

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.

Social Security Administration v. Nanny & Family:

The Mistake

A family hired a life-long nanny who had never been paid legally and was nearing the age of retirement. Realizing that she would not receive Social Security and Medicare (FICA) benefits when she reached retirement age, she decided to ask her new family to withhold taxes and pay her legally. Although the benefit she'd receive from contributing for only a couple of years would be extremely small, it was better than nothing.

The family was happy to pay the employee legally and consulted with the in-house accountant for the family business. Unfortunately, the accountant was not an expert in this area. He erroneously concluded that the nanny was a direct contributor to the business and, therefore, could be paid through the company payroll and deducted as a legitimate business expense. All appropriate taxes were withheld from the nanny's pay and remitted to the State and IRS – but it was done as a part of the company payroll and tax process

The Law

Businesses are allowed to take a significant tax deduction on their payroll expense. For the payroll to be deductible, the IRS says the employee must be an "ordinary and necessary expense of the business" and "directly contribute to the success of the business."

The IRS has ruled definitively that household employees (including nannies) do not directly contribute to a business. So it is illegal for a business to report a household professional's wages on business returns and take any deductions on her payroll. A household professional is instead considered a contributing member of the household – which has its own specific tax filing process and corresponding tax breaks.

The Mess

- For 2 years, the business reported all the nanny's wages and taxes on company returns and took the available corporate tax breaks.
- The nanny reached retirement age, retired from working and began the application process to receive monthly Social Security benefits.
- During the application process, the Social Security Administration (SSA) received a miss-match report from the IRS – most likely due to the employee reporting her occupation as nanny while filing a company W-2.
- The Social Security Administration Office notified the nanny that her benefits were rejected due to an error with how her tax contributions were filed in the past few years.
- Due to the misclassification and tax reporting, the SSA denied benefits to the nanny until all past household tax filings were reconciled by the employer

The Outcome

- To correct all tax filing errors, the family amended their business returns and removed the nanny's wages from business payroll, tax returns and tax breaks. The family then had to register as a Household Employer, retroactively file quarterly tax returns for each quarter in which they employed their nanny and amend their personal tax returns.
- The family ended up paying penalties and interest for 2 years of late tax filings as well as the cost to amend all business and personal tax returns.
- The nanny waited for her Social Security benefits while the family trudged through the arduous task of correcting their mistakes.
- The accountant no longer has a job at the family's business.

How the Whole Thing Could Have Been Avoided

Families often assume accountants and other general tax professionals are all-knowing. In reality, the state and federal tax code is too complicated for anyone to fully understand all areas. Families – even those with an accountant and a good understanding of business tax process – would benefit from the expertise and experience of a household employment specialist.

This family did not find their nanny through an experienced, reputable agency. If they had, the agency would likely have advised them to call an expert – and that quick phone call would have saved them thousands of dollars and dozens of hours of misspent time.

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