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Nanny Tax: Pitfalls and Need-to-Knows for Your Taxes



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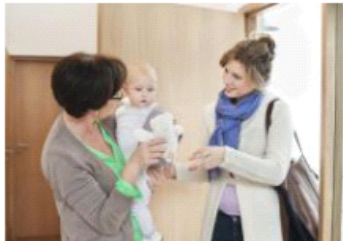
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If you've filed your taxes on time every April for as long as you can remember, chances are you wouldn't think of yourself as a "tax evader" in the eyes of Uncle Sam.

Well, think again!

Under current law, any family or individual who employs someone they pay more than \$1,800 a year is considered an employer in

the eyes of the Internal Revenue Service and is required to pay taxes for that employee.

That sweet old lady across the street whom you pay \$50 a week to pick up your child from the school bus stop and watch them for an hour until you get home from work? She counts (\$2,600 annually). So does that gardener you pay \$25/hour for three hours of work three times a month (\$2,025 over nine months) to make sure your lawn stays well-manicured.

(Read More: [How CEOs Spend It](#))

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How about that part-time nanny? Forget about it. According to Stephanie Breedlove, Head of Care.com HomePay, part-time nannies can make an average of \$12,000 to \$15,000 a year. And a full-time nanny can easily take in more than twice that amount.

So these taxes, commonly referred to as "nanny taxes," aren't just for the 1 percent, as some Americans mistakenly believe. Whether it's a sitter, gardener or maid you pay for just a few hours of work here and there, it's important you do the math.

The Cost of Noncompliance

"No more than 20 percent of our industry pays legally," said Breedlove, who co-founded Breedlove and Associates, a home care employer consulting firm, in 1992 after six years in the consulting division of the now-defunct Arthur Andersen.

The 80 percent of qualified employers who skirt the nanny tax each year do so at their own risk.

"You sign your personal income taxes (which has your home care employer obligations folded into them) under penalty of perjury," said Kathleen Webb, president and co-founder of HomeWork Solutions, a household payroll consultancy in Sterling, Va., who also puts the nanny tax noncompliance rate in the 80 to 90 percent range.

Violators are subject to paying back taxes as well as penalties that compound annually for as long as an employer fails to fulfill their obligations, Webb said.

Although she's heard of only one individual who had actually gone to jail over noncompliance, she has had clients owe the IRS up to six-figures in back taxes and penalties. "It depends on how far back you're going and how much money you owe," she said, "but it can easily double your tax bill."

One client, who employed a full-time live-in elder-care giver for nine years without paying taxes, was subject to paying the government \$90,000 in back taxes plus an additional \$60,000 in penalties. And that figure didn't include obligations the client also owed at the state level, which could end up tacking on thousands of dollars in fees.

While such steep penalties should be enough to make any employer comply, Breedlove said she also advises her clients to consider the "human element" in taking care of responsibilities to employees.

"In a tighter economy, people unfortunately sometimes lose their jobs," she said, "and what we've been seeing recently is that when a household employee attempts to file for unemployment, they're finding that the funds aren't there."



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This is also how many tax dodgers get caught, Breedlove noted. When the government goes to look for the funds to support that out-of-work employee and finds them missing, it's an automatic trigger to Uncle Sam that something's not right. And it's those kinds of triggers that may ultimately lead to an audit.

The Rules of Engagement

Not to worry, though, Breedlove cautions. She advises her clients to follow a simple four-step process to ensure that they remain in compliance.

- If you employ someone in your home, you should establish tax accounts with the state and IRS, giving them your name and social security number—establishing yourself as an employer—and get an **Employer Identification Number (EIN)**.
- Be sure to withhold standard payroll taxes from each paycheck you give your employee, which go toward Social Security, Medicare and federal and state income taxes. (For Social Security and Medicare, the total contribution is 15.3 percent, with the employer and employee each contributing 7.65 percent. Add in a small contribution all employers pay for unemployment taxes and a typical employer's payroll taxes are approximately 9 percent.)
- On a quarterly basis, all employers must remit those withheld taxes to both the state and IRS.
- At year-end, you must provide a W-2 to your employee and file IRS form **Schedule H** with the state and federal government as part of your personal income taxes in April.

According to Care.com, **a nanny making \$600 per week** (\$15 per hour, 40 hours per week) should yield the following breakdown:

- Federal Income Tax: \$75.77
- Social Security: \$25.20
- Medicare: \$8.70
- State Income Tax (3.7%): \$22.20 (NY State)

Total Withholdings: \$131.87

Employers are also required to make the following contributions:

- Federal Unemployment: \$4.80
- Social Security: \$37.20
- Medicare: \$8.70
- State Unemployment: \$24.60 (NY State)

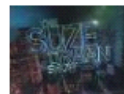
Total Additional Payments: \$75.30

So that means that your weekly child care payment amounts to \$675.30 per week (base plus additional payments), while your nanny takes home \$468.13 (base excluding withholdings) in net wages.



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And any employer considering dodging the nanny tax by classifying their nannies as "independent contractors" should think again, said Bob King, an attorney and founder of Irvine, California-based Legally Nanny.

"[Some employers] think they can just hand their nanny a Form 1099 and label them an 'independent contractor,'" said King. "No. IRS Publication 926 clearly states who is and isn't considered an employee, and nannies are always employees."

King pointed out that these kinds of "misclassifications" are also considered a form of tax fraud and said the IRS has increasingly started cracking down on this tactic as employers have become more savvy.

"People are getting smarter," he said of tax dodgers.

The Upside

There are also some fairly generous credits that come with paying your employee legally. Depending on your annual gross income, you can qualify for a credit of \$2,000 to \$2,300, according to Breedlove.

Of the seemingly high rates of noncompliance, Breedlove said there appears to be a lack of awareness on the part of both employers and employees. And on this she speaks from personal experience.

A working mom of two now-adult sons, she started her company after her first son was born in 1991 and she and her husband sought the help of an in-home nanny.

"We really wanted to pay her legally but couldn't figure out how to do it," she said. Now she wants to make sure that others in her situation don't unwittingly fall prey to the nanny tax trap.

"We want to bring awareness to the fact that folks who work at home are considered employees and are entitled to benefits," she said. "Ultimately, [the employees] are the real winners."

Any employer who wants to know more about their nanny tax obligations, find out who is or isn't considered an employee, and make sure they remain in compliance with the law should consult [IRS Publication 926](#).

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