

# POINT & COUNTERPOINT: LAW AND JUSTICE: HOUSEHOLD WORKERS AS EMPLOYEES OR INDEPENDENT CONTRACTORS

**INTRODUCTION:** The issue of employee versus independent contractor is an old and continuing one, affecting large businesses and small, with many millions of dollars at stake. This Point/Counterpoint moves the debate from the business place to the home by focusing on the special rules applicable to household employees. Harry Charles considers the applicable rules from the point of view of enforcement, or, more accurately, the lack of enforcement. Jerome Borison asks us to go beyond the legal issues to the equitable and extra-legal issues that follow from classification as an independent contractor.

## POINT: WHO'S AFRAID OF THE NANNY TAX?

by *Harry Charles,*  
*St. Louis, MO\**

IRS Publication 926, Household Employer's Tax Guide, is all of 14 pages of single-spaced information on paying employment taxes on household employees. For the year 2000, taxpayers who pay a household employee cash wages of more than \$1,200 must report and pay social security and Medicare taxes on the employee's 2000 wages. The taxes are reported on the employer's IRS Form 1040 federal income tax return via Schedule H, Household Employment Taxes. They can be paid with the return via American Express card, MasterCard or Discover Card, or through estimated tax payments, as the Guide points out. The key issue for employers is the money: 15.3% of cash wages for social security taxes and 0.8% of

cash wages for federal unemployment tax, in addition to state unemployment contributions.

The worker classification issues are illustrated in the IRS' Guide. It points out that if the services are performed in the worker's home, the taxpayer normally isn't considered a household employer. The main issues are whether the worker provides their own tools and offers services to the public as an independent business. Advertising and business cards can be important indicators.

In line with current IRS thinking on employment taxes issues, however, the Guide states that control of how the work is done is the key issue. It contrasts a babysitter who follows specific instructions about household and child care duties and uses the taxpayer's equipment (employee) with the owner of a lawn care service who cuts the taxpayer's lawn (non-employee).

A recent internet search of the term "nanny" resulted in 167,198

hits, including a site called [www.4nannytaxes.com](http://www.4nannytaxes.com), run by Home/Work Solutions of Pidgeon Hill, Virginia, which offers to charge an employer's credit card \$35 per month for basic weekly payroll service for one employee and \$365 per year for a tax remittance service. Other payroll services, such as Paychex, offer similar services and are well worthwhile.

The key problem for household employers, as pointed out by the Nannytax website, is not the IRS, but the state divisions of employment security. If the household worker files for unemployment benefits, the state agency will typically find that the worker was an employee and generate an assessment for back contributions. With penalties and interest, these assessments, while relatively small compared to the IRS, can be significant. The real question is: Even if the employer loses with the state, and has to pay payroll taxes and unemployment contributions, how does the IRS know? The IRS' ETAP (Employment Tax Administration Program) program generated automatic federal employment tax assessments based on state unemployment tax decisions. The IRS' rationale for these adjustments was that there was a discrepancy between wages reported to the IRS and wages as determined by the State audit. The IRS took the position in its Manual that these adjustments were not an examination and were not entitled to the safe haven under section 530 of the Revenue Act of 1978.

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ETAP no longer operates. At the field level, employment tax audits and ETAP assessments in the past several years have been nonexistent, based on anecdotal evidence.

Without an incentive to comply, household employers will continue to cut costs by not paying taxes. If the Congress wishes to change the situation, one solution is simple: Make taxpayers check a box on their IRS Form 1040, confirming that they paid over \$1,200 to a household worker and listing the name(s) and social security numbers of the workers. This would be similar to the means of claiming a dependent on the return. If the IRS is unable to audit any of these returns, at least it could send those taxpayers who answered yes a checklist of the reporting requirements. The IRS could provide the list to the state divisions of employment security the names of the employers and workers so that the states could confirm that employers were paying unemployment contributions. This solution would restore an incentive to classify household workers correctly.

## COUNTERPOINT: HOUSEHOLD WORKERS—NOT YOUR ORDINARY EMPLOYEE

by Jerome Borison, Denver, CO

To the less sophisticated, the world seems black and white when it comes to identifying who are employees and who are not: workers who provide their services to others on a regular

basis are employees and workers who provide services to others on a job-by-job basis are self-employed or independent contractors.

Needless to say, life is not so easy. Classification of workers is one of the more difficult issues in the world of employment law. The problem surfaces in big businesses and small. In this article, I will limit my discussion to household workers, who include Nannies, nurses, maids and groundskeepers. (To the extent I attach a gender to the household worker, it will be the feminine, realities being what they are.)

For purposes of this Counterpoint, I am making five assumptions:

- That we are addressing household workers who work either full-time or near full-time for the particular service recipient, rather than those who work a few hours per week for many families.
- That with the exception of a few high profile people, most homeowners/parents treat household workers as independent contractors. For these purposes, however, I am also assuming that if the right worker is found, the homeowner is willing to classify the worker as an employee if she insists on it rather than telling her to take it or leave it, as so often happens in the business world.
- That most of the workers are relatively low paid and do not have spouses who have jobs where significant fringe benefits are made available.
- That the amount paid the household worker does not include what I refer to as an “independent contractor premium,” *i.e.*, an additional amount of base pay to cover the shift from the service recipient to the worker of certain employment costs, such as Social Security and medical insurance.
- That the homeowner is not using the classification to assist the worker in not reporting her income. What I mean by this is that in contrast to an employment relationship, with respect to which the homeowner must file a Form W-2 with the IRS, in an independent contractor relationship, the homeowner, not being in a trade or business, has no obligation to file a Form 1099. Clearly the latter classification would aid a worker who did not wish to report all of her income.

It is also important to understand both what I do not and what I do intend to discuss in this Counterpoint. I do not intend to spend much time with the question of who would prevail in a legal challenge of the classification should the IRS or one’s state unemployment or worker’s compensation division raise the issue. We all know the drill here, starting with the common law definition, through the IRS’ 20-factor test in Rev. Rul. 87-41, 1987-1 C.B. 296, and the approach taken in the IRS Training Manual drafted in mid-1996 (*see* [http://www.irs.gov/plain/bus\\_info/training.html](http://www.irs.gov/plain/bus_info/training.html) and 96 TNT 153-35) and ending with a plethora of case law. I’ll leave that for others.

Rather, where I want to devote my energies is in raising the readers’ awareness of some of the equitable and extra-legal issues, tax and otherwise, that confront a household worker who has been classified as an independent worker. These matters go

beyond the question of whether it is right to pay such low sums to people

