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EMPLOYMENT TAX ISSUES IN HOME HEALTH CARE CONTRACTS

Ben A. Neiburger*

INTRODUCTION

One of the many tools that an advisor can use to reduce the size of an individual's estate so that the individual can qualify for Medicaid benefits is to transfer assets from the individual to his or her non-spouse family members. However, under Medicaid's transfer penalty rules,¹ certain periods of ineligibility for Medicaid benefits will apply to gifts or transactions that are not made for full market value. One of the ways that an individual can transfer assets to non-spouse family members or other loved ones, without incurring Medicaid transfer penalties, is to pay those people to perform caregiving work for the elder at rates which are prevalent in the marketplace for caregiving services.

Under many state laws, when one family member performs a service for another family member, the service is deemed to have been done for no compensation unless there is an agreement to the contrary. To show the local Medicaid agency that a relative's or friend's service to the elder is not gratuitous (and, hence, not a gift or a transfer for less than fair market value), that person should enter into a written contract with the elder (the elder employer). This contract, commonly called a home health care contract (contract), spells out the duties of the person to the elder employer and also sets out the person's pay for those services. When structured correctly, the money paid under the contract will constitute a transfer for full market value and, therefore, not trigger penalty periods for Medicaid eligibility. While much commentary discusses the Medicaid

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1. See Health Care Financing Admin. Transmittal No. 64 (1994).

aspects of a contract to the elder, not as much commentary exists to explain the federal and state taxation issues that the contract creates.

This article will first discuss the factors the Internal Revenue Service (IRS) uses to classify a worker as an employee or an independent contractor. This classification is important because, if a worker is an independent contractor, the elder employer will not have payroll tax obligations. If a worker is an employee, then the elder employer will have payroll tax obligations. Following the classification discussion, this article will discuss federal tax withholding, payment, and reporting obligations of the elder employer; state tax withholding, payment, and reporting obligations of the elder employer; and, finally, income tax deductions available to the elder for payments made under a contract.

EMPLOYEE V. INDEPENDENT CONTRACTOR

The determination of whether the recipient of the payment for services under a contract (the worker) is the elder employer's employee or an independent contractor for the elder employer will determine how the government will tax and whether the government will require the elder employer to report payments he or she makes under a contract. The first step in determining employment status is to determine whether the elder employer directly retains the worker or if a third party, such as an employment agency or a private duty service provider, retains or refers the worker to the elder.

EMPLOYMENT STATUS WHERE THE ELDER DIRECTLY RETAINS THE WORKER

A person is an independent contractor if he or she is not an employee of the person who directly retains him or her. For federal payroll tax purposes, an employee is "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of employee."² The Federal Employment Tax Regulations set out these common law rules.³ An employer-employee relationship will exist when the person for whom the services are performed

2. I.R.C. § 3121(d)(2).

3. See Treas. Reg. §§ 31.3121(d)-1, 31.3306(i)-1, 31.3401(c)-1.

has the right to control (the control test) and direct the worker who performs the services.⁴ In addition, another factor that will add to the presumption that an employer-employee relationship exists is if the person for whom the work is performed has the right to discharge the one performing the work.⁵

The control test extends beyond actual control to the right to control "not only as to the result to be accomplished by the work but also as to the details and means by which the result is accomplished."⁶ Accordingly, if the elder employer has the right to control the detail and means of how a worker under a contract performs his or her duties, but never exercises that control, the control test still will be met, and the worker will be an employee.

