

The Legal Review

Bringing the Law to Life for the Household Employment Industry

A Complimentary Resource from
LLC

Breedlove & Associates

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In an effort to help you strengthen your business practices and steer clear of legal trouble, ***The Legal Review*** will share findings from relevant real-world situations. These stories will illuminate potential legal landmines for your agency and/or your clients, and more importantly, show you how to avoid them.

Summertime Misadventure

With families beginning to make summer childcare plans, this edition of ***The Legal Review*** will highlight popular misconceptions about employing a summer

nanny -- and serve as a reminder that summer nanny placements frequently enjoy a significant tax advantage which you and your families may be able to leverage.

The Mistake

A family hired a nanny to care for their two children during the summer. They paid her about \$5,500 over 11 weeks and then took a two-week vacation with the kids right before school started. As the relationship was nearing its end, the family sought advice in a parent forum on how to handle the taxes and also how to get the tax breaks. In the online forum, they received conflicting advice. MountainMama94 said they had no obligations since the employment was seasonal. MrZoomerang advised the family to "call the nanny an independent contractor and fill out a Form 1099 to get the tax breaks." Ultimately, the family followed MrZoomerang's advice and gave the nanny a Form 1099. At the end of the year, they filled out Form 2441 in order to take the Child Care Tax Credit.

The Law

The IRS has ruled definitively that nannies should be classified as employees, **not** independent contractors. As employers, families are subject to federal, state and local labor law. In addition, they have employer tax obligations if they pay an individual \$1,700 or more in a calendar year (sorry MountainMama94, the IRS won't buy the "seasonal" argument). Once that threshold is crossed, the family is required to withhold Social Security and Medicare taxes from the employee's wages. They also have an obligation to match the Social Security and Medicare withheld, and pay federal and state unemployment taxes. It's the employer's responsibility to see that all employment tax returns and taxes are filed and

remitted on a timely basis and that the employee receives a Form W-2 at year end (**not** a Form 1099, MrZoomerang). Finally, household employers are required to file a Schedule H with their federal income tax return.

Since MrZoomerang brought up the childcare tax breaks, here's a quick review. Families who fulfill their obligations have access to at least one of the following tax breaks:

1. Dependent Care Account (also known as "Flexible Spending Account" or "FSA"): Many employers allow employees to set aside up to \$5,000 of pre-tax earnings for childcare expenses. Enrolling for this benefit can save families up to \$2,300, depending on their tax bracket.
2. Child or Dependent Care Tax Credit ("CCTC"): Families can take advantage of a 20% credit on expenses of up to \$3,000 for one dependent, or up to \$6,000 for two or more dependents by filling out Form 2441 on their federal income tax return. This tax break saves families \$600 or \$1,200 per year, depending on the number of dependents they have under the age of 13.
3. Those with 2 or more children can leverage the FSA and still itemize \$1,000 on Form 2441 for the Child Care Tax Credit, saving up to \$2,500 per year.

These tax breaks can offset most of the tax cost for those hiring *full-time* nannies; for those hiring *short-term* or *part-time* nannies, the tax breaks usually outweigh the tax costs by a significant margin.

The Mess

- The nanny completed her federal income tax return with the help of a tax preparer at an H&R Block office. After hearing her story about the 1099, he informed her that she had been paid incorrectly and was,

therefore, responsible for both halves of the FICA tax on the \$5,500 in wages, which increased her tax obligation by \$841. In order to help her retrieve that money, he also prepared and filed Form 8919, which is a form the IRS created in 2007 to help collect FICA taxes in cases of worker misclassification.

- The Form 8919 filed by the nanny triggered a review of the family's tax return. Since there was no Schedule H summarizing the household employment activity, the IRS sent a preliminary audit letter asking the family to clarify the situation.
- The IRS quickly surmised that the family had misclassified their employee as an independent contractor. They demanded back taxes plus penalties and interest.

The Outcome

- In all, the family paid wages, taxes, penalties and interest totaling just over \$8,000. Had they paid correctly, they would have paid a total of \$4,913 (see math below).
- The nanny was reimbursed the \$841 in FICA taxes once it had been collected from the family.
- Here's a look at the family's math ***if they had paid correctly:***

Employee's Gross Wages
\$5,500

Employer's Tax Obligation

\$613

Total Cost Before Tax Breaks

\$6,113

Savings from CCTC

<\$1,200>

Total Cost After Tax Breaks

\$4,913

Note: If they had been enrolled in an FSA, the family could have reduced their total cost to as low as **\$3,613** - even though the wages were \$5,500! For an estimate of the taxes and tax breaks your families will receive, visit our [Employer Budget Calculator](#). Most families employing a summer nanny will be very pleasantly surprised.

How it Could Have Been Avoided

Had the family sought tax guidance from a tax professional instead of MrZoomerang, they would have saved a tremendous amount of time, stress and money - for them and their employee. We provide that guidance for free through our website and our team of tax and labor law experts. As a placement agency, if you're not already doing so, please consider leveraging us in order to add financial and legal guidance into your

employment process so none of your families feel the need to seek tax and legal counsel from a parent forum. It's another way to give your clients convenience and expertise. You'll also be giving them guidance on tax-advantaged strategies that may create tremendous financial benefits for your families.

To learn more about leveraging us to be the financial and legal extension of your agency, just give us a call. We're here to help.

**If you have additional questions,
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