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MAY 2024

HOUSEHOLD WORKERS AND THE "NANNY" TAX

This month's *Tax & Business Alert* includes an article about the tax requirements of those who hire household workers as employees rather than as independent contractors. The article, however, does not explain how to determine whether a worker is your employee or an independent contractor. That determination is based on the facts, but the relevant facts are fairly straightforward. If you hire an individual (i.e., not a service that furnishes its employees) and you control not only what work is to be done, but also how that work is to be done, the IRS will conclude that the worker is your employee. Accordingly, you will need a federal employer identification number, and you will be subject to the federal tax and reporting requirements explained in the article. You might also be subject to Louisiana tax and reporting requirements for your household employee.

Failure to report the household wages paid and to remit the applicable FICA and Medicare taxes with your income tax return, as well as failure to file Forms W-2, can result in interest and penalties in addition to the employment taxes due. Also, we understand that there is no statute of limitations for unreported household wages and the related unpaid taxes. Accordingly, failure to treat payments to a household employee as such could result in serious consequences (tax, interest, and penalties) if, for example, the worker applies for unemployment compensation or Social Security benefits claiming to have been your employee for a long period of time.

If you have any questions about your tax treatment of a household worker, we will be happy to help.

INDIVIDUAL RETIREMENT ACCOUNT AND NONTRADITIONAL INVESTMENTS

Prior to his death in 2022, actor James Caan had two IRAs, one of which held an interest in a partnership operating as a hedge fund. The IRA custodial agreement with UBS provided that Mr. Caan was responsible for annually furnishing UBS with the year-end fair market value of such an interest. In 2015, because Mr. Caan failed to furnish the December 31, 2014 value after repeated requests, UBS distributed the IRA's partnership interest to him in accordance with the custodial agreement, issued Form 1099-R reporting a $1.9 million distribution (the December 31, 2013 value), and resigned as custodian.

On his 2015 tax return, Mr. Caan reported the IRA distribution, but reported it as a nontaxable rollover to another IRA. However, the actual "rollover" did not occur until 2017 when Mr. Caan liquidated the partnership interest and transferred the cash to a new IRA. After the IRS assessed 2015 tax for the distribution, the executor of Mr. Caan's estate asked the Tax Court to grant a hardship

(Continued on reverse)

waiver and allow the tax-free rollover (ignoring both the 60-day rollover rule and the fact that the asset was converted to cash before the transfer to the new IRA). The Court declined the request and held Mr. Caan's estate liable for $780,000 income tax on the 2015 distribution, which was revised to the December 31, 2015 value of $1,548,000.

This case illustrates one of the burdens and potential hazards of an IRA owning nonconventional investments such as partnership interests and other assets for which there is no readily determinable market value. Another disadvantage is that an IRA owning an interest in a partnership that conducts a trade or business can owe a current income tax on its share of that income reported on a Schedule K-1 issued to the IRA. For these reasons, we generally believe that IRA investments are best limited to marketable securities.

LESSON: HOW NOT TO CHARITABLY SHARE YOUR FINANCIAL SUCCESS

"Salt. Wound. Together at Last."
Maureen Johnson

Scott Hoensheid and his two brothers owned all of the stock in a successful corporation that they planned to sell. Two days prior to closing the stock sale, Mr. Hoensheid contributed shares worth $2.9 million to a charitable donor advised fund (DAF). By utilizing a DAF, the proceeds from the sale of the donated shares could be applied by the DAF (on advice of the donor) to various charities over several years, but Mr. Hoensheid would get an immediate charitable contribution deduction for the full amount.

In this case, even though the DAF did not have a legal obligation to sell the contributed shares following the donation, the IRS and the Tax Court said that the process of selling the company was so far along that the sale was a virtual certainty at the time of the donation. Accordingly, Mr. Hoensheid was taxed on the sale of the shares that he contributed to the DAF just prior to the sale.

The court further held that Mr. Hoensheid failed to timely obtain a qualified appraisal of the closely-held stock that was donated to the DAF, as the tax law requires. Accordingly, not only was Mr. Hoensheid taxed on the gain for the shares that he had given to charity, he was denied a deduction for the charitable donation. Injury, meet insult.

FORM 1099-K

In early 2025, many taxpayers will receive a 2024 Form 1099-K, Payment Card and Third-Party Network Transactions, if they receive more than $5,000 in 2024 from on-line payment platforms such as Venmo, PayPal, eBay, and Airbnb. Many of these payments will not represent taxable income but will, nevertheless, be reported to the Internal Revenue Service and will require taxpayer and tax preparers' time.

