

## **Pay Increases and Payroll Taxes for Family Child Care and Family Group Child Care**

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Smart Start Workforce Grants for Illinois child care businesses present an opportunity to support your staff through increased wages and salaries. This guide will walk through ways you can offer these financial incentives and examine the long-term tax implications to protect your business.

### **Introduction**

As a child care program business owner, you value your assistant(s) and staff and want to compensate them for the essential services they provide. However, you also know that navigating pay increases can be tricky. Ultimately, offering pay increases can impact your business's bottom line. This guide will review how you can offer pay increases through Smart Start Workforce Grants, while also understanding the tax implications. If you have instances where your staff are not currently paid via W-2, this guide will also walk you through how to determine if staff and assistants should be classified as W-2 employees or contractors, and the steps you will take to set up your employees to be paid via W-2.

### **Understanding Costs of Pay Increases**

For Family Child Care and Family Group Child Care, Smart Start Workforce Grants are used to pay for wages or salaries among assistants, with the remaining amount going toward the business owner's income. When increasing the pay of your assistant, be mindful of the associated costs that you will need to cover. With Smart Start Workforce Grants, the idea is that you will have income that was previously going toward wages, now be free for use in other areas, like covering payroll taxes. While all Smart Start Workforce Grant funding must go toward wages, you may use other income sources to cover costs in other areas. You will need to compare your current pay costs with your new pay costs and include both rates of pay and payroll taxes. Determining the increase in costs when considering pay for your staff or assistant(s) helps you make the strongest decision for your business.

Note: Through dedicated engagement and development at the state-level, Smart Start Workforce Grants are being implemented as a sustainable and long-term program for child care businesses in Illinois. However, like any other state-funded program, funding is contingent on annual appropriations by the Illinois General Assembly. Because of this, this guide will focus on the implications of Temporary Pay Increases and corresponding payroll taxes.

### **Types of Pay Increases**

There are two different types of pay increases that you can consider for your program staff or assistants if you are a Family Child Care or Family Group Child Care business. Each type of pay increase will have a different impact on your business.

### Temporary Pay Increases:

This type of pay increase is meant to last a short timeframe with a clear beginning and ending date. Perhaps you have an assistant or staff member who you want to reward for their performance during a difficult time at your program. You could increase the assistant's pay for the next six months but make sure they know that their pay will return to the original rate when the period ends. Clearly communicating, in writing, with your staff members is critical when choosing to use this type of pay increase.

### Long-Term Pay Increases:

This type of pay increase permanently raises the staff member or assistant's base level of pay, without any planned reduction. However, raising your staff or assistants' pay must be a sustainable business practice.

## An Important Next Step: Are Staff Members and Assistants Contractors or W-2 Employees?

As a child care business, it is essential that you properly identify whether anyone working for you is a contractor or an employee. Contractors and employees are handled very differently under labor laws. A contractor is treated as a completely independent worker, taking care of their own employment taxes, and often you, as the employer, have fewer legal duties to this type of worker. Alternatively, if you have someone classified as an employee, you have more responsibilities to them and greater associated costs, such as employment taxes and benefits.

Seeing that the contractor classification is a less costly route, some child care business owners will choose to have staff treated as contractors when, according to guidelines, they should be treated as staff paid via W-2, even when the staff or assistants would prefer the contractor classification. It is important to note that the decision on how to classify a member of your staff isn't up to you as the employer, nor is it up to the staff member or assistant. There are labor rules that help you know if the staff member you have is a contractor or an employee.

You don't want to unintentionally misclassify someone as a contractor when they should be an employee, as this can cost you time and money. Even if you make an honest mistake, you could be liable for:

- 100% of the employer taxes that you should have been paying all along,
- A portion of the worker's contribution to payroll taxes – this means you would be paying a portion of the taxes that you would have never had to pay in the first place,
- Criminal fines for thousands of dollars, and/or
- The price of any missed benefits and other employee compensation such as paid time off – things that the worker didn't receive as a contractor.

You must [make the correct classification](#) so you can avoid these potential risks.

## Setting Up Your Staff as W-2 Employees

Now that you have established who among your staff must be classified as W-2 employees, you will take steps to pay them via W-2. Following these steps will ensure you are following IRS and state rules.

