Preview Chapter

HOW TO Hire A Nanny

Second Edition

A Household HR® Handbook

Your Complete Guide to Finding, Hiring, and Retaining Household Help

- Nannies
- Babysitters
- Senior Care Workers
- Housekeepers
- And All Types of Household Help

GUY MADDALONE

THE NATION'S HOUSEHOLD HR® EXPERT

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Managing Payroll and Taxes

In the United States today, GTM Payroll Services Inc. estimates that there are more than two million household employees. Exact figures on household help are difficult to obtain. The U.S. Internal Revenue Service (IRS) Schedule H form filings provide a glimpse into the numbers and trends in household employment. The IRS Schedule H form must be completed and filed by household employers with their income tax statements. It is used (among other things) to figure household employment taxes. According to a 2010 news account, data compiled by the IRS show that only 219,000 household employers paid taxes via Schedule H in 2008. (The news report attributed its data from a doctorate thesis, "Household Employer Payroll Tax Evasion: An Exploration Based on IRS Data and on Interviews with Employers and Domestic Workers," by Catherine B. Haskins from the University of Massachusetts at Amherst.) In 2003, when the first edition of this book was published, the data showed that there were 239,810 Schedule H filings. This shows that in five years the number of filings is down almost 10 percent. Even accounting for the percentage of household employees with more than one employer, this amounts to a startling number of household employers in noncompliance—whether or not intentional—with paying payroll taxes.

Many people do not pay payroll taxes because they falsely believe that

- they will not be caught
- they know friends or neighbors who are noncompliant
- their employees do not necessarily want to be paid above board
- the employees will realize more income
- it costs the employer more
- it is not considered a *real* employment situation

Although household payroll taxes may be confusing to many, this chapter describes an easy-to-follow, step-by-step guide to managing household employment payroll and taxes. (For the latest information on payroll and taxes, visit www.gtm.com.)

Employer Responsibilities

It is your duty to clearly and fully understand what your responsibilities are as a household employer and for reporting and paying required payroll taxes. (See Appendix A, page 322, for a calendar on employer tax responsibilities.) Ignorance is no excuse or defense for not complying with laws and regulations.

Household employers who choose to pay their nannies off the books are putting themselves and their nannies at risk. By not paying payroll taxes (dubbed the *nanny tax*), the employer is risking hefty fines, penalties, and even jail time, and the employee is losing valuable protection mandated by law, such as unemployment insurance, Social Security credits, Medicare, and disability coverage. (See "Paying Off the Books—The Risks" on page 244.)

Household employers are not obligated to withhold federal or state *withholding* taxes from the employee's gross wages unless the employer and employee mutually agree to it. For more information, see IRS Publication 926. If these taxes are not withheld by the household employer, the employee can pay these annually if the employee qualifies.

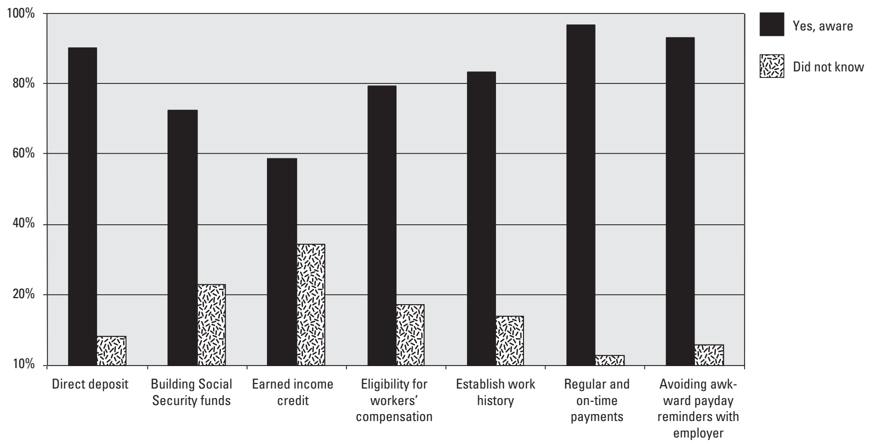
A household employer must understand the federal, state, and local employment laws that pertain to his or her household. Knowing the risks of noncompliance is part of fully understanding your employment laws. Depending on your location, you may have plenty of requirements to meet.

Many laws require the employer to obtain, file, and submit necessary paperwork. For instance, for each person hired, an I-9 Form must be completed. Tax laws also have paperwork requirements, such as reporting wages to the Department of Labor or a state's Wage and Hour Division. While some laws require employers to submit forms to a designated department or division, others require employers to file completed forms and be ready to produce the paperwork when requested by government officials.

Dealing with taxes and payroll is time-consuming, nerve-racking, and complicated. GTM Payroll Services Inc. calculates that a household employer spends more than sixty hours a year handling payroll and tax administration. It is not easy, and many household employers choose to use the services of a professional payroll service, such as GTM's EasyPay. Many household employers find security in knowing that their household payroll and taxes are taken care of by experienced and qualified professionals.

FACTS AND FIGURES

NANNIES PERCEIVED BENEFITS WHEN THEIR EMPLOYER USES A PAYROLL AND TAX SERVICE



Source: GTM Nanny Employment Trends 2011

FACTS AND FIGURES

HOUSEHOLD EMPLOYERS' TAX GUIDE

IF you	THEN you need to
A. Pay cash wages of $1,800 or more in 2012 to any one household employee Do not count wages you pay to: • Your spouse • Your child under age 21 • Your parent • Any employee under age 18 at any time in 2012	Withhold and pay Social Security and Medicare taxes: • The taxes are usually 15.3 percent of cash wages. • Your employee's share is usually 7.65 percent* (You can choose to pay it yourself and not withhold it.) • Your share is 7.65 percent
B. Pay total cash wages of $1,000 or more in any calendar quarter of 2012 to household employees Do not count wages you pay to: • Spouse • Child under age 21 • Parent	Pay federal unemployment tax. • The tax is usually 0.8 percent of cash wages (0.6% in 2012). • Wages more than $7,000 a year per employee are not taxed. • You also may owe state unemployment tax.

