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Requirements and Responsibilities for Families Hiring Private-Duty Care

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In-home, private-duty care is one of the fastest-growing segments of the care industry. The high cost of facility-based care (for elder care and child care), coupled with the desire to enjoy the comfort and convenience of home, makes employing a caregiver an increasingly popular option for families.

Unfortunately, the IRS and state tax agencies don't make it easy for families to understand or comply with the payroll, tax and labor law aspects of employment. Without a strong financial background, most simply lack the knowledge to execute the household employment process correctly – creating significant audit and legal risk.

So whether your client needs private-duty care for a child, elderly parent, adult dependent with special needs, etc., here is a breakdown of several topics you'll need to familiarize yourself with so you can advise them on the right course of action.

Employee vs. Independent Contractor

For tax and legal purposes, IRS Publication 926 is the resource that guides your clients' household payroll and tax requirements. As a household employer, when your client pays a domestic worker over the threshold of $1,900 (2014) within a calendar year, they are required to meet certain tax obligations.[1] And even if they do not meet this wage threshold, they are still required to follow federal and state labor law.

There is a common misconception that household employees (nannies, senior caregivers, etc.) can be labeled as "independent contractors" so that payroll taxes can be avoided. However, the IRS has ruled that the vast majority of domestic workers should be classified as employees — rather than independent contractors — because the family has the right to control how, what, when or by whom the work should be performed.[2] It does not matter how many hours they work, how much they are paid or what they are called in a work agreement. Misclassifying a household employee as an independent contractor (by providing them Form 1099 instead of Form W-2) is considered tax evasion in the eyes of the IRS.

Basic tax and legal responsibilities

From a high-level standpoint, household employers have two basic tax responsibilities:

1) Withhold Social Security and Medicare taxes from the employee's paycheck (or pay it on their behalf) as well as all required state taxes. In 2014, Social Security tax is applied to the first $117,000 of wages, but Medicare tax is uncapped. Household employers are not required to withhold federal and state

[1] See IRS Publication 926
[2] See IRS Publication 15-A

income taxes from their employee's pay, although it is strongly recommended that they do so to help employees avoid underpayment penalties.

2) Pay employer taxes – typically, these will be in the range of 9-10% of their employee's gross wages. Specifically, 7.65% is paid in the form of FICA taxes (6.2% Social Security tax plus 1.45% Medicare tax)[3] and the remainder for federal and state unemployment insurance. Just like employee withholdings, some states have small additional taxes household employers may have to pay.

Additionally, household employers have a legal obligation to verify that their employee is permitted to work in the United States. Specifically, the Department of Homeland Security asks each household employer to utilize Form I-9, which verifies the identity and employment eligibility of all workers. This form does not have to be filed with the U.S. Citizenship and Immigration Services, but it must be kept for either three years after the employee begins work or one year after the employee is terminated, whichever date is longer.[4] Hiring or continuing to employ someone that is not allowed to work in the United States can carry a fine of up to $3,200 for each worker.[5]

Tax breaks

Families that employ a caregiver – and pay him/her legally – can take advantage of tax breaks that can largely offset their employer payroll taxes. For many, the tax savings exceed the cost of employer taxes — meaning families come out ahead by paying their household employees on the books. The tax breaks available to most families with caregiving needs are:

- *Dependent Care Account* (a type of Flexible Spending Account specifically for dependent care needs)
- *Child and Dependent Care Tax Credit* (IRS Form 2441)
- *Medical Flexible Spending Account* (used only for medical care)
- *Medical Care Tax Deduction* (itemized deduction for qualifying medical expenses)

As with most tax breaks and rules, there are a few notes and exceptions:

1) In order to capitalize on dependent care tax breaks, families must pass the "work-related test," meaning both spouses must be employed or full-time students.
2) In the senior care industry, tax breaks are contingent on determining who the employer is and whether the person receiving care can be considered a qualifying dependent.[6]
3) The same expenses cannot be applied to multiple tax breaks.

To accurately calculate how much a family may save by taking advantage of these tax breaks, it's recommended they speak to a tax expert specializing in personal income taxes.

[3] See IRS Publication 926
[4] See Code of Federal Regulations Title 8 Section 274a.2
[5] See Code of Federal Regulations Title 8 Section 274a.10
[6] See IRS Publication 503

A step-by-step guide to compliance

Earlier, the high-level requirements for families to comply with household employer tax and payroll laws were covered. The following is a more complete, detailed breakdown of a family's federal and state obligations:

- *Apply for federal and state tax accounts.* Each state has tax agencies to handle state unemployment insurance taxes and, in most states, state income taxes. Household employers must establish a tax account and obtain a corresponding tax identification number for reporting and remitting employment taxes. In many states, multiple tax accounts and tax identification numbers must be established. These tax IDs must be included on all state tax returns. In addition, the IRS has a similar tax account setup process for federal tax reporting and remittance.

- *Complete and file a New Hire Report.* Every state requires employers to submit a report providing key employment and identification information for every new employee hired.

- *Calculate and manage payroll each pay period.* All appropriate state and federal taxes must be withheld, itemized and tracked every pay period. Employees should be provided a paystub each payday to show their gross and net pay as well as the taxes withheld.

