The Legal Review

Bringing the Law to Life for the Household Employment Industry

A Complimentary Resource from
Breedlove & Associates

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.

Tax Breaks

As families go through the hiring process, many struggle with the dilemma: ***to be*** (legal) ***or not to be*** (legal)? Even though they know it could be extremely expensive (and potentially career-threatening) to pay "under the table," they consider it because of the almost universal misperception that "doing the right thing" will dramatically increase childcare costs. This edition of *The Legal Review* will outline the tax breaks available to household employers who choose ***to be*** (legal). These tax breaks can offset most – if not all – employer tax costs, thereby rendering the gut-wrenching cost dilemma essentially a moot issue.

The Mistake

A family hired a part-time nanny to care for their two young children. The nanny worked an average of 20 hours per week for an average gross wage of $300 per week. When they discovered that taxes would be about $30 per week (or $1,560 per year), the news of the incremental expense hit them like the proverbial "straw that broke the camel's back." After a lot of anxiety, the family decided to pay the nanny "off the books." They loved the nanny and their kids loved the nanny, but in their minds they had to make a compromise somewhere. As a result, they opted to break the law and live in fear.

The Law

There are two tax break options available to families with dependent care expenses –as long as they pay legally. There are no income restrictions on these tax breaks. The IRS only mandates that 1) both spouses be employed, full-time students or looking for employment and 2) the child(ren) receiving care be under age 13.

Dependent Care Account

- A benefit offered by many U.S. employers, which allows a family to set aside $5,000 each year in pre-tax earnings to offset childcare expenses.
- Utilizing the full $5,000 can realize savings of $2,100 - $2,300 per year (depending on the family's marginal tax rate).

*Child or Dependent Care Tax Credit**

- A tax break taken annually on the federal income tax return via Form 2441 (an attachment to the Form 1040).
- A family may itemize up to $3,000 in dependent care expenses for one qualifying dependent, or up to $6,000 for two or more qualifying dependents.
- A 20% tax credit is applied to these expenses, realizing annual savings of $600 for families with one dependent, or $1,200 for families with two or more dependents.

The Law (Cont.)

**Congress is currently considering a bill that would increase the dependent care expense limits for the first time since 1986. With this bill, families may itemize up to $6,000 in expenses for the care of one dependent, or up to $12,000 for two or more dependents. Furthermore, the credit may increase from 20% to 35%.*

Important Note: If a family has two or more dependents, they can maximize their tax breaks by taking advantage of both options. Setting aside $5,000 in the Dependent Care Account leaves a family with a remaining $1,000 in expenses that can be applied to the Child or Dependent Care Tax Credit.

The Mess

The family enrolled in their Dependent Care Account at work. At the end of the first month of the nanny's employment, the family submitted the company childcare expense form for reimbursement using their tax-free dollars. The form requires the Federal Employer Identification Number (FEIN) for reimbursement. The family could not provide their FEIN, because they had decided to pay illegally. Thus, they were not entitled to the tax break.

The Outcome

Feeling trapped, the wife confided in the HR manager at her office that they were paying their nanny in cash and, therefore, they had no FEIN. The HR manager knew of several families at the firm that used our service and told her to give us a call.

The wife then called for a phone consultation with one of our tax and labor law experts. She immediately revealed that they had wanted to "do the right thing" but couldn't afford it. We explained that the $1,560 in employer taxes would be more than offset by the roughly $2,200 she would save from her Dependent Care Account. She screamed when she found out that she and her husband would actually come out $640 ahead by paying legally!

She used that savings to hire us and we immediately got them caught up on all payroll and tax obligations. Because our fees are tax deductible, they were able to offload all the paperwork headaches for the entire year and still come out a few dollars ahead. She and her husband were relieved and the nanny was happy to receive all of her benefits.

How the Whole Thing Could Have Been Avoided

This situation had a happy ending because they corrected their mistake early in the relationship. But the stress and anxiety they endured was completely unnecessary. Instead of struggling with a gut-wrenching dilemma based on assumptions, they could have made a quick phone call during the hiring process and received accurate and comprehensive information in a personalized consultation with one of our tax and labor law experts. Armed with good information, ***to be*** (legal) ***or not to be*** (legal) becomes a much easier question.

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.

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Tax & Payroll Services for Household Employers