The control test is not a bright-line test. In determining whether control exists, the IRS requires its revenue agents to examine the entire relationship between the parties and look at each facet of that relationship.⁷ Historically, the IRS used the following twenty-factor test⁸ to examine the relationship in the contexts of behavioral control, financial control, and how the parties perceive their relationship⁹ to determine the existence of an employer-employee relationship within a contract:

- the worker is required to comply with the elder's **instructions**.
- the elder or another must **train** the worker.
- the elder **integrates** the worker's services into his or her business operations.
- the worker must **render** his or her **services** to the elder **personally**.
- the elder **hires, supervises, and pays assistants** (in addition to the worker).
- there is a **continuing relationship** between the worker and the elder.
- the worker has **set hours of work** for the elder.
- the worker must devote substantially **full time** to the elder's care.
- the worker **does not work for more than one employer**

4. Treas. Reg. § 31.3121(d)-1(c)(2).

5. *Id.*

6. *Id.*

7. Internal Revenue Manual ¶ 4.23.5.4 (2003 CCH).

8. Rev. Rul. 87-41, 1987-1 C.B. 296.

9. Internal Revenue Manual, Exhibit 4.23.5-1 (2003 CCH).

at a time.

- the worker **performs work on the elder's premises.**
- the worker must perform services in the **order or sequence** that the elder sets.
- the worker must submit **oral or written reports** to the elder.
- the elder **pays the worker by the hour, week, or month.**
- the elder **pays the worker's business and/or traveling expenses.**
- the elder **furnishes significant tools, materials, and other equipment** to the worker.
- the worker does not **invest** in facilities that he or she uses in his work.
- the worker **does not realize a profit or suffer a loss** because of his or her services.
- the worker does not **make his or her services available** to the public on a regular and consistent basis.
- the elder has the **right to discharge** the worker.
- the worker **does not have the right to end his or her care relationship** with the elder at any time he or she wishes without incurring liability.

However, these are not the only important factors, and some of the traditional twenty factors may be disregarded as unimportant in certain cases. "Every piece of information in a case that helps [determine] the extent to which the firm does or does not retain the right to control the worker is important."¹⁰

Accordingly, while the application and weight of each of these factors is unclear, there are several IRS Revenue Rulings and IRS Private Letter Rulings that partially address this issue.

The IRS held that an employer-employee relationship existed where:

- a worker entertained a convalescent, cared for the convalescent's personal needs, lived in the convalescent's home, accompanied the convalescent on trips, and provided any other services necessary for the comfort or well being of the convalescent.¹¹
- a brother engaged his sister, who was independent of his

10. *Id.*

11. Rev. Rul. 56-109, 1956-1 C.B. 467.

financial support, to act as his housekeeper and companion and to perform minor nursing services for him in his home during regular hours and according to his instructions.¹²

- relatives were retained to provide personal care in the home of a family member and were paid, in part, by a welfare agency.¹³
- a hospital resident retained a private attendant to perform services of a domestic nature for the resident where the resident hired that attendant from a list provided by the hospital.¹⁴

On the other hand, the IRS held that an independent contractor relationship existed where a licensed or registered nurse performed private-duty nursing services for a client. In this case, the IRS held that the nurse had discretion in performing her nursing services due to her high skill level (as indicated by her nursing license).¹⁵ However, the IRS held that the nurse would be an employee if the nurse performed services of primarily a household nature.¹⁶

If still not sure how to classify a worker after applying this guidance, the elder employer could request a private letter ruling from the IRS on whether the worker is an employee or an independent contractor by completing and submitting a Form SS-8 to the IRS.

EMPLOYMENT STATUS WHERE A THIRD PARTY RETAINS OR REFERS THE WORKER TO THE ELDER

The employment analysis where a third party, such as an employment agency or a private duty service provider, retains the worker to provide services to the elder is similar to the analysis in the previous section. However, you must first apply this analysis to the third party. If the third party is deemed the employer, then the analysis stops and the elder is not the

12. Rev. Rul. 54-572, 1954-2 C.B. 341.

13. Priv. Ltr. Rul. 93-09-026 (Dec. 4, 1992).

14. Rev. Rul. 74-388, 1974-2 C.B. 325.

15. Rev. Rul. 61-196, 1961-2 C.B. 155; *see also* Treas. Reg. § 31.3401(c)-1(c).

16. *Id.*

employer. If the third party is not the employer, then you must apply the analysis in the section above directly between the elder and the worker.

