

Dear Client:

You've asked me about your federal **tax** obligations under the so-called "**Nanny Tax**." The "**Nanny Tax**" isn't limited to a **nanny**. It also applies to a housekeeper, maid, baby-sitter, gardener or other household employee who isn't an independent contractor. The **tax** doesn't apply to a household employee who's also a farm worker.

If you employ someone who's subject to the "**Nanny Tax**," you aren't required to withhold federal income taxes. You have to withhold only if your **nanny** asks you to and you agree to withhold. (In that case, have the **nanny** fill out a Form W-4 and give it to you, so you can withhold the correct amount.) However, you may be required to withhold social security and Medicare **tax** (FICA). And you may also be required to pay (but not withhold) federal unemployment (FUTA) **tax**.

FICA: You have to withhold and pay FICA taxes if your **nanny** earns cash wages of \$1,700 (annual threshold) or more (excluding the value of food and lodging) during the calendar year 2011. If you reach the threshold, the entire wages (not just the excess) will be subject to FICA. However, if your **nanny** is under age 18 and child care isn't her principal occupation, you don't have to withhold FICA taxes. Thus, if your **nanny** is really a student who is a part-time baby-sitter, there's no FICA **tax** liability for her services. On the other hand, if your **nanny** is under age 18 and the **nanny** job is her principal occupation, you must withhold and pay FICA taxes.

You should withhold from the start if you expect to meet the annual threshold; your **nanny** won't appreciate a large, unexpected withholding from her pay later on. If you aren't sure whether the annual threshold will be met, you can still withhold from the start. If it turns out the annual threshold isn't reached, just repay the withheld amount. If you make an error by not withholding enough, withhold additional taxes from later payments.

Both an employer and a **nanny** have an obligation to pay FICA taxes. As an employer, you are responsible for withholding your **nanny's** share of FICA. In addition, you must pay a matching amount for your share of the taxes. The FICA **tax** is divided between social security and Medicare. For 2011, a two-percentage-point reduction in the employee's share of social security **tax** is in effect. Therefore, the social security **tax** rate is 6.2% for the employer and 4.2% for the **nanny**, for a total rate of 10.4%. The Medicare **tax** is 1.45% each for both the employer and the **nanny**, for a total rate of 2.9%.

Example: In 2011, you pay your **nanny** \$300 a week, and no income **tax** withholding is required. You must withhold a total of \$16.95, consisting of \$12.60 for your **nanny's** share of social security **tax** ($\$300 \times 4.2\%$) and \$4.35 ($\$300 \times 1.45\%$) for your **nanny's** share of Medicare **tax**. You would pay her a net of \$283.05 ($\$300 - \16.95). For your (employer's) portion, you must pay \$22.95 ($\$300 \times 7.65\%$), for total taxes of \$39.90.

If you prefer, you may pay your **nanny's** share of social security and Medicare taxes from your own funds, instead of withholding it from her pay. Using the figures from the above example, for each \$300 of wages, you would pay your **nanny** the full \$300 and also pay all of the total \$39.90 in taxes.

If you do pay your **nanny's** share of these taxes for her, your payments aren't counted as additional cash wages for social security and Medicare **tax** purposes. In other words, you don't have to compute **tax** on the taxes. However, your payments of her taxes are treated as additional income to the **nanny** for federal income **tax** purposes, so you would have to include them as wages on the Form W-2 you provide, see below.

FUTA: You also have an obligation to pay (but not withhold) FUTA **tax** if you pay a total of \$1,000 or more in cash wages (excluding the value of food and lodging) to your **nanny** in any calendar quarter of the current year or last year. The FUTA**tax** applies to the first \$7,000 of wages paid. The maximum FUTA **tax** rate was 6.2% for the first half of 2011, and is 6.0% thereafter. FUTA **tax** is paid only by the employer, not by the employee, so don't withhold FUTA from the **nanny's** wages.

Reporting and paying: You must satisfy your "**Nanny Tax**" obligations by increasing your quarterly estimated **tax** payments or increasing your withholding from your wages, rather than making an annual lump-sum payment.

As an employer of a **nanny**, you don't have to file any of the normal employment **tax** returns, even if you're required to withhold or pay **tax** (unless you own your own business, see below). Instead, you just report the employment taxes on your **tax** return, Form 1040, Schedule H.

On your income **tax** return, you must include your employer identification number (EIN) when you report the employment taxes for your **nanny**. The EIN isn't the same number as your social security number. If you already have an EIN from a previous **nanny**, you may use that number. If you need an EIN, you must file Form SS-4 to get one. I've enclosed a blank form you can use.

However, if you own a business as a sole proprietor, you must include the taxes for your **nanny** on the FICA and FUTA forms (940 and 941) that you file for your business. And you use the EIN from your sole proprietorship to report the taxes for your **nanny**.

You're also required to provide your **nanny** with a Form W-2. If her 2011 wages are subject to FICA or income **tax** withholding, the W-2 is due by Jan. 31, 2012. Additionally, you must file a Form W-2 for 2011 with the Social Security Administration by Feb. 29, 2012. Your EIN must be included on the Form W-2.

Recordkeeping: Be sure to keep careful employment records for each **nanny** and domestic employee. Keep the **tax** records for at least four years from the later of the due date of the return or the date when the **tax** was paid. Records should include: employee name, address, social security number; dates of employment; dates and amount of wages paid; dates and amounts of withheld FICA or income taxes; amount of FICA taxes paid by you on behalf of your nanny; dates and amounts of any deposits of FICA, FUTA or income taxes; and copies of all forms filed.

I realize this is a lot of information to absorb. I'd be happy to go over any questions you still have about how to comply with these employment tax requirements. If you think you might have any problems for earlier years I can also help. I look forward to hearing from you.

Very truly yours,