

# Nanny Payroll and Taxes



Families and nannies alike often have questions about the nanny tax, and their respective responsibilities. The following FAQ is merely intended as an introduction. The INA recommends that you discuss your particular situation with a qualified, reputable professional. Several well known household payroll services are INA members, and you may also consider using your accountant or attorney as a resource.

## Enclosed

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## DO I NEED TO DEDUCT PAYROLL TAXES FROM MY NANNY'S PAY?

As a household employer, you are responsible for paying to the Internal Revenue Service all Social Security and Medicare tax levies – the so-called “Nanny Taxes”. These taxes may either be deducted from the nanny’s pay, or you may agree to pay this for the nanny yourself. She may not pay her Social Security and Medicare taxes directly.

Your nanny will also pay any appropriate income taxes. You are not required to deduct these taxes; however, many families do this to make their nanny’s tax planning easier.

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

- Half of Social Security & Medicare (7.65%)
- Federal income taxes (based on the number of allowances chosen on Form W-4)
- State income taxes (if applicable)

Note: By law, employers are required to withhold Social Security and Medicare taxes from their employee’s salary each pay period. If the household employer fails to collect from the nanny’s pay check, the employer assumes responsibility to pay this tax on the worker’s behalf. Withholding income taxes in household employment is optional, but it’s highly recommended so that your employee does not get surprised with a large tax obligation at year end.

## IS A NANNY A HOUSEHOLD EMPLOYEE OR AN INDEPENDENT CONTRACTOR?

The IRS has ruled definitively that nannies and most 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, and a family directly hiring a nanny to work in their home absolutely has the right and responsibility to exercise control over how the nanny performs her work. 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. An independent contractor also has greater tax responsibility than an employee because they have to pay both the employee and employer taxes.

The IRS views household workers to be employees – with very few exceptions. If you’d like a formal ruling, you can obtain one from the IRS by filling out Form SS-8.



## DO I HAVE TAXES AS AN EMPLOYER?

Yes. Household employers can expect to pay the following employment taxes:

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

These employer taxes are typically about 10% above the nanny's gross payroll. Nanny employers often qualify for favorable tax breaks that will largely offset their employer taxes.



## WHAT ARE MY TAX BREAKS?

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.

**Note:** For most families, 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 REQUIREMENTS FOR VACATION, HOLIDAYS AND SICK DAYS?

With a few local exceptions, families are not required to provide paid vacation, holidays and sick days – although most families recognize that these types of benefits help attract and retain a quality nanny. A minimum general paid time off package is typically 10 days per year, with 5 days scheduled to coincide with the family's convenience and 5 at the nanny's convenience. Federal holidays if paid should be defined as it is rare that a nanny gets every federal holiday as paid time off.

## DO I HAVE TO PAY OVERTIME?

Yes! According to federal law, household employees are entitled to overtime pay for all hours worked over 40 in a 7 day workweek. Please note some states have stricter wage and hour rules. Overtime must be paid at no less than 1.5 times the hourly wage. While many families think of their nanny's pay in terms of a salary, care must be taken at the time of employment to properly translate the 'salary' into two pieces: the regular rate and the overtime rate. For example, an employee and family agree upon a gross salary of \$600 per week for a 45 hour workweek. The regular rate for the first 40 hours is \$12.63 per hour; the overtime rate for the remaining 5 hours per week is \$18.94 per hour; and the total weekly salary is \$600.

No limit is placed on the number of hours worked in a 7 day workweek, as long as the employment contract is fulfilled and the employee is fairly compensated.

Please note that most (but not all) Live-In household employees do not have to be paid overtime but are entitled to the regular wage for every hour worked.





## ARE THERE TAX BREAKS IF I OFFER HEALTH INSURANCE?

Generally the answer is yes – however with the Affordable Care Act's implementation many of the methods and procedures that families must follow to maintain the favorable tax treatment of employer paid health insurance premiums are under revision. Please contact [HealthCare.gov](http://HealthCare.gov) for current guidance.



## WHAT IS WORKERS' COMPENSATION?

Workers' Compensation is not a tax; it's an insurance policy that provides financial assistance for lost wages and medical expense in the event of injury or illness resulting from the workplace. Every state has a workers' compensation system, which entitles workers to prompt payment of benefits with a minimum of legal formality and expense. In return, the employee gives up the right to sue for any injuries from work related accidents – regardless of fault. Some states require household employers to carry a workers' compensation policy and some do not. The INA recommends that you consult with a state licensed insurance professional to discuss your situation and your state's laws. Alternately, our supporting members who provide payroll and tax services typically have relationships with insurance firms that can assist.

## CAN I RUN MY NANNY'S PAYROLL THROUGH MY OWN BUSINESS?

Sole Proprietorships and For-Profit Farms may report and pay their nanny's payroll taxes through their regular reporting, however it is not recommended. Here's a quick explanation.