Accordingly, a private duty firm that supplies a worker to the elder will be the employer of that worker when it pays the salary (and withholds payroll taxes, etc.), sets the hours, and generally controls and directs the worker. In this situation, the elder will not be the employer of the worker. On the other hand, employment agencies that function as referral sources for "sitters" are not employers of the workers they refer,¹⁷ provided they do not pay or receive the worker's salary and are compensated by the worker or the client on a fee basis.¹⁸ A "sitter" is defined as an individual who furnishes "personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled."¹⁹ Accordingly, if an agency refers a home health care worker to an elder, the agency will not be the worker's employer when the worker negotiates rates of compensation, hours of work, and the work to be done, and the elder directly pays the worker.²⁰ An advocate will need to apply the principles in the previous section in determining whether the worker would then be an employee or an independent contractor of the elder.

EMPLOYER-EMPLOYEE CONCLUSION

Unfortunately, the determination of whether a home health care contract creates an employer-employee relationship is not clear-cut. However, the more direction and control that the elder has over the worker under a contract, the more likely it will be that the IRS would find that an employer-employee relationship exists. On the other hand, the less direction and control the elder has over the worker, the more likely it will be that the IRS would find an independent contractor relationship exists.

In the unlikely event of an income tax or employment tax audit, the IRS could examine a situation where the elder classified a worker as an independent contractor and conclude

17. I.R.C. § 3506(a).

18. Rev. Rul. 80-365, 1980-2 C.B. 300. A "fee basis" means either a flat dollar fee or a set percentage of compensation paid to the worker.

19. I.R.C. § 3506(b).

20. Tech. Adv. Mem. 93-44-003 (Nov. 5, 1993).

that the relationship is really an employer-employee relationship. After this conclusion, the IRS would then assess liability on the "employer" for unpaid and unreported payroll taxes. Accordingly, the most conservative stance in interpreting the relationship between the elder and the worker under a contract would be to treat the worker as an employee instead of as an independent contractor.

FEDERAL PAYROLL TAX ISSUES

If an employer-employee relationship does not exist, the reporting and tax issues are relatively simple. However, if an employer-employee relationship exists, the issues become complicated.

FEDERAL TAX WITHHOLDING, PAYMENT, AND REPORTING OBLIGATIONS FOR AN INDEPENDENT CONTRACTOR

The tax withholding and reporting requirements for independent contractors are simple. In general, the law does not require the elder employer to withhold, report, or pay taxes on monies paid to an independent contractor. The law would require the elder to file an IRS Form 1099 if the elder employer pays a worker \$600 or more in any year and the elder's trade or business is providing care.²¹ Because the services the worker performs generally are for personal care and are not business related, the IRS Form 1099 reporting requirements would not apply.

However, these requirements change if the independent contractor is a "statutory employee" under IRC § 3121(d)(3). Generally, independent contractors providing services in a home health care situation would not be considered statutory employees. A statutory employee includes agent drivers or commission drivers, full-time life insurance sales people, home workers, and traveling or city salespersons.²² A "home worker" is a person "performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by

21. I.R.C. § 6041(a) requires a reporting by all persons *engaged in a trade or business* making payment in the course of such trade or business.

22. I.R.C. § 3121(d)(3).

him."²³

If the independent contractor is a "statutory employee," the elder employer must make Federal Insurance Contributions Act (FICA) contributions and may need to make Federal Unemployment Tax Act (FUTA) contributions²⁴ on behalf of the worker. The elder employer would not be subject to income tax withholding requirements.

FEDERAL TAX WITHHOLDING, PAYMENT, AND REPORTING OBLIGATIONS FOR AN EMPLOYEE

The three components to the tax withholding and reporting requirements for employees are (1) payroll and income tax withholding, (2) wage reporting and tax payments, and (3) civil and criminal penalties for non-compliance.

PAYROLL AND INCOME TAX WITHHOLDING REQUIREMENTS

If a worker under the contract is an employee, the elder employer could be responsible for three types of "payroll" taxes: (1) social security, (2) unemployment, and (3) wage (income tax) withholding.