Form 1099-K, until the American Rescue Plan Act of March 2021, was required only when payments by on-line platforms totaled more than $20,000 or 200 transactions within a year. The 2021 law change dropped the threshold from $20,000 to $600. A recent announcement left the threshold for 2023 at $20,000 or 200 transactions per year and set the payment amount threshold for 2024 at $5,000. As a result of the delay in imposing the new threshold, the number of 2023 Forms 1099-K expected to be filed will remain at approximately 15 million rather than increasing to about 44 million forms.

The Revenue Service has made it clear, however, that the 2024 threshold of $5,000 is only a transitional amount, and the annual reporting threshold will ultimately be $600 of payments received.

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Tax & Business Alert

MAY 2024

THE ADVANTAGES OF HIRING YOUR MINOR CHILDREN FOR SUMMER JOBS

If you're a small business owner and you hire your children this summer, you may be able to obtain tax breaks and other nontax benefits. The kids can gain on-the-job experience, save for college and learn how to manage money. You may also be able to shift some of your high-taxed income into tax-free or low-taxed income. In addition, you could realize payroll tax savings (depending on the child's age and your business entity). Plus, your kids will spend time with you.

A LEGITIMATE JOB

If you hire your child, you'll get a business tax deduction for employee wage expenses. In turn, the deduction reduces your federal income tax bill, your self-employment tax bill (if applicable) and your state income tax bill (if applicable). However, for your business to deduct the wages as a business expense, the work performed by the child must be legitimate and the child's salary must be reasonable.

Let's say you operate as a sole proprietor in the 37% tax bracket. You hire your 16-year-old daughter to help with office work full-time during the summer and part-time in the fall. Your daughter earns $10,000 during 2024 and doesn't have any other earnings.

You save $3,700 (37% of $10,000) in income taxes at no tax cost to your daughter. That's because she can use her $14,600 standard deduction for 2024 to completely shelter her earnings.

Your family's taxes are lower even if your daughter's earnings exceed her standard deduction. Why? The unsheltered earnings will be taxed to her beginning at a rate of 10%, instead of being taxed at your higher rate.

HOW PAYROLL TAXES MIGHT BE SAVED

If your business isn't incorporated, your child's wages are exempt from Social Security, Medicare and federal unemployment taxes if certain conditions are met. Your child must be under age 18 for this to apply (or under age 21 for the federal unemployment tax exemption). Contact us to learn how this works.

STARTING EARLY MAKES A RETIREMENT GARDEN GROW

An early start on saving for retirement can be key to wealth building. A child who earns income from a job can contribute to a traditional IRA or a Roth IRA and begin funding a nest egg. For the 2024 tax year, a working child can contribute the lesser of his or her earned income, or $7,000, to a traditional or Roth IRA.

What if your business has a retirement plan? Depending on its terms, your child may qualify to begin earning retirement benefits that can grow for many decades. And the money may be tapped penalty-free for certain eligible reasons, such as paying education costs and making a down payment of up to $10,000 on a first home.

Be aware that there's no exemption for employing a child if your business is incorporated or is a partnership that includes nonparent partners. And payments for the services of your child are subject to income tax withholding, regardless of age, no matter what type of entity you operate.

KEEP ACCURATE RECORDS

Hiring your child can be a tax-smart idea. Be sure to keep the same records (such as timesheets and job descriptions) as you would for other employees to substantiate the hours worked and duties performed. Issue your child a Form W-2. Contact us with questions about how these rules apply to your situation. ■

3 WAYS YOUR BUSINESS CAN UNCOVER COST CUTS

Every business wants to cut costs, but it sure isn't easy. We're talking about clear and substantial ways to lower expenses, thereby strengthening cash flow and giving you a better shot at strong profitability.

Obvious places to slash costs — such as wages, benefits and overhead — often aren't viable options because the very stability of your operation may depend on them. But there might be other ways to lower expenses if you dig deeply enough. Here are three possibilities.

1. STUDY YOUR SUPPLIERS

Many companies find that just a few suppliers account for the bulk of their spending. By identifying these vendors and consolidating spending with them, you may be able to put yourself in a stronger position to negotiate volume discounts. This may also help to streamline the purchasing process.

On a related note, how well do you know your suppliers? It might be a good idea to conduct a supplier audit. This involves collecting key data regarding a supplier's performance to manage quality control and ensure you're getting an acceptable return on investment.

