Are You Ignoring the Household Employee Payroll Rules?

Article Highlights:

- Household Employees
- Tax Avoidance
- Filing 1099s
- Correct Procedures
- W-2s, Payroll Taxes and Reporting
- Overtime
- Hourly Pay Or Salary
- Separate Payrolls

If you hire a domestic worker to provide services in or around your home, you probably have a tax liability that you don't know about – or one that you do know about but are ignoring. Either situation can come back to bite you. When the worker is your employee, your liability includes both withholding and paying payroll taxes as well as issuing a W-2 after the close of the year.

Sure, it is a lot easier simply to pay your worker in cash so as to avoid federal and state payroll taxes – and all the paperwork that goes with them. Your domestic worker will likely be fully cooperative with a cash deal because he or she can also avoid paying taxes. However, if the IRS or your state employment department finds out about these payments, the result could be very unpleasant for you.

Not everyone who performs services in or around your home is classified as an employee. For instance, a plumber or electrician who makes repairs in your home will generally be a licensed contractor; the government does not classify contractors as employees.

On the other hand, the IRS has conclusively ruled that nannies, housekeepers, senior caregivers, some gardeners and various other domestic workers are employees of the people for whom they work. It makes no difference if you have a written contract with the employee; similarly, the number of hours worked and the amount paid do not matter.

You are probably thinking, "Wait a minute" – perhaps everyone you know pays in cash, and none of them has paid payroll taxes or issued a W-2 for a household employee. However, if a worker gets injured on your property or if you dismiss the worker under less-than-amicable circumstances, it's a pretty sure bet that your household employee will be the first one to throw you under the bus by reporting you to the state labor board or by filing for unemployment compensation.

Even some big-name people have been caught up in this issue. Just recently (as seems to happen every four years), a presidential nominee, Rep. Mick Mulvaney (R-SC), was revealed to have failed to pay more than $15,000 in taxes on behalf of the nanny for his newborn triplets. He subsequently paid the back taxes and was confirmed as Director of the Office of Management and Budget.

Some individuals try to circumvent the payroll issue by treating a household employee as an independent contractor, incorrectly issuing the household employee a Form 1099-MISC.

Here are the correct actions you should take for domestic employees:

- Obtain a Federal Employer Identification Number (FEIN), which you will use in lieu of your Social Security Number when filing the required reporting forms. *Note:* If, as the owner of a sole proprietorship business, you already have a FEIN, you should use that number instead of requesting a separate one as a household employer.

- Obtain a state ID number for unemployment insurance and state tax withholdings.
- Withhold Social Security and Medicare taxes from the employee's pay if it exceeds the annual threshold ($2,000 for 2017).
- Withhold income tax from the employee if the worker requests and if you agree to do so.
- File state employment tax returns as required – generally quarterly (although beware that some states require monthly returns) – and make the required deposits for state employment taxes.
- Prepare a W-2 for the employee and a W-3 transmittal; file them by the end of January.
- File Schedule H with your federal individual income tax return, and pay all the federal payroll and withholding taxes (i.e., the federal taxes that you withheld from the employee's pay, plus your matching share of Social Security, Medicare and federal unemployment taxes). *Limited exception:* If you operate a sole proprietorship with employees, you may include the payroll taxes of your household workers with those of the business's employees, but you cannot take a business deduction for those taxes. Generally, it is better to keep the personal and business reporting separate.

Some additional issues to consider are as follows:

Overtime – Under the Fair Labor Standards Act, domestic employees are nonexempt workers and are entitled to overtime pay after working 40 hours in a week. Live-in employees are an exception to this rule in most states.

Hourly Pay or Salary – It is illegal to treat nonexempt employees as if they are salaried.

Separate Payrolls – If you own a business with a payroll, you may be tempted to include your household employees on the company's payroll. The payments to the household employees are personal expenses, however, and are not allowable deductions for a business. Thus, you must maintain a separate payroll for household employees; in other words, you must use personal funds to pay household workers and instead of paying them from a business account.

Eligibility to Work in the U.S. – It is illegal to knowingly hire or continue to employ an alien who is not legally eligible to work in the U.S. When hiring a household employee who works on a regular basis, you and the employee each must complete Form I-9 (Employment Eligibility Verification). You will need to examine the documents that the employee presents to establish the employee's identity and employment eligibility.

Other Issues – Special situations not covered in this overview include how to handle workers hired through an agency, how to gross up wages if you choose to pay an employee's share of Social Security and Medicare taxes, and how to treat noncash wages.

Please call this office if you would like assistance with your household employee tax and reporting requirements or with any special issues that apply to your state.