SOCIAL SECURITY (FICA)

The Federal Insurance Contributions Act (FICA) imposes Social Security taxes on the "wages" (defined below) an employee receives from his employer. The FICA tax is levied on both the employer and the employee. The Internal Revenue Code requires the employer to pay its portion of FICA taxes and to collect and remit the employee's portion of FICA taxes when the employer pays wages to the employee. The employer collects the FICA tax from the employee by deducting it from the employee's wages.²⁵ FICA taxes have two elements: (1) old age, survivor, and disability insurance (OASDI) and (2) hospital insurance (HI). Both the employer and the employee are subject

23. Treas. Reg. § 31.3121(d)-1(d)(iii). The Internal Revenue Service further defines a home worker as a person who makes "buttons, quilts, gloves, bedspreads, clothing, needle craft products, etc. The work is done away from the employer's place of business, usually in the worker's home, the home of another, or his own workshop." Internal Revenue Manual, Exhibit 4-23.5-3 (CCH 2003).

24. Internal Revenue Manual 4.23.5.6.4 (CCH 2003).

25. I.R.C. § 3102(a).

to an OASDI tax equal to 6.2%²⁶ and a HI tax equal to 1.45%²⁷ of the wages paid to the employee for a total of 7.65% to the employer and 7.65% to the employee. The employer must withhold the employee's portion of this tax from the employee's wages and then pay the employee's portion and the employer's portion of the tax to the Treasury.²⁸ Accordingly, the maximum FICA tax liability on an employee's wages, including both the employer and employee's portion of the tax, is 15.30% (7.65% x 2).

For purposes of FICA, "wages" mean all remuneration paid to the employee derived from employment (including benefits), unless specifically exempted.²⁹ Wages subject to the OASDI portion of FICA are limited to wages that do not exceed the OASDI taxable wage base (\$90,000 for 2005).³⁰ All wages are subject to the HI portion of the FICA tax.

FICA wages do not include compensation paid in a **medium other than cash** to an employee for (1) service not in the course of the employer's trade or business or (2) "domestic service in the private home of the employer."³¹ This means that items such as "lodging, food, clothing, car tokens, transportation passes or tickets, or other goods and commodities" are not FICA wages.³² It follows that a transfer of real property as payment for services under a contract would also not constitute FICA wages.³³ However, there is an exception to this rule if payment is for domestic services provided on a for-profit farm.³⁴

FICA taxes will not be due for **cash wages** paid for "domestic service in a private home,"³⁵ such as the services a

26. I.R.C. §§ 3101(a); 3111(a).

27. I.R.C. §§ 3101(b); 3111(b).

28. I.R.C. § 3102(b). An employee is not liable for the payment of FICA taxes after the FICA taxes are collected from him or her. Treas. Reg. § 31.3102-1.

29. I.R.C. § 3121(a).

30. I.R.C. § 3121(a)(1).

31. I.R.C. § 3121(a)(7)(A).

32. Treas. Reg. § 31.3121(a)(7)-1(b).

33. The author did not find any precedent that expressly stated that the transfers of real property were not FICA wages other than the IRC section exempting payments made in "a medium other than cash." I.R.C. § 3121(a)(7)(A). However, the author called the IRS technical assistance line on this issue, and the agent he spoke with said there seemed to be no precedent he could find stating that the transfer of real property would be FICA wages. The opinions given on the technical assistance line are non-binding on the IRS. Please note that any compensation paid to a worker (including real property) will still be taxable income to that worker and must be reported in that worker's Form W-2.

