

Tax & Business Alert

JULY 2016

HAVE A HOUSEHOLD EMPLOYEE? BE SURE TO FOLLOW THE TAX RULES

Many families hire people to work in their homes, such as nannies, housekeepers, cooks, gardeners and health care workers. If you employ a domestic worker, make sure you know the tax rules.

IMPORTANT DISTINCTION

Not everyone who works at your home is considered a household employee for tax purposes. To understand your obligations, determine whether your workers are employees or independent contractors. Independent contractors are responsible for their own employment taxes, while household employers and employees share the responsibility.

Workers are generally considered employees if you control what they do and how they do it. It makes no difference whether you employ them full time or part time, or pay them a salary or an hourly wage.

SOCIAL SECURITY AND MEDICARE TAXES

If a household worker's cash wages exceed the domestic employee coverage threshold of \$2,000 in 2016, you must pay Social Security and Medicare taxes — 15.3% of wages, which you can either pay entirely or split with the worker. (If you and the worker share the expense, you must withhold his or her share.) But don't count wages you pay to:

- Your spouse,
- Your children under age 21,
- Your parents (with some exceptions), and
- Household workers under age 18 (unless working for you is their principal occupation).

The domestic employee coverage threshold is adjusted annually for inflation, and there's a wage limit on Social Security tax (\$118,500 for 2016, adjusted annually for inflation).



Social Security and Medicare taxes apply only to cash wages, which don't include the value of food, clothing, lodging and other noncash benefits you provide to household employees. You

can also exclude reimbursements to employees for certain parking or commuting costs. One way to provide a valuable benefit to household workers while minimizing employment taxes is to provide them with health insurance.

UNEMPLOYMENT AND FEDERAL INCOME TAXES

If you pay total cash wages to household employees of \$1,000 or more in any calendar quarter in the current or preceding calendar year, you must pay federal unemployment tax (FUTA). Wages you pay to your spouse, children under age 21 and parents are excluded.

The tax is 6% of each household employee's cash wages up to \$7,000 per year. You may also owe state unemployment contributions, but you're entitled to a FUTA credit for those contributions, up to 5.4% of wages.

You don't have to withhold federal income tax — or, usually, state income tax — unless the worker requests it and you agree. In these instances, you must withhold federal income taxes on both cash and noncash wages, except for meals you provide employees for your convenience, lodging you provide in your home for your convenience and as a condition of employment, and certain reimbursed commuting and parking costs (including transit passes, tokens, fare cards, qualifying vanpool transportation and qualified parking at or near the workplace).

OTHER OBLIGATIONS

As an employer, you have a variety of tax and other legal obligations. This includes obtaining a federal Employer Identification Number (EIN) and having each household employee complete Forms W-4 (for

withholding) and I-9 (which documents that he or she is eligible to work in the United States).

After year end, you must file Form W-2 for each household employee to whom you paid more than \$2,000 in Social Security and Medicare wages or for whom you withheld federal income tax. And you must comply with federal and state minimum wage and overtime requirements. In some states, you may also have to provide workers' compensation or disability coverage and fulfill other tax, insurance and reporting requirements.

THE DETAILS

Having a household employee can make family life easier. Unfortunately, it can also make your tax return a bit more complicated. Let us help you with the details. ■

KNOW YOUR CUSTOMERS BEFORE YOU EXTEND CREDIT

The funny thing about customers is that they can keep you in business — but they can also put you out of it. The latter circumstance often arises when a company overly relies on a few customers that abuse their credit to the point where the company's cash flow is dramatically impacted. To guard against this, diligently assess every customer's creditworthiness before getting too deeply involved.

INFORMATION, PLEASE

A first step is to ask new customers to complete a credit application. The application should request the company's name, address, website, phone number and tax identification number; the number of years it's existed; its legal form and parent company, if one exists; and a bank reference and several trade references.

If the company is private, consider asking for an income statement and balance sheet. You'll want to analyze financial data such as the profit margin, or net income divided by net sales. Ideally, this will have remained steady or increased during the past few years. The profit margin also should be similar to that of other companies in its industry.

From the balance sheet, you can calculate the current ratio, or the company's current assets divided by its current liabilities. The higher this is, the more likely the company will be able to cover its bills. Generally, a current ratio of 2:1 is considered acceptable.

CHECK REFERENCES AND MORE

Next up is contacting the potential customer's trade references to check the length of time the parties have been working together, the approximate size of the

potential customer's account and its payment record. Of course, a history of late payments is a red flag.

Similarly, you'll want to follow up on the company's bank references to determine the balances in its checking and savings accounts, as well as the amount available on its line of credit. Equally important, you'll want to find out whether the company has violated any of its loan covenants. If so, the bank could withdraw its credit, making it difficult for the company to pay its bills.

After you've completed your own analysis, find out what others are saying — especially if the potential customer could be a significant portion of your sales. Search for articles on the company, paying attention to any that raise concerns, such as stories about lawsuits or plans to shut down a division.

In addition, you may want to order a credit report on the business from one of the credit rating agencies, such as Dun & Bradstreet or Experian. Among other information, the reports describe the business's payment history and tell whether it has filed for bankruptcy or had a lien or judgment against it.

