A Quick Checklist for Your "Nanny Tax" Clients

"Oh, by the way, we hired a nanny to watch the kids last year."

It's one of those 11th-hour declarations that make accountants cringe. You're already slammed preparing your clients' personal income and business tax returns and now a pile of nanny tax paperwork – usually unorganized and incomplete – is thrown onto your plate. Even worse, by procrastinating, the chances are very high that your client has made several tax and other compliance mistakes that can be expensive and frustrating for all involved.

To help you prevent this stress for you and your clients, we encourage you to make household employment one of those areas you proactively address during the year. If the family plans to hire a domestic worker and pay him/her $1,900 (2015) or more during the calendar year, here's a simple compliance checklist. And remember, we're here to support your agency should you have clients you'd rather send our way rather than handle these items yourself.

✓ **Make sure the worker is classified correctly**

The IRS has ruled that the vast majority of nannies, housekeepers, senior caregivers and other domestic workers are employees of the families for whom they work – regardless of the amount of hours worked, wages paid or what's written in the contract. Worker misclassification is illegal and the IRS and Department of Labor have teamed up recently to increase enforcement.

✓ **Obtain federal and state employer tax IDs**

Household employers need to obtain a Federal Employer Identification Number (FEIN) as well as state tax ID(s) for Unemployment Insurance and, if applicable, State Income

✓ **File a new hire report with the state**

All employers are required to file a New Hire Report with the state immediately after each new hire.

✓ **Withhold Social Security & Medicare taxes from the employee's pay each pay period.**

FICA taxes must be withheld from the employee's pay (or, alternatively, the employer may pay it for the employee). In addition to FICA taxes, we also recommend that employers withhold income taxes so that the employee is not subject to underpayment penalties at year end.

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✓ **File household employment tax returns as required (typically quarterly) and remit employee and employer taxes.**

Household employers are required to file state wage reports and remit employer and employee taxes throughout the year.

Note: Some states require monthly deposits. For federal taxes, we recommend that employers make 1040-ES payments throughout the year to avoid underpayment penalties.

✓ **Prepare year-end tax forms.**

Provide the employee with Form W-2 by the end of January. File Form W2 Copy A/Form W3 with the Social Security Administration by the end of February. File Schedule H with your personal income tax return by April 15.

✓ **Handle overtime correctly.**

The Household employees are considered non-exempt workers under the Fair Labor Standards Act (FLSA) and are required to be paid overtime for all time over 40 hours in a 7-day workweek. Live-in employees are generally an exception to this rule, although a few states require live-ins to be paid overtime as well.

Note: Many families run into overtime issues by offering a "salary" because, in their minds, a salary allows them to legally pay a fixed amount of wages regardless of how many hours the employee works. This is true for most professionals because they are considered exempt workers, but in the case of household workers (defined by their role as non-exempt by the IRS), a fixed salary is illegal.

✓ **Keep personal and business payroll separate.**

Families that own businesses sometimes attempt to run their household employee's payroll through their company. But the IRS has ruled that household employees are not considered direct contributors to the success of a business and, therefore, including those expenses on the company tax returns is considered an illegal tax deduction.

Domestic worker payroll and tax reporting should be handled separately through the household employment reporting process (see Publication 926). If the expense is childcare related, the family can take the dependent care tax breaks associated with those wages – but it must be handled on the personal income tax return.

✓ **Take advantage of childcare tax breaks.**

Many families with qualified dependent care expenses can take advantage of the Flexible Spending Account and/or the Child and Dependent Care Tax Credit (Form 2441). Qualified expenses (up to $3,000 per child per year and a maximum of $6,000 per family per year) may include any combination of the following:

- Wages paid to a nanny;
- Taxes paid on the nanny's wages;
- Fees paid to find a caregiver;
- Daycare;
- Day camps (overnight camps are excluded).

There are no income restrictions on these tax breaks. However, families must pass the work-related test, meaning both spouses must be employed, searching for employment or full-time students.

By using this checklist ***during*** the year, you can help your families avoid expensive, time-consuming employment mistakes – and ensure that you're not wasting time dealing with last-minute fixes. An ounce of prevention is definitely worth a pound of cure.

In addition, the family's employee will have an easier time qualifying for the benefits that come with legal pay, such as Social Security, Medicare and Unemployment Insurance – benefits that all workers need and deserve.

If you or your clients have any questions about the household employment tax process in your state, you're welcome to use our free resource, Nanny Tax Requirements by State for helpful information and tools. Or give us a call at 888-273-3356 for a free consultation. We're here to help.