

How does receiving the Child Care Stabilization Grant affect your taxes?

Both the state of Michigan and the federal government have worked to provide financial relief to support child care programs during the pandemic. One of the most common questions about these funds is how they will affect your taxes.

Is the grant taxable income?

Yes. The Child Care Stabilization Grant is income to your business and is taxable by the state and federal government.

Programs that are awarded a grant will receive an IRS Tax Form 1099-NEC. This funding is subject to the same state and federal tax rules as regular Child Care Development Fund (CCDF) funding.

Will my taxes go up?

Maybe. It will depend on how you spend your grant. Some expenses paid with your grant award are still fully deductible. For example, a child care provider that uses 100% of the grant award to pay bonuses and additional wages to employees will likely not have a tax increase because the grant award is offset by deductible business expenses. In other words, you may be able to minimize your potential tax burden by using grant funds for deductible business expenses.

We strongly urge you to work with your tax preparer to create a plan for how to estimate the tax implications for planning purposes.

What's the best way I can plan for higher taxes?

Support through the Child Care Stabilization Grant can be critical to the recovery of your child care business. The grant provides a source of funds to pay for operating expenses and other immediate needs for your business. The receipt of the grant will therefore likely prove to be useful to your business, even if receipt the grant could result in a tax increase in certain cases.

If you anticipate that the receipt of the grant may increase your tax liability, then there are several practical ways in which you can ensure the liability is paid. One way is to set aside an amount of the grant proceeds based upon your federal tax rate and state tax rate. Alternatively, you may choose to make or increase quarterly estimated tax payments to cover the expected tax increase.

You may wish to consult with your tax preparer about the potential for higher taxes and how best to plan for them.

A portion of my grant award will be used for staff bonuses. What are the tax implications?

The grant application requires that recipients use at least a portion of the proceeds as a “bonus” paid out to all full and part-time employees. A bonus payment — broadly defined for tax purposes as any consideration paid to an employee beyond the employee’s regular wage — is treated as a supplemental wage under federal tax law.ⁱ

Supplemental wages are taxable when received by the employee and, thus, subject to mandatory tax withholding (federal and state) and employment taxes by the employer.ⁱⁱ Your business may therefore have certain reporting, withholding, and payroll tax obligations for grant amounts that are paid to employees.ⁱⁱⁱ

I have more questions about my taxes. Who should I contact?

The state is not able to provide tax advice about your specific situation. The best approach is to contact your tax preparer for help.

ⁱ IRC 3402; 26 CFR 31.3402(g)-1(a)(1)(i) (treating bonuses as supplemental wages). Supplemental wages are “compensation” for purposes of IRC 3402 and therefore subject to the Michigan withholding requirement. MCL 206.703(2).

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This is regarded as compensation as defined under IRC 3402 and therefore required to be withheld for Michigan tax purposes.

ⁱⁱⁱ For employers, the term “payroll tax” typically refers to any employer-paid portion of employment taxes levied on an employee’s wages, which includes FICA, the employer share of which is computed on 7.65% on the first \$142,800 of wages, Federal Unemployment Taxes (FUTA) and State Unemployment Taxes (SUTA).