

HIRING A HOUSEHOLD EMPLOYEE

Many don't realize that there are federal and state tax obligations when hiring household staff. Such staff can include nannies (why this is often referred to as the 'nanny tax'), medical aids, housekeepers, maids or gardeners.

If you employ someone who's subject to the "Nanny Tax," you aren't required to withhold federal income taxes. You have to withhold only if your nanny asks you to and you agree to withhold. (In that case, have the nanny fill out a Form W-4 and give it to you, so you can withhold the correct amount.) However, you may be required to withhold social security and Medicare tax (FICA). And you may also be required to pay (but not withhold) federal unemployment (FUTA) tax.

FICA: You have to withhold and pay FICA taxes if your nanny earns cash wages of \$1,700 (annual threshold) or more (excluding the value of food and lodging) during the calendar year 2011. If you reach the threshold, the entire wages (not just the excess) will be subject to FICA. However, if your nanny is under age 18 and child care isn't her principal occupation, you don't have to withhold FICA taxes. Thus, if your nanny is really a student who is a part-time baby-sitter, there's no FICA tax liability for her services. On the other hand, if your nanny is under age 18 and the nanny job is her principal occupation, you must withhold and pay FICA taxes.

You should withhold from the start if you expect to meet the annual threshold; your nanny won't appreciate a large, unexpected withholding from her pay later on. If you aren't sure whether the annual threshold will be met, you can still withhold from the start. If it turns out the annual threshold isn't reached, just repay the withheld amount. If you make an error by not withholding enough, withhold additional taxes from later payments.

Both an employer and a nanny have an obligation to pay FICA taxes. As an employer, you are responsible for withholding your nanny's share of FICA. In addition, you must pay a matching amount for your share of the taxes. The FICA tax is divided between social security and Medicare. For 2011, a two-percentage-point reduction in the employee's share of social security tax is in effect. Therefore, the social security tax rate is 6.2% for the employer and 4.2% for the nanny, for a total rate of 10.4%. The Medicare tax is 1.45% each for both the employer and the nanny, for a total rate of 2.9%.

Example: In 2011, you pay your nanny \$300 a week, and no income tax withholding is required. You must withhold a total of \$16.95, consisting of \$12.60 for your nanny's share of social security tax ($\$300 \times 4.2\%$) and \$4.35 ($\$300 \times 1.45\%$) for your nanny's share of Medicare tax. You would pay her a net of \$283.05 ($\$300 - \16.95). For your (employer's) portion, you must pay \$22.95 ($\$300 \times 7.65\%$), for total taxes of \$39.90.

If you prefer, you may pay your nanny's share of social security and Medicare

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taxes from your own funds, instead of withholding it from her pay. Using the figures from the above example, for each \$300 of wages, you would pay your nanny the full \$300 and also pay all of the total \$39.90 in taxes.

If you do pay your nanny's share of these taxes for her, your payments aren't counted as additional cash wages for social security and Medicare tax purposes. In other words, you don't have to compute tax on the taxes. However, your payments of her taxes are treated as additional income to the nanny for federal income tax purposes, so you would have to include them as wages on the Form W-2 you provide, see below.

FUTA: You also have an obligation to pay (but not withhold) FUTA tax if you pay a total of \$1,000 or more in cash wages (excluding the value of food and lodging) to your nanny in any calendar quarter of the current year or last year. The FUTA tax applies to the first \$7,000 of wages paid. The maximum FUTA tax rate was 6.2% for the first half of 2011, and is 6.0% thereafter. FUTA tax is paid only by the employer, not by the employee, so don't withhold FUTA from the nanny's wages.

Reporting and paying: You must satisfy your "Nanny Tax" obligations by increasing your quarterly estimated tax payments or increasing your withholding from your wages, rather than making an annual lump-sum payment.

As an employer of a nanny, you don't have to file any of the normal employment tax returns, even if you're required to withhold or pay tax (unless you own your own business, see below). Instead, you just report the employment taxes on your tax return, Form 1040, Schedule H.

On your income tax return, you must include your employer identification number (EIN) when you report the employment taxes for your nanny. The EIN isn't the same number as your social security number. If you already have an EIN from a previous nanny, you may use that number. If you need an EIN, you must file Form SS-4 to get one. I've enclosed a blank form you can use.

However, if you own a business as a sole proprietor, you must include the taxes for your nanny on the FICA and FUTA forms (940 and 941) that you file for your business. And you use the EIN from your sole proprietorship to report the taxes for your nanny.

You're also required to provide your nanny with a Form W-2. If her 2011 wages are subject to FICA or income tax withholding, the W-2 is due by Jan. 31, 2012. Additionally, you must file a Form W-2 for 2011 with the Social Security Administration by Feb. 29, 2012. Your EIN must be included on the Form W-2.

Recordkeeping: Be sure to keep careful employment records for each nanny and domestic employee. Keep the tax records for at least four years from the later of the due date of the return or the date when the tax was paid. Records should include: employee name, address, social security number; dates of employment; dates and amount of wages paid; dates and amounts of withheld FICA or income taxes; amount of FICA taxes paid by you on behalf of your nanny; dates and amounts of any deposits of FICA, FUTA or income taxes; and copies of all forms filed.

If you have questions, please do not hesitate to contact us-we will be happy to assist you