

## How Do Smart Start Workforce Grants Affect Your Taxes?

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This resource provides helpful information on the tax implications of Smart Start Workforce Grants and other funding programs.

### Introduction

Following the Illinois Child Care Restoration Grants, Strengthen and Grow Child Care Grants, and Smart Start Transition Year Grants, [Smart Start Workforce Grants](#) offer child care programs stable, ongoing funds that are needed to cover costs and invest in quality staff without burdening families by raising tuition or Child Care Assistance Program (CCAP) co-pays. Eligible programs receive consistent funding in advance, and funds will cover the cost of higher wages and operating a classroom. Programs receiving these grants will be required to pay classroom staff a wage floor, regardless of performance. These competitive wages will help to attract more staff and meet parents' needs at a rate that they can afford.

After reading this guide, you will be able to:

1. Recognize the tax implications of Smart Start Workforce Grants,
2. Consider the impact that federal relief credits will have on your taxes, if you were to receive them, and
3. Use this information as a resource as you prepare to file your taxes.

*This information is intended to serve as one of many resources in your toolkit. It does not substitute for, nor should it be construed as personalized advice from a tax preparer.*

When implementing the increase in staff wages funded by the grants, programs will need to consider tax implications in two ways:

- When increasing staff wages there will be an increase in payroll taxes. You can find a guide [here](#) that will walk you through how to calculate these increases in payroll taxes and will allow you to take action to withhold the proper payroll taxes once you implement the wage increases. Having an accurate accounting of these increases can result in better budgeting and help to create a more accurate cash flow projection. You can find more information on creating a cash flow [here](#).
- Programs will also need to address the increases they will experience in federal and state taxes upon receiving the grant funds. Often there is the concern that grant funding will raise taxes to the point where taxes will be more than the program received. **This is not the case.** With proper planning, programs can avoid unwelcome surprises at tax time and can move forward with the knowledge that Smart Start Workforce Grants will bring much-needed assistance and can improve the quality of their programs. This guide will outline strategies you can use to be better prepared at tax time!

## Tax Implications of Smart Start Workforce Grants

Smart Start Workforce Grants provide funding to cover costs for payroll for [certain time frames](#). Consequently, **you must report the funds as income** on your federal taxes in the year that you receive the payment. This means that the federal government will tax your grant money at your federal income tax rate. Because you will need to pay taxes on Smart Start Workforce Grants, your tax bill will most likely increase; however, this can be offset by claiming payroll expenses paid for by the grant as business deductions.

Let's look into the upsides of Smart Start Workforce Grants funding in the tax process:

First, federal and Illinois state taxes on Smart Start Workforce Grants funding do **not affect how greatly you are taxed on your earned income**; the additional tax money you are paying is being taken out of the funds you received from the grants, it does not increase the amount of taxes you will pay on your self-employment income. This means that while you will pay taxes on the grant funding, receiving the grant funding does not increase other taxes, the exception being payroll taxes, since you are increasing the amount, you pay assistants and staff. The amount of your grant, even after you pay your federal and state taxes, will greatly exceed the increases in all taxes incurred related to grant funding. Programs utilizing Smart Start Workforce Grants must understand that the benefits of receiving the funding far outweigh the tax implications they will incur.

Second, expenses covered by the grant continue to qualify as allowable tax deductions. Let's look at an example case of how new wages, which are an allowable tax deduction, offset the grant funds received:

Ashley was eligible for Smart Start Workforce Grants funding, and she received a total of \$5,400 in support in 2024. Ashley allocates the money to her qualifying 2024 payroll expenses.

When Ashley does her 2024 taxes, she can still report payroll expenses — they qualify as eligible deductions. This means that Ashley is reducing her tax burden by deducting eligible expenses, even though those expenses were paid from Smart Start Workforce Grants funding rather than Ashley's earned income.

Ashley's 2024 earned income is \$40,000 (this does not include the amount of the Smart Start Workforce Grants she will receive). As a single filer in 2024, Ashley would owe the federal government \$8,581.10 in taxes if she did not receive a grant. However, Ashley needs to add any additional Smart Start Workforce Grants funding that she received to her income. Ashley adds the \$5,400 in grant funds to her taxable income.

Now, Ashley's total income is \$45,400. Since Ashley is in the 22% federal tax bracket, she is taxed an additional \$380.82 on the \$5,400 Smart Start Workforce Grants, which increases her federal tax bill from \$8,581.10 to \$8,961.92. Note that she is taxed on the grant funds received apart from the taxes on her earned income, receiving the grant funds did not increase the amount of taxes she paid on the \$40,000 of income.