NOTE: If neither A nor B above applies, you do not need to pay any federal employment taxes, but you may still need to pay state employment taxes.

**At time of print, legislation is being discussed for the Social Security tax for employees to be set at 5.65% for 2012.*

Source: IRS Publication 926: Household Employer's Tax Guide for wages paid in 2012.

CASE STUDY

HILARY LOCKHART
PRESIDENT
A+ NANNIES, INC.
MESA, AZ

Hilary Lockhart of A+ Nannies said a nanny she placed learned the importance of being paid above board. This nanny was working in a position for nine months and was told by her employer that her services were no longer needed. The employer and nanny agreed at the outset to payment under the table. So, when the nanny was let go, she was five months' pregnant and unable to collect unemployment insurance benefits. She looked for work for six or seven weeks unsuccessfully before her doctor ordered bed rest until she delivered her child.

"The nanny couldn't collect any [unemployment] money at all because there was no record of her ever working," said Lockhart. "So, the nanny—five months' pregnant—is unable to find work being a nanny. No one seems to want to hire a nanny for four months and then give six weeks off for maternity leave."

Now, Lockhart tells clients and nannies to follow the law and pay all taxes. "Number one, I tell them it's against the law to pay under the table," said Lockhart, whose business places an average of four to ten child care workers a month. "I give all my clients a lot of information on taxes and the law. I used to ask clients if they were going to pay cash. I don't ask that any more. I tell [nannies] to get the taxes done right, especially in light of situations like this."

As a former nanny for seven years, Lockhart brings to her business a well-rounded perspective—a nanny, mother, and president of a referral agency. Constantly learning, she said she considers her clients' wishes and requirements against her own litmus test of placing herself as the nanny in that situation, which is why she now strongly advocates proper payroll and tax payments.

Paying household employment taxes involves a lot more than adherence to the law. Unemployment coverage also protects employees in instances when they become involuntarily unemployed. If a former employee files a claim for unemployment insurance coverage, then the state unemployment fund, which the employer had paid into through payroll taxes, pays the employee his or her unemployment insurance payment, which is a percentage of the employee's average weekly wage. The employer is not subject to additional or ongoing payments once the employee leaves the household. However, the household employer may incur higher payroll taxes (i.e., a higher unemployment insurance rate) with future employees.

—Guy

FACTS AND FIGURES

PAYING OFF THE BOOKS—THE RISKS

There is no doubt about it; paying off the books is risky business. It puts the employer and employee in peril by not providing the payroll coverage employers and employees are entitled to by law.

Liability to household employer:

- increased exposure to an IRS audit
- the penalty for failing to file (or attempting to evade or defeat tax payments) is $25,000-$100,000 and potential jail time
- a false or fraudulent statement or failure to furnish a tax statement could result in a minimum $1,000 fine
- payment of all back employment taxes, interest, and penalties
- no eligibility for tax breaks, Dependent Care Assistance Program (DCAP), or Child Tax Credit

Liability to household employee:

- IRS penalties due to failure to file timely income taxes
- no unemployment insurance benefits

- no legal employment history or credit history
- no contributions to Social Security and Medicare, and therefore no eligibility to these benefits
- no workers' compensation or disability coverage

Getting Caught Paying Off the Books

Many employers mistakenly assume that because the employment of domestic work is within their home they are unlikely to get caught paying their employee illegally. Because there is a long history of household employment being paid in this way, many employers assume that this is the accepted way of paying for work in the home. Even if they are aware of the consequences, many believe getting caught is so unlikely to happen that the risk is worth it. This is not the case. Paying a household employee off the books may mean an employer is investigated by the IRS. Some of the circumstances where this can occur are as follows:

- If you have formerly paid payroll taxes on past household employees but then do not with a new employee.
- You use an agency or an online registry and the IRS audits that entity for information about household employers not reporting payroll taxes.
- You terminate an employee who has not been paid legally and they complain to the IRS.
- You have mistakenly assumed the employee is an independent contractor and not an employee, so have not withheld the correct tax obligations.
- A former employee files for unemployment benefit but cannot get it because you have not paid unemployment tax.
- An employee is injured on the job so tries to claim worker's compensation and has to name you as the employer.
- A retired employee wants to claim Social Security and reports working for you.

Understand the Laws

Ignorance is no excuse for breaking the law. As an employer, it is critical for you to understand the laws and regulations governing household employment, payroll taxes, hiring, and so on. This handbook aims to help you do so.

Employee vs. Independent Contractor

As detailed in Chapter 2, determining whether one is an employee or an independent contractor is important in household employment.

The majority of household employees are just that—employees. Therefore, they need to be accurately paid according to applicable labor and tax laws. More information on employee vs. independent contractor status is available in *Independent Contractor or Employee? (IRS Publication 1779)* and *Supplemental Tax Guide (IRS Publication 15A).*

Researching Tax Laws

The IRS states that a household employer who pays an employee $1,800 or more (as of 2012) in gross wages during the calendar year must comply with all state and federal laws. (See "Comply with Tax Laws" on page 248.) For more information, see IRS Publication 926, *Household Employer's Tax Guide*, at www.irs.gov or www.gtm.com.

Follow Payroll Regulations

According to the Fair Labor Standards Act (FLSA), all household employees must be paid at least the federal or state minimum wage, whichever is higher. The federal minimum wage is $7.25 per hour (in 2012), but state minimum wages may be higher. (See page 194 for a state-by-state minimum wage chart.) Under certain conditions, benefits such as room and board can account for a portion of the employee's wage. Overtime pay is required for most live-out employees (according to FLSA) and there may be additional requirements for household employees, including live-ins, depending on the state in which the household resides. (See page 209 for more information on overtime). Paid vacations, holidays, and sick days are not required by law, and are at an employer's discretion, in most states. Some states have new laws in place that do require paid time off. For example, New York's Domestic Bill of Rights (2010) entitles domestic workers to receive overtime pay, one day of rest per week or overtime pay when they work on their day of rest, and three days of paid time off after one year of employment.

