

Tax Law 101

A Brief Overview Written for Household Employers by Household Employers

A Complimentary Resource from
Breedlove & Associates

© 2007-2008 Breedlove & Associates, L.P.

The Definition of a Household Employer

A household employer is defined as someone who pays an individual to perform duties in or around their home. Household employees include nannies, medical caregivers, housekeepers, gardeners, cooks, personal assistants, household managers, etc. By law, these individuals cannot be classified as independent contractors.

If a household employee is paid more than \$1,600 (2008) in a calendar year, household employers are required to meet the state and federal payroll tax obligations outlined below. If a household pays an employee less than the threshold within a calendar year, payroll taxes are not required to be withheld and remitted. However, the household is still legally considered an employer and, therefore, must adhere to federal and state labor laws.

What are the Financial and Legal Responsibilities for Household Employers?

1. Household Employers are required to pay federal and state employer taxes. Specifically:

- Half of Social Security & Medicare (7.65% of employee's gross wages)
- State Unemployment Insurance (varies by state)
- Federal Unemployment Insurance (0.8% on first \$7,000 of employee's gross wages)

These taxes must be reported and remitted to the IRS and state on a quarterly basis. For budgeting purposes, employers can expect these taxes to be about 9-10% of their employee's gross wages.

Note: The good news is savings from tax breaks can offset — sometimes exceed — the tax costs (see Tax Breaks & Other Benefits of Paying Legally).

2. Household Employers are required to withhold taxes from their employee each pay period and then report & remit those taxes along with the employer taxes each quarter. Specifically, the employee taxes to be withheld are:

- Half of Social Security & Medicare (7.65% of employee's gross wages)
- Federal Income Tax (amount withheld based on allowances chosen by employee on W-4 form)
- State Income Tax (where applicable; amount withheld based on allowances chosen by employee on W-4 form)

Note: It is not legally required that state and federal income taxes be withheld; however, it is strongly recommended in order to help employees avoid a large income tax liability at year end. By law, Social

Security & Medicare must be withheld each pay period and then reported & remitted quarterly.

3. Household Employers in many states are required to carry a Workers' Compensation policy on household employees.

Workers' Compensation is not managed through the payroll and tax process. It is an insurance policy that is purchased annually through the state or a state-licensed independent insurance provider. Workers' Compensation benefits cover lost wages and medical expenses in the event of job-related injury or illness. If you are required to carry this insurance, or decide you want to carry this insurance, check your homeowner's insurance carrier first; many umbrella homeowner's policies include workers' compensation. If not, your insurance company can usually add a rider to the policy. For more information about the requirements in your state, call us at 1-888-BREEDLOVE (273-3356) or visit our website at www.breedlove-online.com.

4. Household Employers must meet federal and state labor law requirements.

Overtime must be paid for more than 40 hours in a 7-day work week. Overtime must be paid at a rate of 1.5 times the regular wage. The only exception is for live-in employees, who don't have to be paid overtime rates, but must be paid for every hour they are on duty (exception: NY residents must pay live-in employees overtime when they go beyond 44 hours in a 7-day work week).

With very few exceptions, Household employers are not required by law to provide paid vacation, sick days or holidays.

Tax Breaks & Other Benefits of Paying Legally

Household employers are entitled to tax breaks — if the employee is paid legally. Most companies allow their employees to contribute up to \$5,000 of their pre-tax earnings to a Dependent Care Account to cover child-care expenses. Depending on the tax bracket, this deduction can save household employers up to \$2,300 per year, offsetting a large portion — if not all — of their employer tax liability. Those that don't have access to a DCA are able to claim the Tax Credit for Child or Dependent Care (IRS Form 2441) on their personal income tax return at year end. For most tax brackets, this tax credit is worth up to \$600 for one child or \$1,200 for two or more children.

In addition to tax breaks, there are other advantages to paying legally. Specifically:

- **Job History.** Employees establish an employment history which is necessary to qualify for a car loan, home loan, student loan, credit cards and many other everyday transactions.

- **Social Security & Medicare.** Employees receive retirement benefits and basic medical coverage through Social Security and Medicare contributions. Research shows that, on average, employees will receive \$5 for every \$1 they contribute.
- **Unemployment Benefits.** Employees are generally entitled to receive up to six months of unemployment benefits at up to 50% of their salary, if they lose their job through no fault of their own.
- **Earned Income Credit.** If your employee is a single parent, she may qualify for significant tax breaks provided under the federal EIC program.
- **Peace of Mind.** The IRS is cracking down on household employers who pay illegally. It is considered tax evasion and offenders are saddled with expensive back taxes, penalties and interest. In some cases, they've been stripped of professional licenses. It's simply not worth the risk.

The Compliance Process

Here's a summary of the process required of household employers — all of which we handle for our clients:

- Register for federal and state tax accounts
- Complete and file a New Hire Report
- Calculate the correct amount of federal and state taxes to withhold each pay period
- Track gross pay, net pay, federal and state taxes withheld, and federal and state employer taxes
- Prepare state tax returns quarterly and remit both employer and employee taxes

- Prepare federal tax estimates four times per year and remit both employer and employee taxes
- Prepare year-end tax forms (Form W-2, Form W-3, Schedule H, and State Annual Reconciliation)
- Respond to IRS and state requests/inquiries
- Monitor ever-changing household employment tax law

The IRS estimates that the entire process takes the average individual 50 to 55 hours per year.

How Breedlove & Associates Makes It Easy & Affordable

Breedlove & Associates was created *by* household employers *for* household employers specifically to handle the complex compliance process for busy families — eliminating headaches, hassles, financial risk and tedious paperwork. We serve more than 5,000 clients with comprehensive management of payroll & taxes — as well as unlimited guidance and support from tax & labor law experts — all for a small quarterly fee and no long-term commitment.

Tax and payroll services for household employers is all we do — all we've ever done since 1992. Our focus has enabled us to become the country's largest tax and payroll firm specializing in household employment and helped us gain notoriety in publications such as *Kiplinger's*, *Forbes*, *Business Week*, *SmartMoney.com* and *The Wall Street Journal*.

Despite the growth and accolades, our goal remains simple: we want to make the financial, legal and HR aspects of household employment simple and affordable so busy families can spend their time and money on better things.

If you have any questions or would like a free consultation on your specific situation, please don't hesitate to call. We're here to help.



Tax & Payroll Services for Household Employers