

The Legal Review

Bringing the Law to Life for the Household Employment Industry

A Complimentary Resource from
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 legal cases. We've found that the easiest way to gain a practical understanding of complex tax and labor law is by reviewing real-life situations. These stories will illuminate potential legal landmines for your agency and/or your clients, and more importantly, show you how to avoid them.

Form W-2: Avoiding a Common Year-End Mistake

We're quickly approaching the deadline for all U.S. employers to prepare and distribute a Form W-2 Wage and Tax Statement (commonly referred to as "W-2") to each of their employees. The 2009 form must be mailed or hand delivered by January 31, 2010.

The following case illustrates one of the common W-2 mistakes and underscores the importance of knowing the law — for both the employer and the employee.

The Mistake

A family hired a nanny to care for their newborn. Their excellent relationship lasted a little over a year, at which time the nanny gave notice that she was moving to another city. She had been paid "on the books," but they had mutually agreed to not withhold income taxes from her pay.

The family hired another nanny and, at the end of the tax year, submitted their federal year-end tax forms — Form W-2 Copy A and Form W-3 to the Social Security Administration as well as Schedule H with their federal 1040. The family also prepared a Form W-2 Copy B2C for both their current and former nannies. However, the former nanny did not leave a forwarding address. The family assumed they would eventually get a call from the former nanny requesting her W-2. The call never came and the family eventually forgot all about it.

The Law

For the employer: In addition to state and federal year-end filings, employers are required to prepare Form W-2 Copy B2C for each employee and distribute them no later than January 31. If an employer does not know an employee's current address, the employer must send the form to the employee's last known address. If the W-2 is returned by the post office as undeliverable, the employer must keep a copy of the document for four years.

For the employee: When an employee is paid more than the \$1,700 (2009-2010) Social Security and Medicare reporting threshold, she should request a Form W-2 from her employer in order to prepare and file a personal income tax return by April 15th. Upon termination, the employee should make the former employer aware of any address changes.

The Mess

- The employee failed to file her income tax returns or pay the income tax she owed.
- Approximately 15 months later, the IRS sent an Earnings Withholding Order to the nanny's new employer. The Order indicated that the nanny owed several thousand dollars in taxes plus penalties and interest and instructed the new employer to garnish wages until the debt was paid off.

The Mess (Cont.)

- The nanny called the original family in a rage, accusing them of making filing mistakes and asking them to pay off the debt.
- The shocked family defended themselves by reminding the nanny that they had agreed to not withhold her income taxes.
- The nanny countered that she never got the paperwork she needed (Form W-2).
- The family explained that they did not have her new address.
- While the family felt bad about the nanny's tax problem, they had no intention of paying the nanny's income tax burden. Having decided to join Breedlove & Associates, they called us to get our professional opinion on whether or not they had liability in this situation.
- After researching the issue with the IRS, we concluded that the responsibility fell solely on the shoulders of the nanny. She had agreed to not have income taxes withheld, thereby acknowledging that she would handle remittance at year-end. She also had responsibility to notify the family when her address changed. Finally, the IRS makes provisions for filing tax returns without a Form W-2. The only failure by the family was not mailing the W-2 to the employee's last known address in order to demonstrate a good-faith attempt to distribute the form to their former employee. But that failure did not constitute liability to pay the nanny's income tax bill.

The Outcome

The nanny had to pay approximately \$4,500 in taxes and penalties to state and federal tax agencies via wage garnishment. After the ordeal, she convinced her new family to get set up with our service in order to ensure that taxes were withheld properly and also to ensure that she had a trusted resource that she could call if there was ever a question about her tax obligations. (We provide both employers and employees with unlimited access to our team of tax and labor law experts — a fact that she became aware of through a nanny forum).

How the Whole Thing Could Have Been Avoided

Education and Support. A thorough discussion about income tax withholding would have helped both the family and nanny understand the benefits of withholding. Pre-paying taxes — a little from each paycheck — is mandated in every other industry. This discipline prevents an employee from having a huge liability at year-end, which ultimately makes life easier for all parties. For this reason, we consult with every family to strongly encourage this practice (note: we do not charge extra for income tax withholding and remittance so there is no reason to invite these problems into the relationship).

Upon termination of the relationship, a service-oriented payroll firm should provide support and detailed guidance to prevent these kinds of problems. We would have counseled both the family and the nanny to ensure that they knew what to do/expect at year-end.

Service. As of 2009, we have added another service convenience for our clients. We now mail Form W-2 Copy B2C directly to all current and former employees so families don't have to worry about managing addresses of former employees or going to the post office (in addition, online copies are available for download through our client service website myBreedlove.com).

If you have additional questions, please call 888-BREEDLOVE (273-3356) or visit www.breedlove-online.com. We're here to help our agency partners provide their candidates and clients with information, tools and resources that improve the employment relationship, eliminate legal risk for all parties, and increase the professionalism of the industry.



Tax & Payroll Services for Household Employers