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# The Nanny-Tax Amnesty

By [ARDEN DALE](#)

It is all too easy to fumble taxes when paying a nanny or other household worker. But the Internal Revenue Service is making it easier for people who mishandled such issues to make things right.

This year, the IRS is allowing more people to enter a special program that eases penalties for those who haven't been following the rules.

Questions often surface during tax-preparation season about how household employers handled tax-withholding requirements and other tax issues, financial advisers say.

A lot of people either aren't familiar with the rules or don't want to be bothered to jump through all the hoops. They might pay a nanny under the table or treat the worker as an independent contractor. That can prompt an audit and lead to penalties.

Such a scenario could become more common as the IRS steps up efforts to get employers to follow the rules, which call for the withholding and paying of Social Security and Medicare taxes if a worker is paid \$1,800 or more for 2013.

The IRS requires employers to file a Form [W-2](#) and Schedule H annually.



Associated Press

Zoë Baird, shown in 1993: Her nomination for U.S. attorney general was dashed for failing to pay nanny tax.

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Throughout the year, the employer must withhold Social Security and Medicare taxes, along with any applicable state taxes, from the worker's paychecks. An employer's contributions for Medicare and Social Security will add at least 7.65% to the cost of child care, and can be much higher if the employer also pays state tax, unemployment insurance and workers' compensation insurance. An employer also needs an employer identification number, and must determine if the worker can legally work in the U.S.

In December, the IRS revised its Voluntary Classification Settlement Program, or VCSP, which started in 2011 and made it easier for employers who haven't followed the rules to qualify.

The program lets employers reclassify workers they treated as nonemployees or independent contractors, lets them off the hook for interest and penalties for previous years, and can even reduce their total tax bill.

All kinds of workers, not just household help, are affected by the program. In the past, taxpayers who misreported could get a settlement only if they had been audited, according to IRS spokesman Eric Smith. Now, "you don't have to wait to hear from us," he says.

In extreme cases, the so-called nanny-tax issue has derailed political careers. The most famous episode is that of Zoë Baird, whose nomination by President Bill Clinton for U.S. attorney general in 1993 was pulled after it was disclosed she and her husband failed to pay [payroll taxes](#) for two household workers. The matter, which the media dubbed "Nannygate," helped raise awareness of the issue.

Some advisers, like Murray Stoltz, president of Manchester Capital Management, a family office based in Vermont, say knowing about clients' hired help is part of their job. "Our dialogue with the client is close enough that we know this is part of their financial and home world," he says.

Other advisers acknowledge that clients sometimes keep employees secret—or simply don't think to mention them.

Renee Kwok, a financial adviser in Boston, says she underscores the need for

Government of Washington, D.C., that reviewed the estimated property, sales, auto and [income taxes](#) a family paid in 2011 in the largest city in each state. (Photo: Getty Images)

correct reporting whenever she learns a client has a nanny. Ms. Kwok often recommends outsourcing the withholding, paying and reporting of taxes of household workers to a payroll expert who fully understands the complicated rules. There also are firms that perform these services online, such as [HomeWork](#)

### [Solutions](#) in Sterling, Va.

Stephanie Breedlove, co-founder of Breedlove & Associates, a household tax and payroll firm in Austin, Texas, recalls how one family came to her this year. A nanny they employed tried to use a national tax-preparation company to file her taxes as an independent contractor. That tax preparer refused, insisting she go back to her employers and have them report her earnings properly.

A further complication: There are separate and often different federal and state employment requirements. Some states insist employers pay workers' compensation and unemployment insurance, for example.

One couple—a veterinarian and his wife with a daytime baby sitter—sought accountant Brian Schultz's help but decided to look elsewhere when he told them about the tax rules, he recalls. They seemed surprised to hear they would have to file a W-2 form and payroll taxes.

Says Mr. Schultz, who works with a wealth-management team at accounting firm Plante Moran in Southfield, Mich.: "They weren't excited about it."

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