CHECKLIST FOR CHILD CARE PROVIDER'S USE OF HOME

(This information is in addition to the Schedule C information found here)
A special exception for child care[1] providers eliminates the "exclusive use" requirements of Section 280A of the Internal Revenue Code. Nonetheless, guidance is in order to take maximum advantage of the benefits of this exception. The first important point is this exception requires "regular" use. If you intend to seek home office benefits, therefore, be sure all areas of the home used for daycare meet this threshold test.

The formula for this deduction is

<u>annual hours of operation</u> x <u>percentage of use of the home</u> x <u>home expenses</u>.

<u>Determining Annual Hours of Operation</u>

Do not make the mistake of including only the actual hours during which children present in this value. Depending on the number of children being cared for and the times they arrive and depart, you will find yourself spending time on set-up and clean-up while no children are present. A half hour to an hour before and after the actual care takes place may usually be justified easily. The test will be whatever may be justified as ordinary and necessary under all the facts and circumstances.

<u>Determining Percentage Use of the Home</u>

Like the calculation of hours, the percentage determination should be done thoroughly. First of all, if a portion of the home is used exclusively for the day care operations, the original rules of 280A apply and all expenses are 100% deductible for that portion. The above ratio only applies to areas not exclusively used for the childcare.

In determining what portions of the home are not used, however, keep in mind even the master bedroom frequently comes into play for "naptime.' Larger childcare providers generally use the entire house, with the notable exception of their own children's' bedrooms. Even the garage is used for storage of ride toys.

<u>What about the Yard?</u>

This issue frequently arises and can be complex. In a 1994 court case, the IRS lost their attempt to limit daycare to the house itself. The court was very generous to the two daycare providers who contested the IRS disallowance of parts of a garage, a basement laundry room and a child's playhouse. What is difficult is the quantification of the

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[1] Childcare providers include those who care for seniors over 65 years of age, or those who care for individuals who are physically or mentally incapable of caring for themselves.

deduction of expenses for areas outside the house. There are no hard and fast rules directly on point as exist for the house itself, so I draw on other aspects of the tax Code.

For example, if I put in an elaborate children's playground for several thousand dollars to help in my thriving daycare business, it would seem logically to be a legitimate and direct business expense eligible for depreciation. To a certain degree, this is correct and to a certain degree it is not. This is because the value of the playground also enhances the value of the home itself. The taxpayer may therefore only depreciate the value of the playground to the extent the cost exceeds the value added to the home by its presence. This type of project requires advanced planning before the plans are drawn up; otherwise the normal assumption would be the expense is completely deductible.
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Doing the Math

In order to determine the scope of the home office deduction for a child care provider, I need the following information:

1) If this is your first year, I need to know the date you began using your home office, the amount you paid for the home and a copy of the current tax bill.[2]
2) All forms 1098 for the property showing mortgage interest paid. If you pay your own property tax, I will need those totals for the year as well. (This information is part of the basic checklist for taxes as well)
3) Totals of the following five utilities on an annual basis:
    a. Electric
    b. Gas
    c. Water
    d. Sewer
    e. Garbage
4) Total paid for fire, theft and other property insurance.
5) Totals paid for improvements and repairs to the home in general.
6) Any expenditures specifically made for the home office.

What about the Food?

This is a favorite of the IRS. Daycare providers who feed their charges (and most do) frequently do not keep records of the food they purchase for the daycare vs. that purchased for their family. Without these records, an IRS auditor may disallow all food expenses as a personal expense.

The best way to do this is certainly not the most practical. That would be to purchase and isolate all food items separately for business and personal use. As anyone who has made breakfast for a group of children knows, this is nearly impossible.

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[2] These figures are for calculating depreciation. Therefore I must breakdown the costs between land and improvements. The tax bill provides a general, but not determinative indication of these values. If you have an impound account, you may or may not receive a copy of this bill. If it is not available I will do a general estimate.

My suggested method is an allocation by percentage of use. While certainly not the most precise, in my experience the IRS will always accept a clearly explainable method which yields reasonable results. If you serve a total of x meals (counting each individual) during the year, then use a figure of y/x, where y is the total number of meals served to daycare clients.