

# Frequently Asked Payroll and Tax Questions

Offered by:



## Is a nanny an employee, or can she be classified as an independent contractor?

Nannies and most other household workers are employees of the family for which they work. The difference between employees and independent contractors hinges on the amount of control one has over the worker. If the family controls work hours, work place, responsibilities, work tools (to name just a few), the worker is their employee. An independent contractor usually provides her own tools, her own place of work, sets her own hours and offers services to the general public.

## If a nanny is an employee, what taxes need to be withheld?

Your nanny's taxes usually range from 15-20% of gross wages. These include:

- Half of Social Security & Medicare (7.65%)
- Federal income taxes
- State income taxes (if applicable)
- Employers are only required to withhold Social Security and Medicare taxes from their employee's salary each pay period. If both parties agree, employers can also withhold federal income taxes.

## Do I have taxes as an employer?

Yes. Household employers can expect to pay employment taxes that amount to approximately 10% of their employee's gross wages. These include:

- Half of Social Security & Medicare (7.65%)
- Federal and state unemployment insurance

## Can I take advantage of any tax breaks?

Yes. To lighten the burden that falls on working parents, Congress has enacted tax benefits for families through employer-provided dependent care assistance (Dependent Care Account) and the Tax Credit for Child or Dependent Care. However, these tax breaks are only available if the employee is paid legally.

- **Dependent Care Account.** Most companies allow employees with child or dependent care expenses to contribute up to \$5,000 of their pretax earnings to an individual Dependent Care Account. The money in this account is then used to cover childcare expenses, free of taxes. The savings are approximately \$2,300 per year.
- **Tax Credit.** For those who don't have access to a Dependent Care Account, they can claim the Tax Credit for Child or Dependent Care (Form 2441) on their income tax return at year-end. Basically, they can take a tax credit of 20% to 30% of qualifying childcare expenses. But only expenses of up to \$3,000 for one dependent, or up to \$6,000 for two or more dependents can be counted.

Only one of these tax savings options may be used each year. The Dependent Care Account usually provides the greater tax savings. Oftentimes, the tax savings exceed the employer's share of the taxes, actually saving money by being legal!

## **What are the vacation, holiday and sick pay requirements?**

Paid vacation, holidays and sick days are not required by law. These benefits are to be agreed upon as a part of the employment contract. In addition, overtime is not required for holidays worked.

## **What is the process for handling payroll and taxes?**

The payroll and tax process is quite detailed. Here's an overview of what's involved:

- Research employment tax and labor laws to understand legal obligations.
- Register for federal and state tax accounts.
- Complete and file New Hire Reporting.
- Identify and calculate taxes to withhold each pay period.
- Track gross pay, net pay and taxes withheld.
- Calculate the employer's federal and state tax liabilities.
- Prepare state and federal tax returns quarterly and remit the employer and employee taxes.
- Respond to IRS and state inquiries.
- Monitor ever-changing household employment tax law.

Comprehensive services offered by Breedlove & Associates can make this process simple and provide peace of mind at an affordable price.

## **What is Worker's Compensation?**

Every state has a worker's compensation system. Under these systems, workers injured on the job are entitled to prompt payment of certain medical and wage-loss benefits with a minimum of legal formality and expense. The systems are based on the idea that the employee gives up the right to sue for any injuries from work-related accidents, in exchange for receiving benefits regardless of fault. Some states exclude household services from the worker's compensation system.

## **Are there any tax breaks if I offer health insurance?**

Yes. When a household employer contributes toward health insurance premiums, these dollars are not considered taxable income. Neither employer nor employee is required to pay taxes on these dollars. A family may choose to pay the healthcare premium directly to the health insurance company. Families may also choose to give these dollars directly to their employee. In this case, the family must keep a copy of a current health insurance card on file for proof of a current insurance policy.

## **Can I run my nanny's payroll through my own business?**

No. This is illegal. Here's a simple explanation: All businesses are allowed to take tax deductions on employee payroll. The logic is that employees are direct contributors to the success of the business, and the owner is allowed a "tax break" on a portion of total payroll to offset some of this expense. A nanny does not directly contribute to a business; therefore, it is illegal for a business to receive any kind of "tax break" on her payroll. A nanny is considered a contributing member of the household; therefore, a family is entitled to take a "tax break" on her payroll as a childcare expense instead.