Independent Contractor vs. Household Employees: Classification and What Household Employers Need to Know

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When a person is hired to perform work at a personal residence, does that person qualify as a domestic employee? The answer to this question depends upon the specific circumstances at hand, and sometimes leads to situations in which a household unknowingly becomes an employer. Many families falsely assume that only full-time workers trigger tax responsibilities. As the year comes to a close, it's a great time for households to consult with their tax and financial advisors to ensure that they are correctly tracking, compensating, and insuring their household staff.

While it's beneficial to discuss this in detail with a trusted advisor, here are a few key factors to consider. Note, this list is not exhaustive, and additional information may be required to determine whether an individual is an employee or an independent contractor.

Clarifying the Distinction Between Household

Employees and Independent Contractors: Key Differences

Employers of household employees file and pay employment taxes, while independent contractors handle their own tax filings.

According to the IRS, the determination of worker classification is primarily based on:

- who controls the work being performed;
- who has the right to control or define the work to be done; and
- who decides how the work will be done, where it will be done and how long it may take to do the work.

The short answer is that under the common law, a worker (such as a nanny, housekeeper or home health aide) that a person hires directly (not through an outside agency) is an employee, and their employer is responsible for reporting wages and paying certain taxes.

And that brings us to the nanny tax.

What is the Nanny Tax?

The nanny tax is a federal tax paid by people who employ household employees and pay wages of $2,700 or more per year or $1,000 or more per quarter.

Despite the name, it applies to all household employees, not just nannies.

Why You Should be Concerned

It's a fairly common practice to pay household help "under the table," meaning that the employer doesn't withhold wages or report that income to the IRS. Operating in this way can present exposure to risk.

Penalties for failing to comply with household employee tax regulations range from tax penalties and fines to criminal charges that could lead to felony convictions. Also, as of 2023, payments for goods and services made through Venmo, CashApp, or other comparable third-party platforms that exceed $20,000 (though some states have thresholds as low as $600) will trigger 1099-Ks, creating a tax obligation for workers paid via those platforms.

Also, certain worker classifications trigger benefits for employees such as overtime pay, unemployment and disability coverage. The government is cracking down on employers who misclassify employees in a way that deprives them of the benefits to which they would otherwise be entitled.

Household Employee vs. Independent Contractor

Just because someone works in your home doesn't mean they're necessarily an employee.

The determining factor that is used to discern whether an individual is a household employee or an independent contractor is the degree of control and independence the household employer has over the worker. The general rule is that if the household employer has the right to control and direct the work of the employee, including what work is done and when and how it is done, **the worker is considered an employee.**

On the other hand, if the worker is free to perform the work as they see fit, with limited direction or control from the household employer, **they are considered an independent contractor**.

For example, a nanny who provides full-time, in-home care for children and was not hired through an agency is most likely a household employee, as the person who hired them is controlling when, how, and where the work is performed.

On the other hand, a housekeeper who has her own home-cleaning business, serves multiple customers, brings her own supplies, and hires and pays any workers she needs would be considered an independent contractor.

Types of Household Employees

To be considered a household employee, workers must perform services in or around your private home. However, services “not of a household nature,” such as a tutor or private secretary, are not considered household work.

Examples of people the IRS might consider household workers include:

- Babysitters
- Caretakers
- Cleaning people
- Domestic workers
- Drivers
- Health aides
- Housekeepers
- Maids
- Nannies
- Private nurses
- Yard workers

Reporting Requirements

Assuming a worker qualifies as a household worker, not an independent contractor, what are the employer’s obligations?

- The first step is to file to become an employer and receive an employer identification number (EIN) from the IRS.
- The next is to verify that your employee is legally eligible to work in the United States (Form I-9 should be completed by both employee and employer).

If an employee earns wages of $2,700 or more in 2024, the employer:

- Should withhold 3% of the total amount for social security and Medicare taxes. The employer and employee should each contribute half (7.65% apiece). If the employee earns $1,000 or more in wages per quarter, the employer is responsible for paying a 6% federal unemployment tax on annual cash wages up to $7,000.
- Employers should report the income and taxes of their household employees

by providing their employee with a Form W-2, filing a Form W-3and Form W-2 Copy A with the Social Security Administration (SSA), and

- Submit a Schedule H reporting the employee's wages and taxes with their federal tax return.

The Silver Lining

Employers who have registered their employees appropriately with the IRS are eligible to obtain workers' compensation insurance, protecting them in the event of an accident in the home that involves an employee.

What to do if applicable taxes were not reported and paid

If this prompts a realization or concern that proper withholding or tax reporting did not occur for domestic help, please contact your Anchin Relationship Partner or Lina Fiks, a manager in Anchin's Private Client Group at lina.fiks@anchin.com.