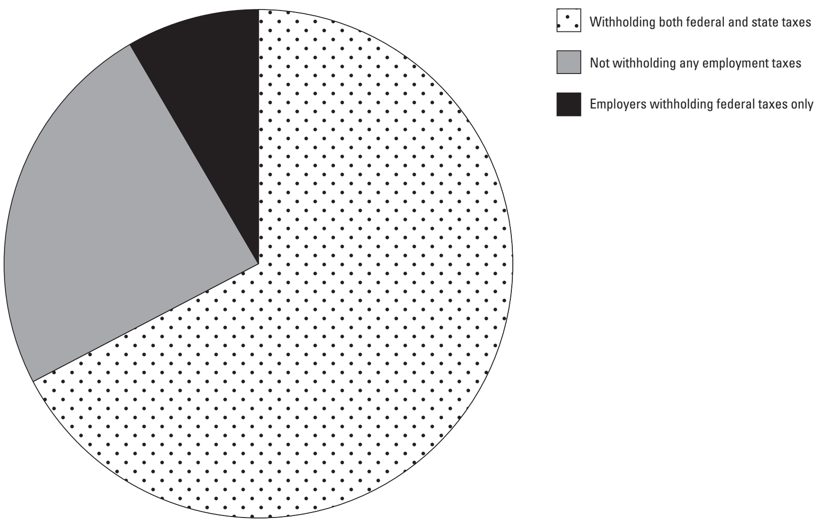
Expert Advice

"I cannot imagine trying to do my own tax payments. To me, doing payroll and tax payments yourself is penny-wise and pound foolish. I am a strong believer in having professionals do the work. These people are professionals, and this is what they're good at."

—Stephanie Oana
Household Employer
Oakland, CA

FACTS AND FIGURES

IS YOUR EMPLOYER WITHHOLDING AND REPORTING YOUR PAYROLL TAXES?



Source: 2011 International Nanny Association Salary and Benefits Survey

Information in this report is based on the year 2010 from 528 in-home child care providers. For more information, see www.nanny.org or http://tinyurl.com/INASurvey.

Comply with Tax Laws

GTM Payroll Services Inc., which provides tax and payroll services to household employers through its EasyPay Service, estimates that *employers* can expect to pay 9–12 percent of the employee's gross pay for the following:

- federal unemployment insurance (usually 0.8 percent. 0.6 percent for 2012)
- Social Security and Medicare (7.65 percent)
- state unemployment insurance (about 2–5 percent in most states)
- other state and local taxes (e.g., employment training or workforce taxes)

GTM estimates that, according to average salaries, *employees* can expect to pay 10–30 percent of their gross pay for:

- Social Security and Medicare (usually 7.65 percent)
- other state and local taxes (e.g., disability), if applicable
- federal and state income taxes, if they choose (estimated at 15–25 percent)

Though tempting to many, not paying taxes is illegal. By not paying an employee lawfully, the employer is liable for all unpaid taxes, interests, and penalties, and may face a potential jail term.

Obtain the Necessary Paperwork

It is extremely important that you obtain all the necessary paperwork needed when you hire your household help. This includes several federal and state forms. Some of the documents you will be familiar with, probably having filled them out yourself when starting a job. Others are more unique to this type of employment or are documents you would probably not be familiar with unless you have been an employer before. From your employee's perspective, these are the forms needed to ensure he or she is getting paid and getting paid properly. To properly pay an employee, an employer should obtain the following documents (all the forms that follow are discussed in detail later in this chapter).

Federal Requirements

- Form SS-4 *Employer Identification Number* from the IRS
- Form W-4 *Employee's Withholding Allowance Certificate* to provide to newly hired employees
- Form I-9 *Employment Eligibility Verification* to provide to newly hired employees

- Form W-10 *Dependent Care Provider's Identification and Certification* for DCA Dependent Care Assistance (DCA)
- Form 1040 Schedule H *Household Employment Taxes*, an annual form
- Form 1040ES *Estimated Tax for Individuals*, optional

State Requirements

- Registration form for a state unemployment identification number
- Registration form for a state withholding number (if applicable)
- State withholding certificate (if applicable)
- State's new hire report (if necessary)

Federal Taxes

There are several federal taxes that apply to the household employer's payroll. Known as *payroll taxes*, these federal taxes are paid to the federal government via the employee's pay and are established to protect the employer and employee in the event the employee is no longer employed by the employer. For instance, if the employee is no longer needed by the employer, he or she may be covered by federal unemployment insurance. It is important to be aware of all federal, state, and local taxes applicable to you as an employer. Key federal taxes include Social Security, Medicare, federal income tax, and the Federal Unemployment Tax Act (FUTA).

Social Security

Social Security tax, otherwise known as Old Age Survivor's Disability Insurance (OASDI), is required to be paid by both the employer and the employee. Each pays half of the Social Security taxes owed to the federal government. This usually calculates to 6.2 percent each of the employee's gross salary (for the employee is withholding, 6.2 percent from the employer is a matching contribution, totaling 12.4 percent). The tax is capped at a gross salary of $110,100 in a calendar year as of 2012 (for both the employee and the employer).

Paying into Social Security is an important benefit to your employee, as it provides retirement coverage when he or she becomes older. Protection for his or her future years is a valuable benefit and shows your employee that you respect his or her position.

Note: At time of print, legislation is being discussed for the Social Security tax for employees to be set at 4.2% for 2012.

Medicare

Like Social Security, Medicare taxes require the employer and employee to contribute equally. This tax is 2.9 percent, so both pay 1.45 percent of the employee's gross salary. There is no salary limit earned for this tax.

As with Social Security, Medicare is an important benefit for your employee to have when he or she is older and retired, providing basic medical insurance when many need it the most.

Federal Income Tax

Withholding federal income tax (FIT) from an employee's paycheck is optional, but if agreed to by employer and employee, then the employer must withhold income taxes based on the employee's completion of Form W-4. This is an employee-only withholding, and the employer does not incur any additional expenses. The FIT amount owed by each employee varies according to his or her income and filing status.

Paying federal income tax from each paycheck helps the employee disburse payment across the year, and not face paying the total federal income tax all at once. It also ensures that both employer and employee are complying with the law.