34. Treas. Reg. § 31.3121(a)(7)-1(a)(1).

35. See Treas. Reg. §§ 31.3121(a)(7)-1(a)(2), 31.3306(c)(2)-1(a)(1), 31.3401(a)-3.

worker provides under a contract, if the cash wages paid to a worker in one year are \$1,400 or less (for 2005).³⁶ However, as soon as payments to the domestic worker exceed \$1,400, FICA taxes will apply to all wages paid to that worker during the tax year. Cash payments for domestic service in the private home of the employer are also exempt from FICA if payment is made to an individual under age eighteen (or a child of the employer under age twenty-one) for domestic service which is not the principle occupation of such individual³⁷ or if payment is for the employee's portion of the tax imposed by FICA or a state unemployment compensation law.³⁸ This last exception means that the elder employer can decide to pay the employee's portion of FICA taxes without withholding those taxes from the employee's wages. The additional FICA taxes that the employer pays will not be additional FICA wages for the employee (but it will still be taxable compensation).

The IRS defines domestic service in a private home as service of a household nature performed by an employee in or about the private home of a person by whom he is employed. A private home is a fixed place of abode of an individual or a family. In general, services of this type include those rendered by cooks, waiters, butlers, housekeepers, governesses, maids, valets, baby sitters, janitors, laundresses, furnace men, caretakers, handymen, gardeners, footmen, grooms, and chauffeurs of automobiles for family use. Services not included are those rendered by private secretary, tutor, or librarian, even though performed in the employer's private home.³⁹

Services performed in a nursing home, convalescent home, or hospital may qualify as domestic services if they are of a domestic nature and the facts and circumstances show that the room or suite is the patient's residence.⁴⁰

FEDERAL UNEMPLOYMENT TAX ACT

The second type of payroll tax is the unemployment tax. The Federal Unemployment Tax Act (FUTA) imposes an unemployment tax on wages the employer pays. The FUTA tax

36. I.R.C. § 3121(a)(7)(B).

37. I.R.C. § 3121(b)(21).

38. I.R.C. § 3121(a)(6).

39. Rev. Rul. 71-389, 1971 C.B. 341.

40. See Rev. Rul. 74-388, 1974-2 C.B. 325; Rev. Rul. 56-109, 1956-1 C.B. 467.

is levied on the employer at a rate of 6.2% for all of the wages it pays during a taxable year⁴¹ reduced by certain credits for state unemployment tax payments. In general, the FUTA rate after the application of these credits is 0.8%.

For purposes of FUTA, "wages" have essentially the same meaning as "wages" for FICA, except that only wages up to the FUTA wage base of \$7,000 are subject to the tax.⁴² In general, FUTA taxes are levied once an employer (1) pays aggregate cash wages of \$1,000 or more in any calendar quarter or (2) has at least one person as an employee for some part of the day in each of twenty different calendar weeks.⁴³ However, these rules do not apply for household employers. FUTA taxes are levied on household employers once the employer pays wages of \$1,400 or more during a calendar year. Once levied, the taxes are based on wages paid in the current and prior calendar years. There are some exceptions to FUTA for wages paid to children under the age of eighteen, spouses, and parents. Additionally, as with non-cash payments to domestic workers under FICA, non-cash payments are not "wages" for purposes of FUTA.

WAGE WITHHOLDING TAX

The third type of payroll tax is a wage withholding tax. In general, an employer is responsible for deducting and withholding income tax on the wages it pays its employees.⁴⁴ However, an employer of an employee who provides domestic services in the employer's home is not required to withhold income tax with respect to the household employee's wages unless the employee asks the employer to withhold income taxes on wages and the employer agrees to make the withholding.⁴⁵ Due to this exception from income tax withholding for domestic employees and the low likelihood that an elder would agree to withhold income taxes from a worker's wages, this article will not discuss the complicated income tax wage withholding requirements.

41. I.R.C. § 3301.

42. I.R.C. § 3306(b)(1).

43. I.R.C. § 3306(a)(1)(B). The calendar weeks do not need to be consecutive and it does not have to be the same individual each day.

