

# Sweep Away “Nanny Tax” Concern

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If you employ a household worker, such as someone to watch young children, you may be liable for the so-called “nanny tax.” However, you can sidestep any dire tax consequences if you pay close attention to the rules.

Under current law, you must pay employment taxes if the wages paid to certain household employees exceed a specified annual threshold. The IRS has announced that the annual threshold for 2010 is \$1,700 (the same as it was in 2009).

For many years, nanny tax obligations were often ignored, but several high-profile cases have increased IRS scrutiny. Failure to observe the rules could result in tax penalties. There are three major areas to be concerned about.

**1. Social Security tax:** The 6.2% Old Age, Survivors, and Disability Insurance portion of Social Security tax is withheld from employees and matched by the employer up to the amount of the annual wage base. The wage base for 2010 is \$106,800 (the same as 2009). In addition, you must withhold and match the 1.45% Medicare portion of the tax on the full amount of wages.

**2. Federal unemployment taxes:** You must pay a 6.2% tax on the first \$7,000 in wages, but this amount is reduced by a 5.4% credit. Thus, the net tax is only 0.8% if you paid all your required state unemployment and disability taxes.

**3. State unemployment and disability taxes:** You are responsible for both your share and your employee’s share of these state taxes. If you do not withhold the requisite amount of tax in a timely fashion, you must pay it yourself.

The nanny tax actually applies to a wide variety of household employees. This includes workers who perform jobs in and around your home, such as nannies, babysitters, private nurses and other caretakers, cleaning people, yard workers and similar domestic workers. However, a worker is an “employee” only if you control the conditions. For instance, if you pay an agency directly, the agency is treated as the employer of the worker and pays the employment taxes.

Alternatively, if the worker controls how and when the work is performed and works for several households, he or she may be treated as a self-employed individual. This typically occurs when the

worker offers services to the general public and provides his or her own tools and supplies. Self-employed individuals are responsible for their own employment taxes.

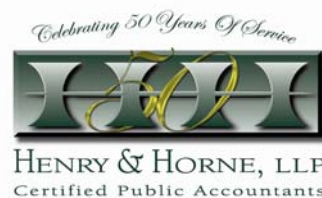
In addition, the law contains several other exceptions. Significantly, you are not responsible for the nanny tax for amounts paid to

- your spouse
- your child if he or she is younger than 21 years
- your parent or in-law (unless a certain special exception applies)
- an employee who is younger than 18 years at any time during the year, except if providing household services is the employee's principal occupation

If you have any questions concerning your responsibilities under the nanny tax, do not hesitate to contact your Henry & Horne, LLP tax adviser.

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