Most credit reports can be had for a nominal amount these days. The more expensive reports, not surprisingly, contain more information. The higher price tag also may allow access to updated information on a company over a period of time.

STAY INFORMED, ALWAYS

Although assessing a potential customer's ability to pay its bills requires some work upfront, making informed credit decisions is one key to running a successful company. Please let us know how we can help you with this or other financially critical business practices. ■

MARRIAGE PENALTY LEAVES MANY (BUT NOT ALL) NEWLYWEDS SINGING A SAD TUNE

Love and marriage — according to the song, they go together like a horse and carriage. But matrimony can leave some couples singing a sad tune when they encounter the ominously named “marriage penalty.” However, for other couples, marriage brings tax-saving *opportunities*.

IN A NUTSHELL

When tax brackets for married couples aren’t twice as big as those for singles, newlyweds could wind up in a higher tax bracket than if they were able to file as singles. This, in a nutshell, is the marriage penalty.

A 2012 tax law made marriage penalty relief permanent for the 10% and 15% brackets. Here, brackets for married filing jointly are now exactly twice the size of those for singles (and brackets for married filing separately are equal to those for singles).

RATES MOVE FAST

But there remains a financial danger for married couples in the middle and higher brackets, and the danger is substantial for those who hit the 39.6% bracket. As single tax filers, neither spouse would be subject to the 39.6% rate for 2016 until his or her own taxable income exceeded \$415,050. But married couples face that rate as soon as their *combined* taxable income hits \$466,950 — only \$51,900 more.

So let’s say that each spouse has taxable income of \$400,000. The tax that they’d pay as a married couple is more than what they’d pay as two unmarried people. In this simplified example (not taking into

account any credits or other tax breaks), the couple would face a tax bill more than \$31,000 higher than if they were single.

EXCEPTIONS AND OPPORTUNITIES

Even if a married couple is in the middle or higher brackets, the marriage penalty doesn’t always apply. For example, if only one spouse is working, being married might actually *save* the couple tax — in other words, the marriage penalty can turn into a marriage bonus. If the spouse who isn’t employed expects to be working the next year, the couple might benefit from accelerating some income into the current tax year and deferring deductible expenses to the next one.

Another tax-saving opportunity may be available if one spouse earns substantially less than the other and has incurred significant medical expenses. For taxpayers under age 65, medical expenses are deductible only to the extent they exceed 10% of their adjusted gross income for the year. Filing jointly, the couple might not exceed the threshold. But, filing separately, the lower-earning spouse might be eligible for a valuable deduction. (This needs to be weighed against any additional tax liability the higher-earning spouse faces from filing separately.)

DIFFERING SOLUTIONS

How to best deal with the tax consequences of marriage will vary from couple to couple. For help with your situation, please contact us. ■

TAX CALENDAR

July 15

- If the monthly deposit rule applies, employers must deposit the tax for payments in June for Social Security, Medicare, withheld income tax, and nonpayroll withholding.

August 1

- If you have employees, a federal unemployment tax (FUTA) deposit is due if the FUTA liability through June exceeds \$500.
- The second quarter Form 941 (“Employer’s Quarterly Federal Tax Return”) is also due today. (If your tax liability is less than \$2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until August 10 to file the return.

August 15

- If the monthly deposit rule applies, employers must deposit the tax for payments in July for Social Security, Medicare, withheld income tax, and nonpayroll withholding.

September 15

- Third quarter estimated tax payments are due for individuals, trusts, and calendar-year corporations.
- If a five-month extension was obtained, partnerships should file their 2015 Form 1065 by this date.
- If a six-month extension was obtained, calendar-year corporations should file their 2015 income tax returns by this date.
- If the monthly deposit rule applies, employers must deposit the tax for payments in August for Social Security, Medicare, withheld income tax, and nonpayroll withholding.

GETTING COMFORTABLE WITH THE HOME OFFICE DEDUCTION

One of the great things about setting up a home office is that you can make it as comfy as possible. Assuming you've done that, another good idea is getting comfortable with the home office deduction.

To qualify for the deduction, you generally must maintain a specific area in your home that you use regularly and exclusively in connection with your business. What's more, you must use the area as your principal place of business or, if you also conduct business elsewhere, use the area to regularly conduct business, such as meeting clients and handling management and administrative functions. If you're an employee, your use of the home office must be for your employer's benefit.

The only option to calculate this tax break used to be the actual expense method. With this method, you deduct a percentage (proportionate to the percentage of square footage used for the home office) of *indirect* home office expenses, including mortgage interest, property taxes, association fees, insurance premiums,



utilities (if you don't have a separate hookup), security system costs and depreciation (generally over a 39-year period). In addition, you deduct *direct* expenses, including business-only

phone and fax lines, utilities (if you have a separate hookup), office supplies, painting and repairs, and depreciation on office furniture.

But now there's an easier way to claim the deduction. Under the simplified method, you multiply the square footage of your home office (up to a maximum of 300 square feet) by a fixed rate of \$5 per square foot. You can claim up to \$1,500 per year using this method. Of course, if your deduction will be larger using the actual expense method, that will save you more tax. Questions? Please give us a call. ■