Although Ashley's federal tax bill did increase by \$380.82, Ashley was able to directly put \$5,019.18 of Smart Start Workforce Grants funding toward the expenses incurred by the new wage increases covered by the grants (\$5,400 Smart Start Workforce Grants minus the \$380.82 in taxes equals \$5,019.18). Ultimately, Ashley ended up with more money than she otherwise would have and was able to reduce her tax burden using grant-funded deductions. The

receipt of Smart Start Workforce Grants funding allowed Ashley to help her staff, her business, and her family.

## Are there any Tax Implications Surrounding Smart Start Tax Grants You Should be Concerned About?

As you can see in the above example, Ashley received her Smart Start Workforce Grants funding in 2024 and spent the funds on the increased payroll incurred in 2024. In that example, the amount of her expenses fell within the same tax year she received the funding, and she was able to claim the same amount of expenses that she received in funding, making her tax liability for the grant funds \$0.00 in 2024. This rule regarding tax liability would be the same for any funding received where the expenses covered by a grant were offset by the grant itself in the same tax year.

Ashley will want to consider that there may be circumstances where she receives Smart Start Workforce Grants funding in a tax year, but the amount of her increased payroll expenses are not incurred until the **following** tax year. Because Smart Start Workforce Grants funding cannot be used for back pay, there is the possibility of receiving funding in one tax year and then incurring the expenses the following tax year.

- If Ashley receives the \$5,400 in Smart Start Workforce Grants in the last quarter of 2024 but does not implement the payroll increases until 2025, she will not have the corresponding increased wage expense in 2024 to offset the taxes on the grant funds that year. In this instance, Ashley will pay the increased tax bill of \$380.82 with her 2024 taxes. She will, however, be able to claim those expenses on her 2025 taxes after she has implemented the wage increases, thereby lowering her 2025 tax liability.
- What action should Ashley take regarding this increase in her 2024 tax liability? A smart practice would be to set aside \$380.82 in an account for use next year when she files her 2024 taxes. By planning and depositing the money in an account until next year Ashley will be prepared to address the higher taxes.

## Are the Tax Implications of Smart Start Workforce Grants Different than Other Grants You May Have Received in the Past?

It is important to remember that the same tax rules existed when you received other grant funding in the past; the difference may be that you were allowed to spend previous grant funds on expenses that had already occurred. This is not the case with Smart Start Workforce Grants funding.

Many of the pandemic-related stabilization grants offered to child care businesses did allow businesses to use funding towards expenses that may have occurred earlier in the pandemic. In some cases, programs experienced similar tax situations like that we just discussed, although the opposite circumstances were true and expenses occurred in a previous tax year, were claimed on that year's tax return and when the funding was received there were no eligible expenses to deduct from the current year's taxes. Like in our previous example, the year in which they received funding was different than the year in which they had eligible expenses. In both circumstances tax liability was higher than expected but business owners always have the option to calculate the difference in taxes and set aside money to use if they should incur a larger tax bill.

## What if I Receive In-Kind Supplies?

If you receive in-kind gifts of tangible supplies (rather than money to buy the supplies), you most likely will not face tax liability. Consult with your accountant or tax preparer to determine the best way to record the donation.

## Tax Treatment by Funding Sources

FUNDING SOURCE	TAX TREATMENT REVENUE	TAX TREATMENT DEDUCTIONS	
		Federal	State
Smart Start Workforce Grants	Included as Taxable	Expenses are deductible	Expenses are deductible
Other stimulus grant programs	Included as taxable	Expenses are deductible	Expenses are deductible
In-Kind Supplies	Not Taxable	Consult Your Tax Professional	Consult Your Tax Professional

## Getting Ready for Tax Time

Smart Start Workforce Grants are critical to your child care business's financial operations and success. Even though this support can increase your tax liability, the new income that it offers you is valuable and well worth receiving. You should not be discouraged that you will pay more in payroll, federal, and state taxes, as the grant amount will exceed the amount you will pay in taxes.

The best way to prepare for this taxation is to organize your payroll documentation and denote the amount of the grant funds used to pay for your new wage increases for federal and state tax purposes. What you are allowed to deduct may vary for your federal vs. state tax filings, so you will want to be prepared for each. You should then set aside an amount of grant funds equal to your marginal tax rate so that you are prepared to pay any owed tax. If you are unsure, you can use 22% for federal taxes, which is the most common tax rate in the US. In Illinois, you will want to set aside an additional 4.95% of your grant funds for tax purposes. (To learn more about tax time, find additional resources [here](#).)

## 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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