2. GO GREEN

Operating an environmentally friendly company is generally a good idea and it might save you money. Instead of purchasing brand-new computers and office equipment, you may find refurbished items at

substantial savings. Equipment and office furniture that you no longer need may be sold to a liquidator or dealer. You'll not only make some money, but also free up the space you're using to store and maintain them.

In addition, if you own the property on which you operate, research energy-efficient upgrades to the HVAC and lighting systems. Naturally, there will be an initial cost outlay, but over the long term, you may lower your energy costs. You might also qualify for tax credits for installing certain items.

3. EXPLORE OUTSOURCING AND TECH UPGRADES

Many business owners try to economize by doing everything in-house — from accounting to payroll to HR. But if the staffing and expertise just aren't there, these companies often suffer losses because of mistakes, mismanagement and wasted time. Although you'll obviously incur costs when outsourcing, the time and labor it saves you could end up being a net gain.

Carefully chosen and implemented technology upgrades can serve a similar purpose. Many products on the market today are so robust and fully featured, upgrading to them may be almost comparable to outsourcing. The same may be true with a customer relationship management system that can help generate sales leads and allow you to focus on your most profitable existing customers. Again, there will be an initial cost that could eventually lower your cost of doing business.

SNIP, SNIP, SNIP

Lowering expenses is often difficult, but keeping an eye out for ways to do it is important, especially now that inflation is a major factor in the economic landscape. Please contact us for help identifying and lowering your company's most "cuttable" costs. ■

TO GET AN "EARLY" REFUND, ADJUST YOUR WITHHOLDING

If you received a large refund this year, you may want to adjust your withholding. Each year, millions of taxpayers claim an income tax refund. To be sure, receiving a payment from the IRS for a few thousand dollars can be a pleasant influx of cash. But it means you were essentially giving the government an interest-free loan for close to a year, which isn't the best use of your money.

Fortunately, there's a way to begin collecting your 2024 refund now: You can review the amounts you're having withheld and any estimated tax payments you're making and adjust them to keep more money in your pocket during the year.

CHOOSING TO ADJUST

It's particularly important to check your withholding and/or estimated tax payments if:

- You received an especially large 2023 refund,
- You've gotten married, divorced or added a dependent,
- You've bought a home,
- You've started or lost a job, or
- Your investment income has changed significantly.

Even if you haven't encountered any major life changes during the past year, tax law changes may affect withholding levels, making it worthwhile to double-check your withholding and estimated tax payments.

MAKING A CHANGE

You can modify your withholding at any time during the year, or even more than once a year. To do so, simply submit a new Form W-4 to your employer. Changes typically will go into effect several

weeks after the new Form W-4 is submitted. For estimated tax payments, you can adjust each time quarterly payments are due.

While reducing withholding or estimated tax payments will, indeed, put more money in your pocket now, you also need to be careful that you don't reduce them too much. If you don't pay enough tax throughout the year on a timely basis, you could end up owing interest and penalties when you file your return, even if you pay your outstanding tax liability by the April 2025 deadline.

GETTING HELP

One reason to consider adjusting your withholding is the passage of any new tax legislation. For example, several years ago when the Tax Cuts and Jobs Act was enacted, the IRS needed to revise withholding tables to account for the increased standard deductions, suspension of personal exemptions, and changes in tax rates and brackets. If you'd like help determining your withholding or estimated tax payments for the rest of the year, please contact us. ■

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THE "NANNY TAX" MUST BE PAID FOR NANNIES *AND* OTHER HOUSEHOLD WORKERS

If you employ a household worker who isn't an independent contractor, you may be required to withhold from the worker's wages and pay Social Security and Medicare taxes, and possibly other taxes. You aren't required to withhold federal income tax.

Here's a brief rundown of your obligations. In 2024, when an employee's cash wages reach at least $2,700, you must withhold and pay Social Security and Medicare taxes. This applies to all cash wages.

The employee share, withheld from pay, is half the Social Security tax (6.2%) and half the Medicare tax (1.45%). You, the employer, pay the other half. You also must pay federal unemployment tax on wages of $1,000 or more. This tax is assessed only on the first $7,000 of wages paid.

To pay household worker obligations, increase your quarterly estimated tax payments or increase withholding from your wages. Your tax professional will report the Social Security and Medicare taxes you paid on Schedule H of your individual Form 1040 tax return. For Schedule H, you'll need to include your Employer Identification Number (EIN), which you can obtain by filing Form SS-4. However, if you own a business as a sole proprietor, you may include the tax for a household worker on your business employment reports, using your business EIN.

Having a household worker requires careful record-keeping. Keep track of every paycheck and report and include them in your tax records when we prepare your tax return. Contact us with questions. ■