44. See I.R.C. § 3402.

45. I.R.S. Notice 2003-70, 2003-2 C.B. 916.

REPORTING AND PAYING PAYROLL TAXES

ELDER EMPLOYER OBLIGATIONS

A person who is deemed to pay wages for domestic service in his or her private home must obtain a federal employer identification number from the IRS and report the payment of these wages annually on Schedule H of IRS Form 1040 of his or her annual income tax return.⁴⁶ The elder must remit the taxes reported on Schedule H along with his or her estimated quarterly income tax payments.⁴⁷ As a result, the elder employer may have to start paying quarterly estimated taxes after he or she begins making payments under the contract.

In addition, during a year in which the elder (1) pays more than \$1,400 in wages to a domestic employee or (2) withholds income tax from an employee's pay, the elder must give the employee an IRS Form W-2 by January 31 of the year that follows the year in which the elder paid the wages or withheld income tax⁴⁸ (e.g., by January 31, 2005 for wages paid in 2004). The Form W-2 should reflect all cash and non-cash wages, including transfers of property. In addition, the elder must also send a copy of the Form W-2 (along with the transmittal form, Form W-3) to the Social Security Administration by February 28, unless he or she electronically files the W-2, in which case the due date would be March 31.⁴⁹

THIRD PARTY OBLIGATIONS

If the employer fails to pay withheld taxes, then any lender, surety, or other third party who pays wages directly to employees of that employer is responsible for wage withholding.⁵⁰ Therefore, if the elder has retained the worker through an agency and the elder does not pay the worker, the elder should not be responsible for the worker's payroll taxes if the agency does not pay them.

46. I.R.C. § 3510. *See also* I.R.S. Notice 95-18, 1995-17 I.R.B. 13.

47. I.R.C. § 3510(b).

48. I.R.S. Pub. 926 (Rev. Nov. 2002).

49. *Id.*

50. Treas. Reg. § 31.3505-1(a)(ii).

PENALTIES AND INTEREST

The IRS will impose various penalties for failing to file any required employment tax returns,⁵¹ the Form 1040 Schedule H, as well as the failure to pay taxes (including payroll taxes due with quarterly taxes) or remit withheld taxes when due.⁵² Interest is imposed on all taxes from the date they are due until they are paid,⁵³ with the exception of FUTA taxes.⁵⁴ In addition to interest on taxes, interest also accrues on all assessable penalties for which the IRS has demanded payment from the date that the IRS demands payments.⁵⁵ The IRS can collect unpaid taxes and penalties through a levy upon all property and rights to property of the employer.⁵⁶ Further, if the elder employer transfers its assets to a third party, the IRS may collect unpaid taxes from the transferee.⁵⁷ This could create some potential liability on family members who are recipients of payment the elder makes under a Medicaid asset protection plan. The IRS can also impose criminal liability on individuals for the failure to pay any tax or file any return.⁵⁸ Additional relief may be available to the elder for the failure to pay and report employment taxes, but that relief is beyond the scope of this article.⁵⁹

STATE EMPLOYMENT AND INCOME TAX ISSUES

In addition to federal employment-tax related requirements, states and localities also impose their own employment taxes on local employers. The materials in this section analyze this issue in accordance with Illinois law. Although each state's law may be slightly different on this issue, many of the principles set out below will apply in other jurisdictions.

All employers in Illinois have certain tax and payment obligations with respect to their employees. These include payments under the Illinois Unemployment Insurance Act,

51. See I.R.C. §§ 6651 and 6654.

52. See I.R.C. § 6656.

53. I.R.C. § 6601(a).

54. I.R.C. § 6601(i).

55. I.R.C. § 6601(e)(2).

56. I.R.C. § 6631(a).

57. I.R.C. § 6901 and Treas. Reg. § 301.6901-1.

58. See generally I.R.C. §§ 7201 – 7203, § 7215.

59. See I.R.C. § 530 (1978).

Workers Compensation Insurance, and Illinois income tax withholding. However, these obligations do not apply if the elder is not the employer. The employer-employee analysis under Illinois employment tax law is similar to the FICA employer-employee analysis. Other states may also apply this analysis.

