Child Care Business Startup Costs and Taxes

DECAL
Thriving Child Care
Business Academy

Learn how the expenses incurred as you start up your child care business will be treated at tax time.

As our communities look ahead from the worst of the COVID-19 pandemic, many entrepreneurs are taking the opportunity to launch new center-based and home-based child care businesses. In some cases, these enterprises are being supported by state or foundation funding or local grants to assist new business owners as they launch. While these outside funds will cover some costs, new child care providers may be asking themselves how these will be treated at tax time. Public or grant funds may cover all or most of your child care business startup costs, but depending on the sources of these funds, they may be treated differently at tax time.

When does the Internal Revenue Service (IRS) allow startup costs?

The IRS allows a certain amount of startup funds to be deductible on your taxes, but understanding when to start counting them can be tricky. You are allowed to consider costs incurred as soon as you start planning and organizing your business. However, you cannot begin to deduct them until the first tax year after you officially launch, meaning, when you first get paid for the service or good your business offers. Of course, at that point, your business must also be registered with the IRS.

Let’s consider an example: Isabella is interested in opening a child care business, and she begins planning and working on her business’s launch in August 2021. She officially opens in May 2022, when she invoices families and receives her initial payments. Since she is also registered with the IRS as a business, she will file her first business taxes in spring 2023. When she prepares her taxes, she will be able to deduct startup costs back to August 2021. (In the case of child care, it is not relevant to Isabella’s taxes how, or if, she is regulated by the state child care licensing agency.)

It is common for accountants and preparers to follow a rule of thumb that allows you to consider startup costs from the 12 months before you open your business. According to IRS guidelines this could technically be earlier, but it’s always good to seek professional advice if you have questions specific to your business’s startup timeline.

What happens if you stop pursuing your startup?

A final note on when you're allowed to deduct startup costs: in addition to claiming them after you launch your business, you are also allowed to deduct them if you abandon your business efforts. Once you decide against launching your business, any "startup" expenses would be deducted as a loss in the tax year the decision was made. For example, if you started pursuing a business in 2021 and continued into 2022 and decided to end the startup in November 2022, the startup costs would be reported on your 2022 taxes.

What does the IRS consider valid startup costs?

There are three major categories of startup funds, and the IRS handles each differently. This guide discusses each of these so you can better understand how they impact your taxes: first is startup costs, organizational expenses are next, and finally, the equipment, vehicles, and improvements that may be needed to start a child care business.

It is important to note, whatever category you use at tax time, you must have proper documentation of your expenses. In addition to your receipts or other proof of payment and purchase, you should document any calculations that were done to help divide up mixed personal and business use costs. Examples of when you might need to calculate shared costs are getting your home ready and repaired for your family child care business, establishing a home office you use to secure the location of your new center, or using your personal vehicle throughout the startup process.

Resources and costs like these that have shared personal and business use need a concrete way to determine the share of expenses allocated to your business. Our Time-Space Calculator can help you calculate what percentage of these costs are used for the business.   can help you calculate what percentage of these costs are used for the business.

What are general startup costs?

Valid startup costs that can be deducted up-front include:

- Analyzing and gathering data on potential markets
- Researching and visiting locations for a future center, if applicable
- Understanding and planning necessary changes needed to your home for a family child care business
- Wages or payroll taxes paid to any employee that comes on early for training
- Marketing activities or advertisements related to getting the word out about your new business prior to its opening
- Logo design, website design, brochures, and business cards

- Any consultant support, legal advisement, or professional services that are needed, such as an accountant or bookkeeper
- Travel and related costs to get equipment and supplies
- Outreach and connecting with potential families and partners that will contribute to your business's success
- Investments in software, such as a child care management system, accounting platform, customer relationship management systems, Microsoft Office or other computer or recordkeeping need
- Interest payments for business loans
- Insurance payments related to the business
- Costs related to utilities, office supplies, permits and licenses
- Down payments on rental or purchase property, and rental or lease payments (if applicable, you would apply your Time/Space percentage to any shared personal/business expenses)
- Plus, any improvements needed to a location, such as adding a fence or partitioning rooms inside a building