Federal Unemployment Tax Act

If an employer pays cash wages to a household employee, totaling $1,000 or more in any calendar quarter, then he or she is responsible for paying the *Federal Unemployment Tax Act* (FUTA). This is an employer tax and is not withheld from an employee's pay. It is calculated on the first $7,000 of gross wages per employee at the usual tax rate of 0.8 percent (0.6 percent for 2012), if an employer has paid his or her state unemployment taxes on time. An employer must report FUTA with the Schedule H form, which is filed with his or her 1040 personal income tax return. Federal unemployment, while an employer tax, benefits an employee if he or she finds him- or herself to be out of work.

FACTS AND FIGURES

AN EXAMPLE OF HOW TO FIND OUT WHAT EMPLOYER TAXES TO PAY:

Facts:

Wage = $500 (gross) per week

State = New York

- Federal Unemployment = $3 per week (2012)
- Social Security = $31 per week
- Medicare = $7.25 per week
- New York State Unemployment = $20.50 per week.

Those four taxes add up to $61.75 per week. $61.75 (above taxes) plus $500 (gross wages) gives a total out-of-pocket cost, or the employer responsibility, of $561.75 per week.

Note: it may actually cost you a little bit less if you can qualify with your Dependent Care Assistance Plan (DCAP) at work, or use the Child and Dependent Care Tax Credit.

For more information, see www.gtm.com videos at www.gtm.com.

Employee's Social Security Number

Save for the SS-4, which is discussed below, before you can complete any of the necessary paperwork, you must ensure that your employee has a Social Security number. Do not assume that the employee has one, especially if he or she is not a U.S. citizen, and be sure to verify every employee's number with the Social Security Administration. This can be done by calling the Social Security Number Verification line at 800-772-1213. If an employee does not have a Social Security number and is a legal U.S. citizen, then he or she can apply for one with Form SS-5 (Application for a Social Security Card). If an employee is not a U.S. citizen, an Individual Tax Identification Number (ITIN) can be obtained by using IRS Form W-7 (Application for IRS Individual Tax Payer Identification Number). An ITIN is only used for federal withholding tax purposes.

Necessary Federal Paperwork

- Form SS-4 *Employer Identification Number* from the IRS
- Form W-4 *Employee's Withholding Allowance Certificate* to provide to newly hired employees
- Form I-9 *Employment Eligibility Verification* to provide to newly hired employees
- Form W-10 *Dependent Care Provider's Identification and Certification* for DCA Dependent Care Assistance (DCA)
- Form 1040 Schedule H *Household Employment Taxes*, an annual form
- Form 1040ES *Estimated Tax for Individuals*, optional

Form SS-4

All employers must have an employer identification number (EIN). This is generally the first document you will complete and gives you a specific tax number, much like your personal Social Security number, for dealing with the IRS and other parties. It is provided by the IRS through Form SS-4 *Application for Employer Identification Number*. An SS-4 form may be obtained by telephoning the IRS at 800-829-4933 or visiting www.irs.gov and completing it online.

Form W-4

If an employer and an employee have agreed to withhold income taxes, then employers should provide employees with a Form W-4, *Employee's Withholding Allowance Certificate*, and the employee must complete it. Form W-4 can be downloaded from www.irs.gov or www.gtm.com. The W-4 documents how much income tax is withheld from an employee's salary. If the W-4 is not submitted, then the employer must withhold the employee's income tax at the highest rate—as a single person with no allowances. (See Appendix E, page 381, for a sample *W-4 Form*.)

Employers who have agreed to withhold income taxes for their employees are required to send a signed W-4 to the IRS when an employee:

- claims an exemption from withholding and the employee's wages are normally more than $200 per week
- claims ten or more allowances

Refer to IRS Publication 919 for more information.

Form I-9

Employers need to provide employees with a Form I-9, *Employment Eligibility Verification*. All employers in the United States must obtain a completed I-9 for every employee hired. The I-9 attempts to ensure that only people legally authorized to work in the United States are hired.

Employers can use the I-9 to verify the identity and employment eligibility of employees or can register and complete the USCIS e-verify system at www.uscis.gov. (See Appendix E, page 360, for a sample *I-9 form*.) More information about the I-9 process can be found at www.uscis.gov/i-9central.

Considering the rapid way in which immigration policies are changing and becoming stricter, it is vital that all employers complete the I-9 and keep it on file with appropriate copies of documentation in the employee's personnel file. In short, this proves your employee is eligible to be employed in the United States.

Form W-10

Form W-10 *Dependent Care Provider's Identification and Certification* is an optional form that any taxpayer can use to obtain information about the dependent care provider (household employees or even day care centers). This is the same information that the taxpayer reports on Form 2441 *Child and Dependent Care Expenses* with the 1040 Personal Tax Return. The IRS states that the taxpayer can use Form W-10 or any of the other methods of due diligence to collect this information, including:

- a copy of the dependent care provider's Social Security card or driver's license that includes his or her Social Security number
- a recently printed letterhead or printed invoice that shows the provider's name, address, and taxpayer identification number (TIN); if the provider is your employer's company's dependent care plan, a copy of the statement provided by your employer under the plan
- a copy of the household employee's W-4, if the provider is the household employee and he or she gave the employer a properly completed Form W-4 *Employee's Withholding Allowance Certificate*

Schedule H

Starting in 1995, the Schedule H (Household Employment Taxes) form was added to federal Form 1040 U.S. Individual Income Tax Return for employers who paid more than a total of $1,800 during the calendar year (as of tax year

2012) to household employees, or for employers who paid all employees more than $1,000 in any one quarter during the calendar year. Schedule H enables employers to report wages and taxes withheld for household help to the federal government with their own 1040 form.

FACTS AND FIGURES

HOUSEHOLD EMPLOYER PAYROLL TAX EVASION

According to Catherine B. Haskins at the University of Massachusetts and her 2010 report for her dissertation, "Household Employer Payroll Tax Evasion: An Exploration Based on IRS Data and on Interviews with Employers and Domestic Workers," all data sources indicate that a good deal of tax evasion is going on." Despite the impossibility of accurately determining the true number of household employers who owe nanny taxes, Haskins found that the amount of estimated noncompliance per year is astounding. This evasion rate is calculated as the gap between the number of returns that should have been filed per year (based on government estimates of the number of household workers) and the number of Schedule H returns that were actually filed (from the IRS).