ILLINOIS UNEMPLOYMENT INSURANCE ACT: A STATE TAX EXAMPLE

Essentially, an employer must make Illinois Unemployment Insurance Act (the Illinois Act) payments if the employer is subject to FUTA, because the eligibility rules are very similar (except for certain dollar thresholds). An employer will be subject to contributions for a calendar year if it passes one of two tests: (1) the "one or more test" and (2) payment of wages of \$1,500 or more during a calendar quarter. Under the "one or more" test, an employing unit must pay unemployment contributions for a calendar year if it employs one or more persons in Illinois "on any one day within each of twenty or more calendar weeks in any calendar year . . ."⁶⁰ An employing unit that does not meet the "one or more test" but pays or paid wages for services in employment of \$1,500 or more during any calendar quarter of a calendar year becomes liable for contributions on its taxable payroll for the entire year.⁶¹

Once subject to the Illinois Act, the employer must file quarterly reports with the Illinois Department of Employment Security. The employer must pay contributions and file reports indefinitely unless:

- it has a year with less than "twenty weeks of one employee,"
- all quarterly payments in that year are less than \$1,500,
- it asks the Director of the Illinois Department of Employment Security in writing to be relieved of the requirement, and
- the Director grants the request.⁶²

60. Illinois Dep't. of Employment Sec., GUIDE TO THE ILLINOIS UNEMPLOYMENT INSURANCE ACT (as amended to Dec. 26, 2003), at G-3.

61. *Id.*

62. *Id.*

The Illinois Act has two exceptions that could apply to a home health care contract. These are (1) father, mother, spouse, or child is under the age of eighteen⁶³ and (2) domestic workers in private homes provided that the worker does not earn more than \$1,000 in any calendar quarter.⁶⁴

As described in the section on FUTA above, employers who are subject to both FUTA and the Illinois Unemployment Insurance Act are not required to make full payments under FUTA if they make proper payments to the state first.⁶⁵ Since there is a credit under the FUTA for contributions to states that have certified unemployment insurance laws (and Illinois has one of these), an employer who timely pays contributions to Illinois will receive and offset credit against FUTA obligations. While this article will not discuss the underlying computations, "the maximum credit that may be obtained against the FUTA tax is limited to 90% of that tax at a 'deemed' rate of 6%."⁶⁶ Therefore, "even though the Federal tax is 6.2%, the maximum credit allowed is 5.4%."⁶⁷

The contribution payment rate under the Illinois Act for new employers is currently 4% of the first \$10,500 (in 2005) paid to a worker during the calendar year.⁶⁸ Various factors can reduce this rate once the employer is no longer a "new" employer. The best rate for Illinois employers is currently 2.7%.⁶⁹

There are penalties for failure to file. The minimum penalty is \$50. The Illinois Guide states:

The penalty is \$5 for each \$10,000 or fraction thereof of the total wages for insured work paid during the period or \$2,500 per month, whichever is less. The maximum penalty is \$10 for each \$10,000 or fraction thereof of the total wages for insured work paid during the period or \$5,000, whichever is less.⁷⁰

There are also interest charges and other penalties.

63. *Id.* at G-4.

64. *Id.*

65. *Id.* at G-1.

66. *Id.* at G-9.

67. *Id.* at G-12.

68. *Id.* at G-12.

69. *Id.* at G12-G13.

70. *Id.* at G-14.

WORKERS' COMPENSATION INSURANCE

Any household or residence wherein domestic workers are employed for a total of forty or more hours per week for a period of thirteen or more weeks during a calendar year are required to obtain Workers' Compensation Insurance.⁷¹

STATE INCOME TAX WITHHOLDING REQUIREMENTS

Illinois requires employers to deduct and withhold from an employee's wages an amount equal to three percent of that employee's wages.⁷² Other states may have the same requirement. This applies to every employer who (1) is required to withhold Federal income tax on wages paid in Illinois and (2) maintains an office or transacts business in Illinois.⁷³ Accordingly, since an employer of an employee who provides domestic services is not required to withhold federal income taxes from an employee's wages, there is, effectively, no withholding requirement in Illinois for these employees. However, in the unlikely event that the elder employer agrees to withhold federal income taxes from an employee's wages, he or she will also need to withhold Illinois income taxes. Since withholding in Illinois is unlikely, a discussion of the requirements is beyond the scope of this article.