At tax time, how these costs are deducted depends on the total amount:

1. If you have **$5,000 or less** in startup costs to report, the deduction is straightforward. Simply include the costs in your tax deduction via your Schedule C or a corporate tax return, as appropriate for your business.
2. If your total startup costs equal **more than $5,000 but less than $50,000**, there is a formula to follow.
   - Costs between $5,001 and $50,000 must be amortized or spread out over 180 months.
     Let's say, for example, you had $10,000 in startup costs. You can deduct the first $5,000 in the current tax year (given the standard guidelines above). The other $5,000 would be spread out equally over 180 months. In this case, you would be allowed to deduct $27 per month, or $333 in the second year, $333 in the third year, and so on until the remaining costs are fully deducted.
3. There are additional rules if your expenses are **between $50,000 and $55,000**. In this range, the amount of the deduction in the current year is reduced by the amount you are over $50,000.
   - This can get a little confusing, so let's look at an example:
     Let's say your startup costs equaled $53,000. Since this total is $3,000 over $50,000, that is subtracted from the $5,000 you can deduct this year, meaning you would only be able to deduct $2,000 this year. The remaining funds would be amortized over 180 months, as noted above. In this case, notice there is less of an up-front deduction and a greater deduction over the next few years.

4. If your costs total **more than $56,000** you cannot take a deduction at all.

What are organizational expenses?

The second type of deductible startup costs are called organizational expenses. These are costs related to forming a corporation (including LLCs) or a partnership. Expenses that fall into this category include the fees associated with incorporation or creating a partnership, and the related costs of personnel, transportation, legal services, and temporary fees connected to directors (if you need it), as well as any meeting costs associated with the business formation.

These costs are handled the same way as the startup costs:

- You can deduct $5000 as the baseline, but as you go higher the ability to deduct the costs is affected.
- So, if you have between $5,001 and $50,000 you would take the initial $5000 this year and the balance would be deducted over 180 months. (See the previous section for an example of this breakdown.)
- Then, if your costs are between $50,000 and $55,000, your initial deduction would be less and more would be spread over the 180 months.
- And, if you have more than $56,000 in organizational expenses, you would no longer be able to take the deduction at all.

What are equipment, improvement, and vehicle costs?

The last category the IRS uses for deducting startup costs is for equipment, improvements, and vehicles associated with launching your business. This likely includes many “big ticket items” you may have.

For startup tax purposes, these items are handled in the same way that you would handle depreciation for any large costs. It is important to know that when it comes to startup these costs cannot be deducted until they are put into operation.

For example, imagine you purchased a van in 2022 for transporting children. However, your business doesn’t open for business until February 2023. In this case, you would not be able to take the deduction for the van in 2022 because you’re not officially in operation. Instead, you would take the deduction in 2023 in accordance with all the rules around depreciation. To deduct startup expenses in this category, you need clarity on when any high-ticket items officially go into service for the business.

How can I get help?

Tax time can be stressful, and these rules related to startup costs can seem complicated. Still, it's important to understand them as they provide a tax time opportunity if you're starting a child care business. Being aware of the potential tax impacts of startup expenses will help you prepare your business taxes effectively.

Additional Resources

If you have questions or need help, assistance is available.

GaPDS Website

DECAL Thriving Child Care Business Academy Website

Georgia Licensing Rules and Regulations

To Find Other Study Guides: Click on Resources on the Academy home page

To Find Training: Click on Trainings on the Academy home page

To Register for Training: Click on Schedules & Registration on the Academy home page

To Sign Up for Study Groups: Fill out the Intake Assessment

For questions about coaching or study groups: Email GAcoaching@civstrat.com

To Find Other ECE Resources: Visit the DECAL Website

For General Questions about the Academy: Email thriving@decal.ga.gov

For More Information:
Family Child Care Learning Home Rules and Regulations

Child Care Learning Center Rules and Regulations

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