Study Puts ‘Nanny Tax’ Gap as Large as $5.7 Billion Per Year

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The tax gap from unpaid ‘nanny taxes’ could be $3.3 billion to $5.7 billion per year, according to newly available research.

Failure to pay taxes for household employees has tripped up many high-profile figures, including President Trump’s initial labor secretary nominee, Andrew Puzder, who later withdrew from the confirmation process. Office of Management and Budget Director Mick Mulvaney also said in 2017 that he didn’t pay $15,000 in payroll taxes for a nanny because he didn't view her as being an employee under the law.

Confusion about the responsibilities for both employers and employees can have an impact that goes well beyond such high-profile cases.

In addition to lost tax revenue from unpaid payroll taxes for domestic workers, the workers themselves miss out on Social Security, Medicare, and unemployment insurance when their employers don’t pay, Brian Erard of B. Erard & Associates said during a June 20 presentation at the IRS/Tax Policy Center Joint Research Conference on Tax Administration in Washington.

Households hiring domestic workers are required to file a Form 1040 Schedule H and report payroll taxes, and the workers must make estimated tax payments if they don’t have taxes withheld.

“When you account for all of this, conservatively, there’s 3.6 million folks who probably should be filing Schedule H returns,” Erard said, adding that it is difficult to estimate the number of domestic workers because some only work for part of a year.

Erard said he found nearly 191,000 returns in the tax data and estimated a compliance rate of 5.3 percent. He said the compliance rate was like that of consumer use taxes.

The added cost and paperwork is keeping employers from following the proper steps, and Erard recommended changing the “culture of noncompliance” through increased enforcement, outreach, and clarifying confusing IRS publications.

Erard, who noted that his research was sponsored by the International Nanny Association, also said the IRS should be working with states on the compliance process and reconsidering whether it makes sense for household employees to be the only situation in which employers aren’t required to withhold.