Haskins looked at the years 1996–2006 and reported the first-ever household employer payroll tax noncompliance estimates. Her results are considered conservative low estimates because of the numbers reported—as she mentioned, "true evasion rates are likely much higher because official survey data on domestic workers likely suffer from undercounting."

Despite this qualifier, Haskins estimates that for every year surveyed, "the count of household payroll tax returns is never more than half and sometimes only one quarter as large as the estimate of household employees."

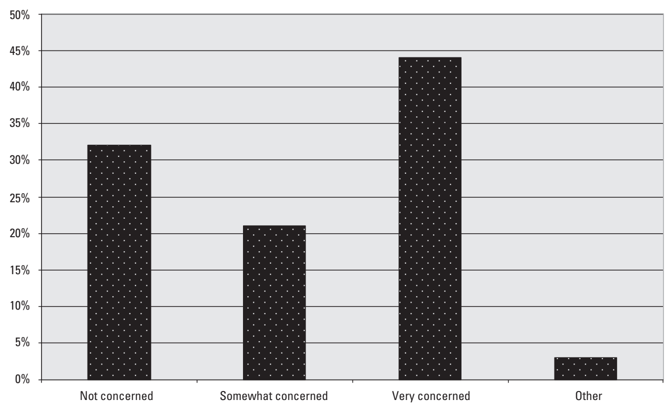
Using American Community Survey and Household Data Annual Averages data for the entire eleven years, Haskins calculated an overall noncompliance rate of 70–71.3 percent for that period.

Haskins also stated that because these results can be considered as "reasonable lower bound estimates" she believed the actual noncompliance rate could be as high as 90 percent. She cited that many in the industry believe that government statistics understate the actual number of household workers which could mean that there is a national domestic worker population in the millions.

Source: Catherine B. Haskins, "Household Employer Payroll Tax Evasion: An Exploration Based on IRS Data and on Interviews with Employers and Domestic Workers" (2010). Open Access Dissertations. Paper 163. http://scholarworks.umass.edu/open_access_dissertations/163

FACTS AND FIGURES

EMPLOYERS' CONCERNS ABOUT TAX COMPLIANCE



Source: GTM Household Employer Employment Trends 2011

FORM 1040-ES

The option of transmitting taxes quarterly versus paying at the end of the year with form Schedule H (Household Employment Taxes) allows a household employer to make estimated tax payments to cover household employment taxes. These vouchers allow you to make payments and pay all of the employment taxes at once or in installments. This form is due on a quarterly basis. (Refer to 1040-ES filing instructions for due dates, and see the table on page 322.)

FACTS AND FIGURES

INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER

Regardless of whether a person is legally employed, an IRS Individual Taxpayer Identification Number (ITIN) can be used by those who are ineligible to obtain a Social Security number but who need to pay taxes on wages earned; these people include certain nonresident and resident aliens, and their spouses and dependents. The ITINs are nine-digit numbers beginning with the number nine and formatted like a Social Security number (9XX-XXX-XXXX). They are not to be used for nontax purposes (e.g., proof of identity for a driver's license, residency claim or employment, or to apply for welfare and health benefits). The IRS Form W-7 (Application for IRS Individual Taxpayer Identification Number) is used to obtain an ITIN and may be submitted to the IRS. According to the IRS, people using an ITIN cannot claim the earned income tax credit.

CASE STUDY

ZUZKA POLISHOOK
HOUSEHOLD EMPLOYER
PACIFIC PALISADES, CA

Zuzka Polishook hired her first nanny after the birth of her second daughter. With a two-and-a-half-year-old daughter and a second daughter just a few months old, Polishook transitioned her babysitter into a full-time nanny and housekeeper to help care for the two girls, as well as for a large house and two dogs.

Although Polishook knew from experience that the employee was responsible and a hard worker, she still painstakingly drafted an employee contract signed by both the nanny-housekeeper and herself. She did this to formalize this existing relationship but, more important, to clear any potential problem areas and resolve any unspoken questions. "The nanny knows where she stands with it, and I know where I stand with it," said Polishook. "It's peace of mind for me. No matter how obvious, I wrote it down. It acts as a checklist for both parties."

However, even though she was exceedingly capable of preparing the paperwork and doing the subsequent necessary payroll and tax responsibilities, she quickly was surprised by the amount of paperwork involved in employing a domestic employee.

"Time is my most valued currency, and I was clueless where to start. I didn't even know what I needed to know." Thus, Polishook took advice from a friend and contracted with a tax and payroll service to manage the payroll and tax piece of the household employment equation. "I'm in the know and in control," she said, "but I don't have to figure the details out." By using a payroll service, she was buying peace of mind, and stated, "now, I am able to dedicate the hours I would have spent figuring payroll and taxes to my children."

Polishook advises families considering a payroll and tax service to calculate the value of their time per hour with the number of hours per month spent addressing tax and wage requirements. Once you determine the value of your time against how much time it takes away from spending with your children, using a payroll service may seem like a cost saving.

As a household employer going it alone, it can be difficult to devote the time and energy needed to stay abreast of the changing employment regulation and tax laws. Using a payroll and tax service is an inexpensive way to save busy household employers valuable time and money.

—Guy

Q&A

Q. Can we put our household employee on our company payroll?

A. Generally, no. Your company payroll should be reserved for those employees who work for your company.

Equally important, you cannot deduct

Reporting and Filing Federal Payroll Taxes

There are two options for filing federal payroll taxes: annually or quarterly. Household employers must report and file all federal taxes by using Form 1040 Schedule H, which is an annual reconciliation form that is used by the employer to report to the

IRS wages paid to the household employee throughout the year.