Businesses are allowed to take tax deductions on their employee payroll expense. The logic is that employees are direct contributors to the success of the business, and therefore, the business is entitled to a tax break on its payroll investment. Unfortunately, the IRS has ruled that nannies are not direct contributors to the success of businesses, thereby making it illegal for any business to take a tax break on household employment payroll. (The IRS considers nannies to be direct contributors to the household, which means families can deduct their nanny's wages as a childcare expense on their personal tax return).



Additionally, for most business entities, the tax reporting and remittance process does not allow for household employees. The only exceptions are Sole Proprietorships and For-Profit Farms, which are allowed to report household wages and remit household taxes on their business tax returns. (Even though they have a reporting exception, it is still illegal for Sole Proprietorships and Farms to take a business tax deduction on household employee payroll expense.)

Generally, the business' workers' compensation insurance plan will not extend coverage to the nanny. Finally, putting a household employee on the company payroll increases legal risk because, in the event of a legal dispute between employer and employee, the family's business assets – as well as personal assets – could be exposed.

For these reasons, it is recommended that all families manage their business and household payrolls separately.



## WHAT IS THE PROCESS FOR HANDLING PAYROLL AND NANNY TAXES?

Nanny payroll and tax is detailed, and many find it complicated. Here's an overview of what's involved:

Research employment tax and labor laws at the Federal and state level to understand legal obligations.

- Register for federal and state tax accounts.
- Complete and file New Hire Reporting.
- A pay rate notice may be required, detailing the hourly and overtime rates the nanny is being paid, the pay frequency and the 7 day work week.
- Identify and calculate taxes to withhold each pay period.
- Maintain records of 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.
- Prepare year-end tax documents (Form W-2, Form W-3, Schedule H and State Annual Reconciliation)
- Respond to IRS and state inquiries.
- Monitor ever changing household employment tax law.
- Nanny Payroll and Tax Help is Available

Many nanny employers find it is much simpler to outsource nanny payroll and nanny tax compliance to a firm that specializes in these household payroll taxes. Additionally, nannies appreciate the convenience of direct deposit payroll. The International Nanny Association has several reputable household payroll and tax services firms as members. You can locate these members in the Member Directory searching under Industry Services.



# AVOIDING PAYROLL TAX & LABOR LAW RISKS

When families become employers, they take on many of the same responsibilities that business employers do. But unlike businesses, families don't have accounting, legal and HR departments to expertly handle all the employment details.

Common Errors that Create Risks

**MISTAKE:** Misclassifying the worker as an independent contractor.



If you hire an individual to work in your home and you have the right to control what, when, how or by whom the work should be performed, the IRS considers that individual to be your employee. It doesn't matter how many hours she works, how much she is paid, or what is written in the contract – she's an employee. Misclassifying the worker as an independent contractor (by using Form 1099) is considered tax evasion.

In addition, workers who are misclassified as independent contractors have a larger tax burden and are denied government benefits (unemployment insurance) than they would qualify for if they are correctly classified as employees.

To avoid tax and legal problems – and ensure that your employee receives all the take-home pay and government benefits to which she is entitled – families should follow the compliance process outlined in IRS Publication 926.

**Note:** The IRS recently announced a major enforcement initiative in conjunction with the Department of Labor. They are focused on collecting billions of dollars of lost tax revenue due to misclassification and have targeted several industries as major violators – one of which is the household employment industry. As of 2015, 23 states are formally sharing enforcement information with the US Department of Labor and the Internal Revenue Service.

**MISTAKE:** Failure to properly address overtime.

Nannies and other household employees are categorized as “Non-Exempt” (hourly) workers under the Fair Labor Standards Act (FLSA). That means that a household employer is required to pay overtime for all hours over 40 in a 7-day work week (live-in nannies are generally an exception to this rule, although a few states such as California, Massachusetts, Maryland, New York, Minnesota and Maine have special overtime laws for live-in employees). Overtime hours must be paid at a rate that is at least 1.5 times the regular rate of pay.

Many families try to side-step overtime by offering a salary. In their minds, jobs that pay on a salary basis – instead of an hourly basis – are legally able to pay a fixed amount of wages regardless of how many hours the employee works. This is true for employees categorized as “Exempt” under the FLSA (generally, “white-collar” professionals) because workers in these types of jobs are considered “well compensated” and “generally not prone to abuse.” But it's not true for protected workers – those categorized as “Non-Exempt” workers. In other words, it's the type of job – not the type of pay – that determines overtime requirements. In the case of household workers, families must make sure to properly address overtime pay.

