

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.

Mis-Reporting Wages

With the tough economy, many families have adopted a do-it-yourself mindset in order to save money. This edition of *The Legal Review* illustrates what can happen when a busy family attempts to take on the complexities of household payroll, tax and labor law issues without doing thorough homework. In this case, it was a seemingly minor oversight that would end up being a major nuisance for both family and nanny.

The Mistake

A young, dual-income family hired a nanny to care for their two young children. Wanting to pay legally, the family decided to cover the nanny's **employment taxes** (Social Security and Medicare). Both parties agreed that the nanny would pay her own federal and state **income taxes**. The family opted not to withhold the nanny's income taxes and remit them on her behalf quarterly. (Unlike most employers, households are not required by law to withhold state and federal income taxes from the employee's pay – although we strongly recommend it so that she's not hit with a large tax bill at the end of the year).

In this situation – the employer covering the employee's Social Security and Medicare taxes combined with a decision not to withhold income taxes – the Gross Wages and the Net Pay appear to be identical. So, the family simply kept track of the wages paid to the nanny and reported those amounts to the state and federal tax agencies each quarter. In January, they fulfilled their compliance obligations by preparing a Form W-2 for the nanny and filing a Form W-2 Copy A and Form W-3 with the Social Security Administration.

Despite all their paperwork and good intentions, the family later discovered that they had made a mistake which caused them to under-report their nanny's wages.

The Law

If an employer elects to pay their employee's Social Security and Medicare taxes (also known as "employer-paid FICA"), that portion of the compensation is **not taxable for employer tax purposes**. So, for unemployment and FICA tax reporting, the Gross Wages would equal the Net Pay amount.

However, for the **employee's income tax purposes**, the employer-paid FICA is considered taxable compensation. Therefore, the nanny's Gross Wages must be adjusted to include the employer-paid FICA.

The Mess

During a routine audit, it was discovered that the family's payments to the nanny equaled the amount of Gross Wages reported on their Schedule H. The auditor immediately assumed that the family had not withheld the nanny's FICA taxes, which means they are then obligated to pay both the employer and employee portions. Confident they had done it correctly, the family explained that they had agreed to pay the FICA taxes for their employee and had remitted the taxes throughout the year.

The Mess (Cont.)

After digging through their tax returns and bank statements, the auditor informed them that they had under-reported the state and federal taxable wages for income tax purposes and issued two mandates:

- The family was forced to amend their Form W-2 Copy A and Form W-3, and file the amended returns with the Social Security Administration.
- The nanny was forced to amend both her state and federal income tax return plus pay the income tax obligations on the un-reported taxable wages.

The Outcome

The family was upset and embarrassed by the hardship they caused their nanny so they decided to pay her incremental tax obligation for her. Cost: \$385.

The family also decided to pay for a tax professional to prepare her amended returns. Cost: \$100.

The family amended their own Form W-2 & Form W-3 with the Social Security Administration.

Once the ordeal was over, the family decided to join our service and let us handle everything. The husband later told us:

From now on, I want the peace of mind from knowing it's all being done right. And your fees are reasonable enough that it's crazy to try to go through this alone. We thought we knew what we were doing, but didn't...even if we did, I don't want to do all the paperwork anymore.

How the Whole Thing Could Have Been Avoided

This situation could have been prevented had the family thoroughly researched all the household employment payroll, tax and labor laws upon hiring their nanny. Short of that, they would be well advised to hire a specialist – the annual cost for which would have been roughly equivalent to this one reporting mistake.

At Breedlove & Associates, we're willing to provide all that "research" for free to each of your families. The goal is not to get them to join our service (although that would be nice!); the goal is to make sure they don't make an expensive mistake or damage their employment relationship. We also help them capitalize on tax breaks, budget properly, and understand all the applicable labor laws. Whether they join our service or not, this no-obligation, no-pressure phone call will likely save them money, time and headaches – and add value to your placement.

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