Lastly, note that some cities, villages, counties, etc. may apply additional "head taxes" on employers in their jurisdictions.⁷⁴ However, it is unlikely that these taxes would apply to domestic employers.

FEDERAL INCOME TAX DEDUCTION AVAILABLE TO THE ELDER FOR PAYMENTS MADE UNDER THE CONTRACT

A taxpayer may take an itemized deduction for the medical care expenses of the taxpayer, taxpayer's spouse, and dependents to the extent that such expenses exceed 7.5% of the taxpayer's

71. 820 ILL. COMP. STAT. 305/3(18) (2004).

72. 35 ILL. COMP. STAT. 5/701 (2004).

73. *Id.*

74. For example, the City of Chicago subjects employers who employ more than fifty full time persons who earn at least \$900 in a calendar quarter to the Chicago Employers' Expense Tax. The tax is equal to \$4 per employee per month. Chicago Munic. Code § 3-20-080.

adjusted gross income.⁷⁵ A medical care expense includes amounts paid for:

- the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body;
- transportation primarily for and essential to medical care;
- qualified long-term care services; or
- medical insurance (including premiums for Medicare Part B and qualified long term care insurance).⁷⁶

Accordingly, payments made under a contract for medical care, transportation to obtain medical care, or for qualified long-term care services would be deductible as a medical expense.

Payments made under a contract that the taxpayer can allocate to medical care or travel to obtain medical care would be a deductible medical expense. In this context, services that are allocable for medical care traditionally would be the services that a nurse would provide.⁷⁷ Therefore, a taxpayer may deduct payments to a worker who performs both nursing care and housework only to the extent of the nursing cost.⁷⁸ In addition, if an elder makes these medical care payments to an employee, the payroll taxes paid on that employee will also be deductible. Although the elder may want to attempt to classify most of the services under a contract as nursing services, it may be difficult to prove this assertion if none of the workers working under the contract is a licensed nurse.

While it may be difficult to characterize a large portion of payments under a contract as medical expenses for this reason, it is much easier to classify the services under a contract as "qualified long-term care services." Qualified long-term care services are "necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services and maintenance or personal care services, which are required by a chronically ill individual, and are provided pursuant to a plan of care prescribed by a licensed health care practitioner."⁷⁹

75. I.R.C. § 213(a).

76. I.R.C. § 213(d)(1).

77. Rev. Rul. 58-339, 1958-2 CB 106.

78. Treas. Reg. § 1.213-1(e)(1)(iii).

79. I.R.C. § 7702B(c)(1).

A "chronically ill individual" is an individual who a licensed health care practitioner certifies within the past twelve months as:

- i. being unable to perform (without substantial assistance from another individual) at least two activities of daily living⁸⁰ for a period of at least ninety days due to a loss of functional capacity,
- ii. having a level of disability similar to the level of disability described in clause i., or
- iii. requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.⁸¹

In general, a licensed health care practitioner includes a physician, registered professional nurse, or licensed social worker.⁸² Maintenance or personal care services include "any care the primary purpose of which is the provision of needed assistance with any of the disabilities as a result of which the individual is a chronically ill individual (including the protection from threats to health and safety due to severe cognitive impairment)."⁸³

Accordingly, under these rules, payments made for care under a home health care contract will be deductible for the elder when a physician, nurse, or social worker (1) certifies the elder as a chronically ill individual and (2) provides a written plan of care that includes the duties contained in the home health care contract.

80. Eating, toileting, transferring, bathing, dressing, and continence.
I.R.C. § 7702B(c)(2)(B).

81. I.R.C. § 7702B(c)(2)(A).

82. I.R.C. § 7702B(c)(4).

83. I.R.C. § 7702B(c)(3).