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Employing A Household Worker

When hiring a household worker to provide daycare help, there are two related issues. The first is the actual cost in "after tax" dollars. The second involves the rules and paperwork required.

Actual Cost In After-Tax Dollars

If you are considering the dollar ramifications of paying an in-house domestic, you must include the extra costs above and beyond the actual salary. From a tax standpoint, you become an employer and, as such, must pay the employer's share of federal and state payroll taxes, as well as any required worker's compensation.

For federal purposes, using 2000 rules, you are responsible for withholding social security and medicare tax (which amount to 7.65% of the gross wages paid). Additionally, as the employer, you must also match that dollar amount. There is also a federal unemployment tax of up to 6.2% on the first \$7,000 of wages paid per employee—although it usually doesn't go that high. If you file your state unemployment taxes on time, the federal rate is usually much less than this, averaging around .8% instead since a credit of up to 5.4% is granted against state taxes paid.

There are several exceptions to these required federal filings. If annual wage payments are less than \$1,200, or are paid to a spouse, parent, or your child under age 21, no tax is usually due. Also, if you pay a household worker under age 18 for occasional help (such as a babysitter) these filing rules usually don't apply either.

For most state purposes, you may have to pay an employer's unemployment tax in addition to withholding state income tax from the domestic's pay. You should also have worker's compensation coverage in case the employee gets a job-related injury.

On the plus side, if this employee qualifies under the IRS dependent care provisions, you may be entitled to a tax credit and/or a tax deduction. The credit is based on a sliding scale percentage of wages paid. The higher your income, the lower the credit with a minimum(if you qualify) of 20% of the first \$2400 in wages paid for one qualifying child care credit, with a maximum of two qualifying dependents allowed. For those taxpayers who qualify at work for a special "flexible spending" plan, a deduction from taxable income of up to \$5,000 may be possible instead.

Paperwork Involved

There are numerous tax filings that must be made to the federal and state governments when you hire an in-house domestic worker.

First, you must register with the federal and state authorities as an employer. This means filing certain registration forms to record you as an employer and to get the necessary tax identification numbers, and employee benefits rates. You also should set up worker's compensation coverage (which is usually done through a commercial insurance carrier) when the state doesn't do it for you.



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Your employee must fill out, sign, and submit to you a W-4 Form which formalizes their name, social security number, and withholding status. Also required for Non-US Citizens is an I-9 Form to prove their legal work eligibility status.

As the employer, you are required to withhold, collect, and send to the federal and state governments the appropriate payroll taxes as discussed above. These taxes are usually sent in on a periodic basis using some form of a coupon or worksheet. The due dates depend on the dollar amount of taxes being collected. For most domestic help situations, it is once a month, once a quarter, or once a year, depending on payroll size.

On a periodic basis you must file appropriate federal and state payroll tax returns. On these forms you are listing the gross wages paid, the taxes withheld and due, and any amounts already paid in through the coupons. For federal purposes, these filings can be done in conjunction with your individual income tax return on "Schedule H." Although the federal taxes due may be paid only once a year, you may wish to elect estimated tax payments throughout the year to avoid a large balance due at tax time. You will probably also need to file a state unemployment tax return for the quarter, showing the total wages paid, and the amount subject to state unemployment tax.

On a yearly basis, you also file appropriate year-end federal and state W-2 forms for your employee. Periodically your worker's compensation carrier will ask for a report to verify the gross payroll in order to adjust the billing charges.

For people who are self-employed, federal treatment may be different. Household filings may be done on different forms. A quarterly form 941 or Form 913, and yearly FUTA form may be required.

There are several minimum recordkeeping requirements of which to be aware. As an employer, you are supposed to provide the employee with appropriate pay stubs. You should also keep all related records for at least four years beyond the year in question.

As you can see, it can get pretty complicated. Of course, failure to follow all these rules and regulations can get even more complicated, and much more expensive if you are charged with penalties and interest for failure to file timely and proper returns.

Naturally, you may elect to have these filings done by a professional. In fact, approximately 50% of the taxpayers involved in these filings do just that to avoid the potential headaches and penalties for improper or late filing of all this paperwork.