

# Remember the Nanny Tax

## When preparing a taxpayer's 2009 tax return

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If a taxpayer during 2009 employed a babysitter, housekeeper or companion who is over 18 years old and not otherwise exempt from the Nanny Tax and paid \$1,700 or more for such domestic services, the taxpayer will owe the Nanny Tax.

## Background

What do Zoe Baird, nominee for Attorney General by President Clinton, Ron Brown, Secretary of Commerce under President Clinton, Bobby Ray Inman, nominee for Secretary of Defense by President Clinton, Bernard Kerik, nominee for Secretary of Homeland Security by President George W. Bush, Nancy Killefer, nominee for Chief Performance Officer by President Obama and Caroline Kennedy, potential nominee for the vacant New York State senate seat and hundreds of thousand of other taxpayers all have in common? All of them failed to pay the Social Security and Medicare taxes with respect to their nannies, from where the term "Nanny Tax" came. For 2007, the latest year for which records are available, of the 86 Million Form 1040s filed by U.S. taxpayers, only 222,146 returns reported household employment taxes. However, it is estimated that two million other taxpayers failed to report and pay the Nanny Tax due with respect to their domestic-service employees.

## What Is the Nanny Tax?

*Nanny Tax* is really an umbrella term covering several different taxes with respect to domestic-service employees, including Social Security, Medicare and the federal unemployment taxes. The Social Security and Medicare Tax (FICA), is 15.3 percent of the gross wages of a domestic-service employee, of which half is contributed by the employer and half is withheld from the employee's wages and paid over by the employer. The Social Security Tax rate is 6.2 percent each for both the employer and employee and the Medicare Tax is 1.45 percent each for both the employee and the employer. The employer is responsible for withholding the employee's share of the FICA taxes from the employee's wages. In addition, the employer must pay a matching amount as the employer's share of the FICA taxes. If the employer pays the domestic-service employee in cash and does not withhold the employee's share of the FICA taxes, the employer is liable for the total amount of the FICA taxes. The Federal Unemployment Tax (FUTA) applies only to the first \$7,000 of wages of a domestic-service employee, as long as the domestic employee earns at least \$1,000 in any one quarter of the current taxable year or previous taxable year. The FUTA tax is only 0.8 percent, as long as the state unemployment tax is paid on time prior to the filing of the employer's tax return. In the event the

state unemployment tax is not paid on time, the FUTA tax rate is 6.2 percent of the domestic-service employee's wages.

## **Employees Subject to the Nanny Tax**

If a person is hired to perform services of a household nature and that person is paid \$1,700 or more during the calendar year for such services, the employer may be subject to the Nanny Tax. The person performing the household services will be considered an employee and the taxpayer will be considered an employer if the employer can control not only what work is done, but also how the work is done. Domestic services performed by an individual who was under the age of 18 during any part of the calendar year and whose principal occupation is not the performance of such services will not be subject to the Nanny Tax. For these purposes, a student's principal occupation will be school. Consequently, the Nanny Tax will not be due with respect to the average school-age babysitter.

In addition, the Nanny Tax will not apply to wages for domestic services paid to a spouse, a child under the age of 21 or a parent, except where the parent is paid to care for a child who is under the age of 18 or who is disabled and the taxpayer is divorced or widowed. If the taxpayer pays \$1,700 or more to any one of those persons for domestic services and the exceptions for parents does not apply, the taxpayer will not be subject to the Nanny Tax on those wages.

If the cash paid to an employee for performing domestic services is equal to \$1,700 or more for the calendar year, all of the wages paid to such employee is subject to the Nanny Tax. The threshold amount applies to each domestic-service employee. Any noncash wages paid, such as room and board, are not subject to the Nanny Tax.

## **What Domestic Services Are Subject to the Nanny Tax?**

The obvious example, which tripped up all of those people supported for different public offices, was services by a nanny. However, the definition goes beyond nannies and includes anyone who performs services of a household nature in or about the home. The regulations have defined domestic service as used in the statute as services of a household nature in or about the home or the club rooms of a facility like a local college club or local chapter of a college fraternity or sorority. Domestic service includes services of a household nature that are performed in or about a private home, including a tent, boat, trailer or hospital or hotel room of the person for whom the services are performed. It includes services that are performed as an integral part of household duties that contribute to the maintenance of the employer's resident or administer to the personal wants and comforts of the employer or members of the employer's household. Thus, domestic service providers include housekeepers, maids, nursemaids, caretakers, gardeners, grooms, chauffeurs, cooks, babysitters, nannies and companions.

## Payment of the Nanny Tax

If a taxpayer paid a person \$1,700 or more during 2009 to perform domestic services and that person is not under the age of 18 or not a spouse, a child under the age of 21 or parent of the taxpayer, the taxpayer will have to prepare Schedule H and attach it to the taxpayer's 2009 Form 1040. In addition the taxpayer will have to pay the Nanny Taxes on the wages paid to that person. Further, the taxpayer will have to obtain an *Employer Identification Number* (EIN) so that the taxpayer can report the employee's wages properly. The taxpayer will also need to prepare a Form W-2 for the domestic-service employee and file a W-2 and a W-3 with the Social Security Administration before March 1st, 2010. If the taxpayer did not pay estimated taxes with respect to the Nanny Tax, the taxpayer may be liable for an estimated tax penalty based on taxpayer's household employment taxes shown on the Schedule H to be due. If the taxpayer fails to file the Schedule H and pay the Nanny Tax with the taxpayer's 2009 Form 1040, the taxpayer will be liable for interest payments plus the late payment penalty and possibly the 20 percent accuracy penalty in the form of the negligence penalty.

## Conclusion

If a taxpayer paid a person cash wages of \$1,700 or more during 2009 to perform domestic services such as a nanny, babysitter or companion and that person is not under the age of 18, not the spouse, a child under the age of 21 or a parent of the taxpayer under certain circumstances, the taxpayer will owe the Nanny Tax and will have to prepare and file Schedule H with the taxpayer's Form 1040 and pay the Nanny Tax due.

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