Alternatively, employers may pay estimated taxes on a quarterly schedule to help alleviate the tax burden at the end of the year. In addition, Schedule H must be filed annually with the employer's personal 1040 federal tax return. To do this, an employer will need to file the 1040 Estimated Tax Form. This calculates an estimate of the following:

- employee federal income tax (FIT)
- employer and employee Social Security and Medicare
- employer federal unemployment tax (FUTA)

This sum is an estimated amount for each quarter. The due dates for submitting this form are explained in the box below.

your household employee's wages from your company's expenses. In most cases, you must pay your federal household employment taxes on your own federal income tax return, either annually or quarterly. The only exception to reporting your federal household employment taxes on your personal federal income tax return is if you are a sole proprietor or your home is on a farm operated for profit. In either of these instances, you may opt to include your federal household employment taxes with your federal employment tax deposits or other payments for your business or farm employees. (See IRS Publication 926 for more information.)

FACTS AND FIGURES

FILING FEDERAL TAXES

Quarter	Due
First (January–March)	April 15
Second (April–May)	June 15
Third (June–August)	September 15
Fourth (September–December)	January 15

If estimated tax payments are not made quarterly, then an employer may want to arrange to have additional federal income taxes withheld from his or her own salary. This will help to avoid owing a significant sum on his or her personal federal tax return and also to avoid a possible 10 percent underpayment penalty.

Each year, an employer must provide employees with Form W-2 (Wage and Tax Statement) on or before January 31. This provides a breakdown of all withholding and income throughout the previous calendar year and helps the employee submit her or his individual income tax forms.

By February 28 (or March 31 if the W-2 is filed electronically), the employer must also file the employer copy of the employee's W-2 and W-3 (a wage transmission report) forms to the Social Security Administration. A W-3 is a reconciliation of all W-2s for each employee, even if an employer is only employing one employee.

It is extremely important for your employee to be able to prove that he or she has a source of income in establishing credit, getting a loan or a credit card, or benefiting from any tax credits. Plus, both employer and employee may benefit from tax credits: an employer may benefit from credits and from a dependent care account at work, whereas an employee may benefit from the federal earned income tax credit.

State Taxes

Along with federal taxes, household employers are responsible for complying with their state and local tax laws. Be sure that you cover all payroll taxes—federal, state, and local.

Necessary State Paperwork

State Requirements:

- Registration form for a state unemployment identification number
- Registration form for a state withholding number (if applicable)
- State Withholding Certificate (if applicable)
- State's new hire report (if necessary)

State Unemployment Identification Number

Household employers are required to obtain a state unemployment identification number with the state where the physical work will be performed. Refer to IRS Publication 926 for a list of State Unemployment Tax Agencies (also available online at www.irs.gov). The ID number is needed to pay state unemployment taxes on a quarterly basis and will appear on the W-2 (Wage and Tax Statement) form for each employee.

State Withholding Certificate

It is optional for an employer to withhold taxes from an employee's paycheck. If an employer and employee decide to withhold state income taxes, then the state's registration form should be completed by contacting the state's withholding agency. This provides an employer with an ID number, a coupon booklet, and instructions on how to submit withholding taxes according to the state's laws. This number will also appear on Form W-2 for each employee.

State New Hire Report

New hire reporting is a process by which an employer has to register any newly hired employee with the state within a certain time of the hire date.

This report usually gives contact and basic identification information for each new employee to the state's department of labor, which then transmits the report to the National Directory of New Hires (NDNH). (The most common use of this information is to help the child support collection unit track down debtors for child support payments.)

Q&A

Q. I am nervous about dealing with the IRS and all federal, state, and local tax forms that I need to complete. What can I do to ensure that I'm doing all I need to be doing, particularly since two friends of mine do not file the same paperwork that I do?

A. Given the circumstances, you're right to be anxious. Following all tax requirements can be confusing and time consuming, but it must be done. Refer to IRS Publication 926 and Publication 15, as well as relevant state and local labor and tax guides. Many household employers contract with payroll services firms like GTM to handle taxes and paperwork and to consult with experts regarding the precise, timely, and lawful handling of wages. Many who choose not to adhere to the tax law unfortunately risk heavy penalties and jail. Paying a household employee under the table puts the household employee in a very vulnerable spot, as he or she is without the protection of unemployment insurance, Social Security, and so on. The important thing is to make sure you pay the correct taxes.

Q&A

Q. Is there a difference between being covered by Social Security and being eligible for Social Security?

A. Yes, and the difference is significant. To be eligible for Social Security, an employee must work forty calendar quarters to be fully insured and eligible for retirement, disability, death, and survivor benefits. To be covered, you must work at least ten calendar quarters to be insured and eligible for limited death benefits.

Workers' Compensation and Disability Insurance

Most states require household employers to carry a workers' compensation and/or disability policy if employing someone full-time or part-time. These policies provide compensation to an employee who is injured on the job. It is recommended that even if your state does not require employers to have a policy, you should consider obtaining appropriate coverage for peace of mind. Some states also require insurance coverage for nonoccupational injury or illness. If you do not cover yourself for an employee injury, you set yourself up for possibly a very costly lawsuit if your nanny, senior caregiver, housekeeper, or other employee is injured on the job. Homeowner's insurance policies often *do not* cover these situations. With the proper insurance coverage, you will protect yourself and your home—while also protecting your employee from the added costs of the injury and potential loss of work.

States that mandate workers' compensation and disability insurance are discussed in Chapter 12.

State Unemployment Insurance

State unemployment insurance is an employer tax and is normally due on a quarterly basis. Unemployment insurance contributions are accumulated in every state's unemployment insurance fund for workers who can claim eligibility. State unemployment insurance is generally calculated between 2 percent and 5 percent on a certain amount of each employee's gross wages for the calendar year, which varies state by state. For example, for new employers, Virginia's state unemployment insurance is set at 3.17 percent on the first $8,000 per employee, whereas Arizona requires 2 percent on the first $7,000 (in 2012).

Unemployment is an important factor for any worker. Sometimes, a new employee just does not work out, or perhaps circumstances change and you no longer need a nanny or other household worker. Unemployment insurance would protect your nanny and his or her family, paying a percent of their income, until he or she is hired elsewhere and no longer needs assistance.