1. If you don't already have one, obtain an Employer Identification Number (EIN). You can apply for an EIN [here](#).
2. It is very important that you verify the employee's eligibility to work in the United States. You will want to take documenting your staff's eligibility very seriously. Payroll software will often walk you through the process of determining eligibility, but you can also visit <https://www.uscis.gov/i-9> for instructions on checking eligibility and filling out Form I-9 (Employment Eligibility Verification).
3. You will then need to have the employee fill out Form W-4 (Employee's Withholding Certificate). This form will allow you to withhold the proper amount of income tax, Social Security tax, and Medicare taxes from their paychecks. You can find Form W-4 in many payroll software programs, but you can also visit <https://www.irs.gov/pub/irs-pdf/fw4.pdf> for the form.
4. Your next step is to set up a payroll system. This system will track your staff's wages and taxes, as well as any other deductions, such as healthcare or retirement. For very small businesses a manual payroll system may work, but it can lead to errors and may take a lot of time to maintain. Popular options for other payroll systems include payroll software (QuickBooks is popular and has many accounting functions,) online payroll companies (like Gusto or Wave), or you can use your bookkeeper or accountant. It is very important that you keep accurate records of wages, taxes and deductions.
5. If you are using a manual payroll system, you will then need to calculate the taxes you will withhold and the employer's portion of taxes to be paid to the government. Payroll software, online companies, apps and your accountant or bookkeeper will perform the calculations for you.
6. You must provide your staff with accurate paystubs that show all gross wages, deductions and the next pay after taxes and deductions for the determined pay period.
7. You must deposit the taxes you pay as an employer, along with the taxes withheld from your staff's wages to both the IRS and the state of Illinois. For federal taxes you use the Electronic Federal Tax Payment System (EFTPS). For more information on EFTPS visit <https://www.eftps.gov/eftps/>.

Businesses must file quarterly Form 941 tax returns reporting the wages that have been paid and the taxes you have withheld (found [here](#)). You will also file Form 940 annually to report and pay federal unemployment (FUTA) taxes (found [here](#)). These forms and any payments due are mailed to the IRS. You can visit <https://www.irs.gov/filing/where-to-file-your-taxes-for-form-941> to find the address where you can mail both Forms 941 and 940.

## Calculating Wages and Payroll Taxes for Long and Temporary Pay Increases

For this calculation exercise, we will be using a Family Child Care program with an assistant as our example.

Our assistant currently makes \$13.00 per hour and works 40 hours a week. Using the Smart Start Workforce Grants we will be able to raise their hourly pay by \$4.00 per hour to \$17.00 per hour.

Our weekly costs increase not only the amount of the new wages, but also the amount of the payroll taxes we will pay.

### Current Scenario

Current wages	\$13.00 per hour	40 hours per week	\$520 total wages per week
Current taxes	\$32.24 Social Security*	\$7.54 Medicare*	\$39.78 total taxes per week
Current total payroll			\$559.78 per week

### Increase Scenario

New wages	\$17.00 per hour	40 hours per week	\$680 total wages per week
New taxes	\$42.16 Social Security*	\$9.86 Medicare*	\$52.02 total taxes per week
New total payroll			\$732.02 per week
Total weekly increase			\$172.24 weekly increase

(\* Social Security taxes are 6.2%, Medicare taxes are 1.45%)

In this example, the total employer cost per week increases by \$172.24 to meet the wage floor requirement for Smart Start Workforce Grants, or \$8,956.48 per year (multiplying the weekly increase by 52 weeks in a year).

Please keep in mind that the grant award for a Family Child Care program with an assistant that works 40 hours per week is \$4,000 per grant round. So, if a Family Child Care program was found eligible and received funds for the three rounds of Smart Start Workforce Grants in FY25, they would receive \$12,000. If you subtract the total projected cost increases for the year from the total grant award amount received in FY25, the program will have \$3,043.52 left over to go toward the owner's income. After FY25, there will be four rounds of grant funding to cover these costs.

### Need More Assistance?

## HAVE QUESTIONS?

The Illinois Network of Child Care Resource and Referral Agencies (INCCRRA) will administer the Smart Start Workforce Grants.

INCCRRA will provide technical assistance answering technical questions and helping with the application process through its website and via email. Email [grants@inccrra.org](mailto:grants@inccrra.org) with questions.

New to Smart Start Workforce Grants is local technical assistance through the local Child Care Resource and Referral (CCR&R) System. This will provide local grant experts to provide technical assistance, and answer questions. Find your local expert [here](#)

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