

# 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.*

## Processing Household Wages through Business Payroll

We often speak to families who think that adding a household employee to their business payroll provides an easy, one-stop solution. Doing this is illegal and there are several snags that can come up when household and business payroll are not maintained separately. The following case illustrates one of them.

### **The Mistake**

A family in New York hired their first nanny to care for their three children. The family owned a small business with about a dozen employees and had been told it would be okay to add the nanny to their company payroll. Their placement agency advised against it and offered them a resource for a second opinion (a complimentary, no-obligation consultation with Breedlove & Associates). Unfortunately, the family never called. They wanted to “make things easy” as well as provide the nanny with access to their company’s healthcare plan. Not fully understanding their options or the possible ramifications, they opted to ignore the agency’s advice and set her up as an employee of their family business.

### **The Law**

Businesses are allowed to take a tax break on the company’s payroll expense because the employees are direct contributors to the success of the business. The IRS has ruled that household employees are not direct contributors to a business and, therefore, their wages – as well as the accompanying tax breaks – must be handled through the personal tax process.

Furthermore, company group health insurance policies may not include non-employees. If a household employee is interested in health insurance, the nanny must obtain an individual policy. However, just like a commercial employer, a household employer can contribute up to 100% of the employee’s health insurance premiums and have it be considered non-taxable compensation. This means that neither the family nor the nanny would pay any taxes on that portion of her compensation.

### **The Mess**

Almost two years into the relationship, the nanny was diagnosed with cancer. She required long-term treatments which amounted to almost \$100,000 in medical expenses. The insurance company ultimately discovered the patient was a nanny. The insurance company refused payment on the grounds that the nanny was not an employee of the company and, therefore, not covered by the group health plan.

## The Outcome

- The family was forced to pay the nanny's medical expenses. They came very close to filing bankruptcy.
- The company had to pay their C.P.A. to amend their business tax returns for the previous two years in order to reverse their illegal payroll deductions.
- The family had to pay their C.P.A. to amend their personal tax returns for the previous two years in order to incorporate their household employee. In addition, they had to file New York household employment tax returns for the previous 8 quarters. The state levied penalties and interest on these overdue taxes.
- The family contacted Breedlove & Associates for help in processing their employee's payroll going forward. In the initial consultation, we informed the family that they can still help the nanny realize the benefit of healthcare coverage by contributing to her monthly premiums on an individual policy – and that the contribution would be non-taxable to the family and the nanny.

## How the Whole Thing Could Have Been Avoided

Had the family heeded their placement agency's warning about adding the nanny to their business payroll, they would have avoided these disastrous financial repercussions. As the husband said at the end of our consultation, "My gut told me to call you two years ago, but I convinced myself that it was not a big deal. I wish I had it to do over again!"

Many well-intended families have made this mistake based on advice they received from a trusted tax professional. This case serves as a reminder that tax and employment law for households is unique and outside of the core competencies of most tax professionals. To help you steer your clients away from expensive legal problems, we've developed an educational flyer to address this topic. (You can download the PDF [Payroll Administration](#) or call us for 4-color print outs). If you encounter a family who wants to add a household employee to their business payroll, please remember this case and encourage them to contact us for a second opinion. As always, we're happy to explain the risks and alternatives, even if they decide not join our service. Ten minutes on the phone will likely save them thousands of dollars, dozens of hours, and immeasurable stress.

**If you have additional questions, please call 888-BREEDLOVE (273-3356) or visit [www.breedlove-online.com](http://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.**