State Withholding Taxes

State withholding taxes are employee income taxes based on filing status and wage level. This practice is not required, unless agreed upon by the employer and employee, but it generally helps employees distribute their owed income taxes throughout the year at regular intervals, rather than requiring a total payment at the end of the tax year. The employee may want the employer to withhold state income taxes from his or her paycheck.

Also, much like federal taxes, paying state withholding taxes documents an employee's legal employment history and is critical in their establishing and improving themselves financially.

Q&A

Q. I am a housekeeper and my employer is paying my Social Security and Medicare but asked me if I would like income taxes withheld. I am uncertain whether to have income tax withheld from my paycheck. What is the best scenario?

A. What is best depends on you. First, choosing to withhold income tax from your paycheck is not the same as choosing whether to pay it. You must pay it. The option is whether you want your employer to withhold income tax from your paycheck or whether you want to pay the income tax yourself. So, this becomes a budgeting and convenience issue. We strongly discourage employees from trying to pay taxes on their own.

Disability Insurance

Some states may require the employer to withhold additional taxes or insurances from the employee's pay. For example, both New Jersey and California have a state disability tax. California State Disability Insurance (SDI) is a partial wage-replacement insurance plan for California workers. The SDI program is state mandated and funded through employee payroll deductions. It provides affordable, short-term benefits to eligible workers who suffer a loss of wages when they are unable to work due to a non-work-related illness or injury, or a medically disabling condition from pregnancy or childbirth.

Local Tax

Some localities require an employer to withhold local income tax, based on either the place of employment or residence of the employee. Such localities include some in Ohio and Pennsylvania, as well as New York City.

Filing State Taxes

Most states require the quarterly filing of state taxes (state unemployment and other taxes). Unfortunately, state tax quarters do not coincide with federal tax quarters.

Instead, states require taxes to be submitted every three months—typically one month after the quarter ends. After an employer has registered with the state to file taxes, the state sends blank quarterly forms with instructions. If an employer uses a payroll service, then he or she may avoid the hassle of signing checks and filing taxes accurately and timely. If they so choose, the employer and the employee may file state income taxes (state withholding taxes) that are typically due each quarter. However, each state has specific filing frequencies based on how much income tax is withheld. The amount withheld from an employee's wages during a quarter generally determines the filing frequency in any given state (e.g., semiweekly, monthly, quarterly, annually). When an employer registers with the state, state tax officials will inform her or him of the filing frequency. Another way to determine filing frequency is to refer to the welcome letter in the correspondence received with the state withholding income number.

More and more states are requiring electronic filing for state taxes, so it is best to check with your state if this is mandatory or not.

Penalties may be applied to employers who remit payment by check and do not e-file. These states are (as of 2011):

State	Withholding	Unemployment Tax
Alabama	X	X
Alaska		X
Arkansas		X
Colorado		X
Connecticut	X	X
Delaware	X	
Florida		X
Idaho	X	
Indiana	X	
Iowa	X	X
Kentucky		X
Maine	X	
Massachusetts	X	X
Minnesota	X	X
Mississippi	X	
Nebraska	X	X
New Jersey	X	X
New Mexico		X
Ohio	X	X
Oklahoma		X
Oregon	X	
Pennsylvania	X	X
South Carolina	X	
Utah	X	X
Virginia	X	
Wisconsin	X	X

FACTS AND FIGURES

STATE FILING DATES

Quarter	Due
First (January–March)	April 30
Second (April–June)	July 31
Third (July–September)	October 31
Fourth (October–December)	January 31

Although these dates do apply for most states, they can vary from state to state. Be sure to double-check your state's due dates.

Record Retention

An employer should make sure that all hiring, tax, and payroll documentation regarding an employee's hire, including all IRS and state forms, is kept in a safe place. It is recommended that these forms be kept on file for at least seven years, in case the IRS or Department of Justice needs to check who is, or has been, employed by the employer. For more information, see Chapter 9.

Employee Responsibilities

The employee who works in your home is responsible for reporting and paying required payroll taxes too. It is worth making sure that employees are aware of their responsibilities at the start of employment, if they do not already know. Nannies and other household employees are liable for four key taxes:

Q&A

Q. What state taxes am I required to pay as a household employer?

A. State employment laws are similar for a worker in the home or in the corporate office. All states have a state unemployment insurance tax, which employers must pay.

This amount is a percentage (2–5 percent) of the household employee's gross salary and is capped at an annual wage amount. For example, Illinois requires 3.35 percent on the first $13,560 (2012) of the gross wage per employee. Some states, such as California and New Jersey, require the employee to contribute a small amount to disability or unemployment out of her or his own gross pay in addition to employer payments.

1. Social Security (OASDI) at (usually) 6.2 percent (2012). If the household employee is getting paid $1,800 gross or more in 2012, they are required to withhold and pay Social Security.
2. Medicare at 1.45 percent. If the household employee is getting paid $1,800 gross or more in 2012, they are required to withhold and pay Medicare.
3. Federal income tax not required to be withheld*.
4. State income tax not required to be withheld*.

*Federal and state income taxes are not required to be withheld unless agreed on by the employer and the employee. It is advantageous to withhold them though because it

- helps employees distribute their owed income taxes throughout the year, rather than as a lump sum at the end of the tax year
- helps to document an employee's legal employment history
- ensures both employer and employee in compliance with the law

FACTS AND FIGURES

AN EXAMPLE OF HOW TO FIND OUT WHAT EMPLOYEE TAXES TO PAY.

Facts:
Nanny's wage: $500 gross wage per week
Nanny's tax classification: claiming single zero
Location: New York City, New York
Federal income tax = $60.77
Social Security = $31*
Medicare = $7.25
State income tax = $17.61
Local income tax = $11.30

Total tax to be withheld = $127.93 per week. Take this from the gross wage of $500, would leave the employee with a net take home pay of $372.07 per week.

For more information, view videos at www.gtm.com.

*calculated at the usual rate of 6.2%

Paying an Employee

Unless an employer already has a firm idea of when he or she wants an employee to be paid, it is probably best to talk to the employee to see what best suits his or her needs and to agree on a regular pay interval. Generally, workers must be paid at least twice a month; however, some states require a weekly pay frequency for household employment.