- *Prepare state tax returns and remit both the employer and employee taxes.* Each state requires household employers to remit the taxes they've been withholding from their employee's pay along with state taxes assessed on the employer. All state employment taxes must be reported correctly via state-specific returns, typically on a quarterly basis (some states may require monthly or annual filing). In most states, returns and payments are due by the end of the month following the calendar quarter, but some states have earlier deadlines.

- *Prepare federal tax filings four times per year and remit both employer and employee taxes.* The IRS has a slightly different reporting and payment schedule than the state tax agencies. Federal household employment taxes are remitted using the personal estimated tax process. Estimated taxes are due four times per year via Form 1040-ES in mid-April, mid-June, mid-September, and mid-January. The payments cover the household employer's FICA and federal unemployment insurance taxes and the federal income and FICA taxes withheld from their employee's pay.

- *Prepare year-end tax documents.* Household employers are required to prepare and file annual federal and state tax returns at the end of each calendar year. First, they must prepare a Form W-2 for their employee(s) and provide it by the end of January. Second, they must prepare and file a W-2 Copy A and W-3 with the Social Security Administration. Finally, they must prepare a Schedule H and file it as a part of their personal federal income tax return. The Schedule H summarizes all employment activity and federal tax liabilities for the year. Some states also require household employers to prepare and file annual reconciliation forms summarizing annual wages and state income taxes withheld.

The benefits of compliance are worth the extra work. The family avoids legal and audit risk while their employee receives the critical benefits and protections funded by our payroll tax system. Failure to comply carries significant consequences. According to United States Code, household employers who do not file employment taxes can face a fine of up to $25,000 and up to 1 year imprisonment – in addition to back taxes.[7]

Wage and hour law

Household employees are classified as non-exempt workers under the Fair Labor Standards Act.[8] As such, families need to be aware of, and comply with, the following labor laws:

• Employees must be paid at least the federal minimum wage of $7.25 per hour for each hour in the standard workweek. Many states (and some municipalities) have a minimum wage that is higher than the federal minimum wage. In these areas, employees must be paid at the higher of the rates.[9]

• Employees must be paid overtime (time-and-a-half) for each hour over 40 in a seven-day workweek. Federal law exempts live-in employees from overtime requirements, but some states have special overtime provisions for live-in workers.

• Household employers are generally not required to provide benefits such as paid time off (although some states and municipalities have special requirements).

• In many states, household employers are required to carry a workers' compensation insurance policy.[10]

Please note that there are many state-specific nuances that families should be aware of. Things like daily overtime, paid sick leave and required mileage reimbursement are just some of the items families in certain states will need to comply with. These details are contained in the Answers section of our website at www.myhomepay.com.

Additional note about companion care

Effective January 1, 2015, third-party employers (senior care staffing firms) will not be able to claim the overtime exemption for companionship services. Individual household employers are able to claim the exemption, but only if the worker is engaged in tightly-restricted "fellowship" activities such as reading, games, crafts, conversation, etc. Any medically-related services and any household work that benefits someone other than the employer (employer must be an elderly person or person with an illness, injury, or disability) will disqualify the employer from being able to claim the companion care exemption and, therefore, qualify the worker for overtime pay. This primarily affects senior care staffing firms, but is

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[7] See 26 USC § 7203
[8] See 29 CFR 552
[9] See www.dol.gov/whd/minwage/america.htm
[10] See www.myhomepay.com/Answers/ExpertAdvice/WorkersCompRequirementsByState.aspx

also a driver toward household employment compliance because many families will find themselves directly hiring a caregiver in order to reduce costs.

Benefits of legal pay

Paying a household employee legally creates an employment history that is critical for obtaining things like a car loan, a mortgage and various insurances. If employment is not documented, it is as if the employee doesn't work at all. Second, employees paid legally are entitled to receive unemployment benefits from the state if they lose their job due to no fault of their own. Lastly, when employees retire, they are eligible for Social Security and Medicare benefits based on how much they paid into those accounts over their working lifetime. If they were never paid legally, no benefits can be paid to help support them in their golden years.

For families, complying with household employer tax law keeps them safe from audits and lawsuits. As one example, if a family pays their caregiver under the table and later lays him or her off, when the caregiver files for unemployment benefits, the state will discover the family never paid unemployment taxes. The state will demand payment for back taxes plus additional penalties and interest, and the IRS will soon attempt to collect the FICA and federal unemployment insurance taxes that were never paid, along with penalties and interest and possible tax evasion charges that can threaten a family's livelihood. There are similar risks with wage disputes, audits, and injuries. The risk is simply not worth it – especially when tax breaks can offset most, if not all, of the incremental employer expenses.

Understandably, your clients may feel overwhelmed by all the employer obligations. Most families don't know where to begin. By understanding the basics of household employment, there is a great opportunity to add value to your service by proactively offering guidance in this area. Care.com HomePay has been helping families with household employment needs for more than 22 years, so feel free to call on us as a resource. Our comprehensive payroll, tax and HR service – built ***by*** household employers ***for*** household employers – eliminates all the work and worry for busy families.