**Note 1:** If the worker and employer agree to a “salary” based on a schedule that regularly includes more than 40 hours, the family should protect themselves by addressing overtime in an employment agreement that is signed by the employee. For example, let's say a family and nanny agree to \$650 per week based on a 45-hour work week. The employment agreement should specify that the weekly compensation is comprised of 40 hours at the regular rate of pay of \$13.68/hour plus 5 hours at the overtime rate of \$20.52/hour. Additionally, it must be stated that any additional hours in a work week will be paid at the overtime rate of \$20.52.

**Note 2:** Overtime issues are particularly dangerous for employers because there is no statute of limitations – allowing former employees to file a wage dispute years after the relationship has terminated. Back wages plus back taxes, penalties and interest can make this a very expensive mistake. The good news is a simple employment agreement makes all the worries go away.



**MISTAKE:** Putting a household employee on the company payroll.

This is a fairly common mistake for families who own a business. The IRS does not consider household workers to be employees of the company because they are not “direct contributors” to its success. And since businesses are entitled to tax deductions on payroll expense, it is an illegal tax deduction to include a domestic worker’s payroll expense as part of the company payroll and tax reporting.

Instead, household employees should be handled separately through the household employment reporting process. If the expense is childcare related so that both spouses can work or go to school, the family can take the childcare tax breaks associated with those wages, but it must be handled on their personal income tax return.

Based on this same logic, it is considered insurance fraud to put a household employee on the company’s group health plan and workers’ compensation insurance plans..

**MISTAKE:** Failure to properly withhold and report payroll taxes.

Household employers are required to administer the payroll tax withholding and reporting process. Sometimes employees will say – or imply – that they will “take care of their own taxes.” Families, especially first-time employers, sometimes conclude that they are absolved of the tax responsibilities. That is not the case; the state and federal tax agencies put the onus – and the liability – squarely on the employer.

**MISTAKE:** Failure to secure workers’ compensation insurance.

Workers’ compensation is not part of the tax process. It’s an insurance policy that provides financial assistance with lost wages and medical costs in the event that your employee has a work-related injury or illness. It also protects employers from lawsuits since workers who accept benefits forfeit their right to sue the employer, regardless of fault.

Workers’ Compensation insurance is required for household employers in some states and is optional in others (click here for the requirements by state). If you are required to carry a workers’ compensation policy – or if you elect to carry one – we suggest that you contact your homeowner’s insurance agent. If you’re not already covered, your agent can usually set up a policy over the phone.

Families who successfully handle these details don’t have to worry about potentially-expensive audits and lawsuits. Additionally, they’re able to take advantage of childcare tax breaks that can offset – sometimes even exceed – the employer’s tax costs. Finally, when paid correctly, the employee is entitled to important short-term and long-term benefits such as Social Security, Medicare, Unemployment, Disability and the ability to obtain loans and lines of credit.



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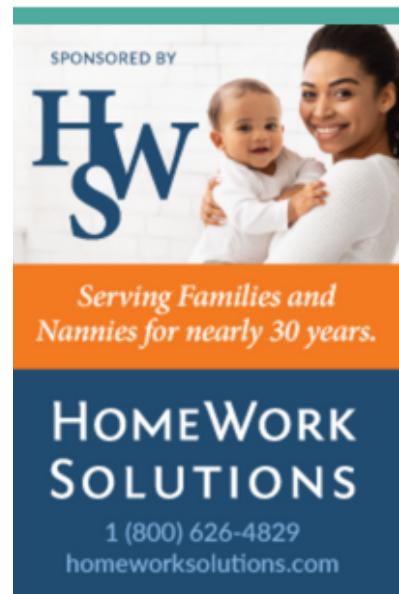


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## About



INA is a volunteer, not for profit educational association that is committed to providing information, education and guidance to the public and to industry professionals. We look to people like you, who are interested in the professionalism of the in-home child care industry, to partner with us and support our efforts.

## JOIN US

For more information on joining INA, please visit our [member benefits](#) page on the INA website, [www.nanny.org](http://www.nanny.org).

If you have questions or comments about INA, please contact us by phone at 888.878.1477 or by email at [admin@nanny.org](mailto:admin@nanny.org).

## Membership is open to:

Nannies and all other in-home child care providers

Nanny Employers

Nanny Placement Agencies and Staff

Industry Service Providers

Individuals who support the in-home child care industry

Industry Educators

## INA Weekly Blog

Each week, INA distributes fresh ideas and valuable resources for Nannies and Agencies via email. Topics include business solutions for effective agency management, innovations in recruitment and family-client communications, and more. [Subscribe here.](#)

## INA Annual Conference

Each year, INA holds an industry conference attended by agencies, nannies and related business partners from around the world. This three-day event features speakers and workshops that help INA members improve business performance, connect with the nanny community, and address challenges and opportunities across a range of issues. Learn more about this year's INA Annual Conference, including our workshop agenda, keynote speakers, costs and dates.