Wages should always be paid by check so both the employer and the employee have an earnings and deduction record for the current pay period and year-to-date accumulated totals (see Appendix D, page 357, for a sample *Paycheck and Payroll Earnings Statement*.) The amount on the check should always be net (after all applicable taxes are withheld).

An employer can also offer the option of direct deposit, which is a convenient payment method for both the employer and the employee.

Some states require more detailed pay rate information, such as under New York State Wage Theft Prevention Act. This law asks for details about whether the employee is paid by the hour, shift, day, week, salary, piece, commission, or other, on their pay statement and pay rate notice at time of hiring.

Employer Benefits of Paying Nanny Taxes	Employee Benefits of Paying Nanny Taxes
• Tax savings which can help underwrite much of the employer's payroll tax expense	• Eligible for Social Security credits
• Eligibility for federal assistance programs e.g. child care tax credit and Dependent Care Assistance Programs (DCAP). This may allow up to $5,000 in pretax earnings per year that can be set aside for child care or eldercare expenses	• Legal employment history
• Ensuring tax compliance	• Coverage for Social Security, Medicare, unemployment, and workers' compensation
• Avoiding state and federal fines and penalties	• May qualify for earned income credit
• Family financial protection, such as workers' compensation in the event the worker is hurt while working on the job	• Ensuring tax compliance
• Peace of mind—knowing you are doing the right thing to protect your family and your employee	• Peace of mind—knowing you are doing the right thing and abiding by the law

Payroll Tax Checklist

- ❑ Understand and abide by all federal, state and local laws.
- ❑ Be aware of applicable state and local laws.
- ❑ Be clear about household tax needs and the importance of lawful tax payments for all household employees.
- ❑ Even if an employee asks to be paid under the table, do not do so. Explain that tax withholding is for the employee's benefit and will ensure unemployment and Social Security coverage.
- ❑ Ensure that the employee knows about his or her tax obligations as a household worker.

When a household employee is hired:

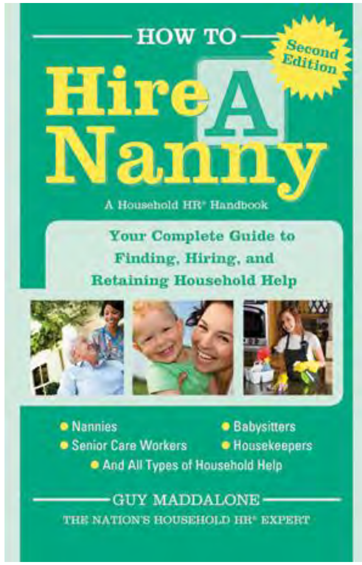
- ❑ Obtain an employer identification number (if not obtained previously).
- ❑ Have household employees complete Form W-4 if the employer is withholding income taxes.
- ❑ Obtain Form I-9 for employee eligibility verification.
- ❑ Apply for a state unemployment ID number.
- ❑ Apply for a state withholding number (if applicable).
- ❑ Apply for a state's new hire report (if necessary).
- ❑ Obtain Form 1040-ES for estimated tax payments (if desired).
- ❑ Check workers' compensation policy requirements for the state.
- ❑ Establish a regular pay period schedule, and inform the employee.

When a household employee is paid:

- ❑ Withhold Social Security and Medicare taxes.
- ❑ Pay on time federal, state, and local taxes that may apply.
- ❑ Withhold federal and state income taxes, if agreed.
- ❑ Send Copy A of Form W-2 with Form W-3 to the Social Security Administration by February 28 (or March 31 if filing electronically) each year.
- ❑ File Schedule H with the employer's federal income tax return (Form 1040) by April 15 each year.
- ❑ Keep records in a safe place for seven years.

Source: IRS Publication 926 Household Employer's Tax Guide

For an easy-to-follow step-by-step tax guide, see Appendix A on page 323. State tax form checklists can be found at www.sourcebooks.com/extras/nanny and links to state departments are available at www.taxadmin.org/fta/link.



Interested in reading more of <u>How to Hire a Nanny, Second Edition</u>? Purchase the entire book today by visiting www.amazon.com or visiting any local bookstore.

To contact **GTM Payroll Services** for expert advice and time savings services, such as nanny payroll and tax, insurance, household human resources, or retirement services, visit www.gtm.com or call (888) 432-7972.

A One-of-a-Kind Guide for All Your Household Help Needs

Hiring someone to watch your children, care for an aging parent, or to provide any other assistance you may need around your home can be an incredibly time-consuming and difficult process. Making sure you comply with all of the employment, hiring, payroll, and tax regulations, as well as just being a good employer, is crucial in making this relationship work.

How to Hire a Nanny provides guidance from the nation's leading expert on household help—Guy Maddalone. For more than twenty years, Guy has assisted countless families with finding the right help to meet their needs. In this book, he walks you through the entire process of being an employer of a nanny, senior caregiver, or other household employee. You'll find help on topics such as forming a work agreement, determining wages and hours, and managing payroll, insurance, and taxes. Now with new chapters on Senior Care in the Home, Finding Help on Your Own, and Employing a Noncitizen, this informative handbook covers everything you need to make the process of hiring and employing household help easy and simple.

"In a comprehensive guide, Guy Maddalone has compiled all the information a household employer needs to properly manage anyone working in the home. He covers the range of domestic help from hiring one nanny to employing a full staff. With practical information and accurate facts, *How to Hire a Nanny* will be a valuable resource and handy tool for all household employers and employees."

—Wendy Sachs, president, The Philadelphia Nanny Network, Inc., Philadelphia, PA

"For most families obtaining and applying for tax and labor law information can be cumbersome and confusing. With this easy-to-follow instructional handbook, Guy Maddalone streamlines an otherwise complicated process for the domestic employer. I applaud his ongoing contribution to helping families be more successful."

—Daryl Camarillo, president, The Association of Premier Nanny Agencies and president, Stanford Park Nannies, Menlo Park, CA

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