in some areas its sponsors compete with each other to enroll providers in the program, all sponsors must follow the same federal guidelines. Any family child care provider who meets their state regulation standards is eligible to participate in the Food Program, and there are no fees to join.

Common Objections to the Food Program

All providers should participate in the Food Program and stay in it for as long as they are in business. Don't let anyone talk you out of participating in the Food Program; it is a major source of income for the providers. If you join this program, you will always have more income after taxes than if you don't. There are some rare circumstances in which you may not want to have a higher income; for example, if more income will make you ineligible for government assistance programs or college scholarship grants for your own children. If this is an issue for you, you will need to carefully weigh your decision to join the Food Program. However, these circumstances apply in very few cases. Those who don't understand the benefits of the Food Program usually raise three main objections to it:

- If I join the Food Program, I will have to pay more in taxes.
- Joining the Food Program will put me in a higher tax bracket.
- The Food Program requires too much extra record keeping.

Let's look at each of these objections in turn, and see why they don't make sense. (For more questions and answers about the Food Program, see pages 52–54.)

Objection 1: If I Join the Food Program, I Will Have to Pay More in Taxes

How would you answer the following questions:

- Do you want to win the lottery?
- Your spouse comes home and says, "I got a raise. Do you think I should I accept it?"
- The parents of the children you care for say, "We think you should be earning more money. We have all decided to pay you $15 more per week. Will you take it?"

You would probably answer yes to each of these questions. If you win the lottery, or your spouse gets a raise, or you earn more money, you will both have more income *and* pay more in taxes. Joining the Food Program has exactly the same consequences. You will pay more in taxes, but you will also have more profit at the end of the year. You should focus on how much money you will have after you pay your taxes, not how much tax you are paying. Let's look at an example to see how this works:

	Without Food Program	**With Food Program**
Monthly Income		
Parent Fees		
($150 a week x 4 weeks x 4 children)	$2,400	$2,400
Food Program Income		
($80 a month per child)		
4 x $80 = $320	$0	$320
Total Monthly Income	**$2,400**	**$2,720**
Monthly Expenses		
Food	$400	$400
Other**	$500	$500
Total Monthly Expenses	**$900**	**$900**
Net Monthly Income		
(income minus expenses)	$1,500	$1,820
Net Yearly Income		
(net monthly income x 12 months)	$18,000	$21,840

** Other monthly expenses include regular monthly expenses, such as household supplies and car mileage, plus a portion of ongoing expenses, such as depreciation of furniture and appliances, toys, property tax, utilities, insurance, interest, publications, and so forth.