

Nanny Tax Considerations
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A couple of years ago, my husband and I interviewed nannies and we were surprised to find that a majority of the candidates had been paid under the table in prior jobs, thus avoiding paying taxes. Even several nanny placement agencies gave us the option of whether we wanted to withhold taxes or not! Although household employee taxes are often overlooked, employers should know that they are by no means optional. The rules below relate to all household employees, including nannies.

Taxes for Employers and Employees

Your requirements as an employer include collecting and paying an employee's taxes. Fortunately, the government allows you to make these payments either through your own withholding or estimated taxes. A Schedule H is filed with your Form 1040 to report the tax liability and withholding amounts.

An employer's required taxes include the following:

- Social Security & Medicare (employer's half) – 7.65% of gross wages *
- Federal Unemployment Insurance – 0.8% on the first \$7,000 of wages paid in a calendar year
- State Unemployment Insurance – varies as a percentage on the first \$7,000 of wages
- California Employment Training Tax – 0.1% on the first \$7,000 of wages

A nanny's required taxes (to be withheld and paid by the employer) include:

- Social Security & Medicare (employee's half) – 7.65% of gross wages *
- Federal Income Tax – based on the employee's W-4
- State Income Tax – based on the employee's W-4
- California State Disability Insurance – 1.1% on the first \$90,669 of wages

* The Social Security and Medicare wage threshold is \$1,700 for 2009 – there is no reporting requirement if you pay a household employee less than \$1,700 in 2009.

If you don't want to complete paperwork, file tax forms, and monitor ever-changing payroll tax laws, a payroll tax services can ensure your tax compliance. One popular payroll service geared towards families who employ nannies is Breedlove at www.breedlove-online.com.

Paying tax on your household employees is not voluntary, and stiff penalties exist for non-compliance. A penalty of up to 25% of the tax due may be assessed, along with interest on the unpaid balance. If income, Social Security, or Medicare taxes that must be withheld are not paid, you may be personally liable to pay them. Additionally, tax evasion charges could include the loss of your professional license and even imprisonment.

Employees vs. Independent Contractors

What's the difference between an employee and an independent contractor? It depends on the facts and circumstances of the situation. In general, a person is your employee if you control his or her working conditions and compensation. An in-home childcare provider who cares for kids from multiple families may be classified as an independent contractor. A nanny sent by a placement agency who exercises control over what work is done and how it will be done is not your employee. However, a nanny who works for you full-time in your home would likely be classified as an employee.

New Hire Paperwork

When your nanny begins work, they should complete the following forms:

- Form W-4 – Employee's Withholding Allowance Certificate
- Form I-9 – Employment Eligibility Verification

Additionally, you should apply for a Federal Employer Identification Number (EIN) online at www.irs.gov/business/small.

Planning Considerations and Strategies

Where possible, structure your nanny's compensation to include more non-taxable items. For example, reimburse your nanny for health insurance, which is a non-taxable benefit. Cell phone reimbursement would also be exempt from payroll tax withholding and reporting (although there are rumours that this rule may change). If your nanny is paying for these charges anyway, reclassify salary dollars as health insurance or cell phone reimbursement to avoid paying tax on these items.

You're entitled to a tax break for your nanny. If you work for a business that has a dependent care or flex spending account, you may defer up to \$5,000 of income that is federal, state, and FICA tax free. This tax break is worth at least \$2,500 to most families. If you don't have access to a flex spending account, you may take a child tax credit of up to \$600 for one child (\$1,200 for two or more children) on Form 2441 filed with your Form 1040.

The benefits to your nanny will be Social Security retirement benefits in the future, plus unemployment insurance and disability benefits if they were to need them. Additionally, your nanny has a tax filing requirement – they are required to report all income received on their income tax return.

Summary

As a household employer, seek tax avoidance not tax evasion. Set up a payroll tax compliance system, structure your nanny's pay so that they are paid with more tax-free dollars in the form of reimbursements, and get peace of mind by knowing you are doing the right thing for your family and your nanny.

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