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The Nanny Tax

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HONORS THESIS ABSTRACT

Guidelines

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HONORS THESIS ABSTRACT
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ABSTRACT (100-200 WORDS):
The number of household employees has increased over a ten year time period, but the compliance rate for household employment tax filings has decreased. This study explores different explanations for non-compliance of household employment taxes in the United States. These explanations include detection risk, the employment of illegal immigrants, psychological considerations, the lack of knowledge about household employment taxes, the decrease in household employees affecting compliance rates, and compliance rates based on income and age. The results of a state-to-state comparison show that employing illegal immigrants and the age of the employer have a potential impact on overall compliance. Other explanations have no direct effect on compliance rates.
THE NANNY TAX

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This study explores different explanations for non-compliance of household employment taxes in the United States. These explanations include detection risk, the employment of illegal immigrants, psychological considerations, the lack of knowledge about household employment taxes, the decrease in household employees affecting compliance rates, and compliance rates based on income and age. The results of a state-to-state comparison show that employing illegal immigrants and the age of the employer have a potential impact on overall compliance. Other explanations have no direct effect on compliance rates.
INTRODUCTION

Employment taxes are an important economic and political issue. The number of household employees has increased over a ten year time period, but the compliance rate for household employment tax filings has decreased (SOI and Bureau of Labor Statistics, 2010). This study explores different explanations that may lead to non-compliance of household employment taxes in the United States. These explanations include detection risk, the employment of illegal immigrants, psychological considerations, the lack of knowledge about household employment taxes, the decrease in household employees affecting compliance rates, compliance rates based on income, and compliance rates based on income and age. A state-to-state comparison is performed and the states are compared to the United States. The states that are used as samples are Illinois, California, Texas, and Pennsylvania. This study is important because the number of unpaid household employment taxes is growing and is causing a gap in tax revenue. Analyzing different explanations for non-compliance rates helps illustrate why non-compliance exists.

LEGAL HISTORY AND NON-COMPLIANCE EXPLANATIONS

If an employer can control what an employee does and how this employee will perform a particular job, the IRS defines this employee as a household employee (IRS Businesses – Hiring Household Employees, 2011). If an employer can only control the result of the job and not how it should be performed, the IRS defines this person as an independent contractor (IRS Businesses – Independent Contractor, 2011). The distinction between a household employee and an independent contractor is important. How a person performing services for someone is classified will determine if household employment taxes are to be paid. The Internal Revenue Code (2011)
states that a person is not allowed to withhold or pay Social Security and Medicare taxes on someone who is their spouse, child (under 21), parent, or employee under the age of 18 who does not consider household work as their principal occupation. In addition, if an employer files a Form W-2 or pays Federal unemployment tax, the employer must also file a Form 1040, Schedule H – Household Employment Tax form. Anyone who misclassifies their employee as an independent contractor may be liable for employment taxes (Internal Revenue Code, 2011). Also, employees who feel that they are being misclassified as an independent contractor may use Form 8919, Uncollected Social Security and Medicare Tax on Wages to report taxes due on their compensation. Changes in the past were made to the tax law to increase household employment tax compliance rates.

The most recent change in the household employment tax law happened with the Social Security Domestic Employment Reform Act of 1994. The act simplified filing requirements for household employers with the intention of increasing compliance rates. Before the new act was passed, the wage threshold for Social Security was $50 or more per quarter of a household employee. When this threshold was met, an employer had to file a quarterly report, Form 942 - Employer's Quarterly Tax Return for Household Employees to the IRS for Social Security and Medicare taxes. An employer also had to file Form 940 - Employer's Annual Federal Unemployment (FUTA) Tax Return for unemployment taxes. The Social Security Domestic Employment Reform Act of 1994 changed the $50 or more per quarter threshold to $1,000 or more annually. It also required household employers to attach a new Schedule H to Form 1040 if they are paying household employment taxes (Young, 1995). Even though the law has been simplified, compliance rates in America are still too low.
According to the Bureau of Labor Statistics, the number of child care workers and personal and home care aids combined totaled to 635,880 household employees employed in the United States in 1998. But only 284,706 household employers filed a Schedule H. Jumping to 2008, the number of child care workers and personal and home care aids totaled to 1,195,860 household employees. But only 218,804 household employers filed a Schedule H that year (SOI and Bureau of Labor Statistics, 2010). That is 65,902 less Schedule H filers and 559,980 more household employees within a 10 year span. Figure 1 below shows the number of household employees vs. Schedule H filers from the 1998-2008 time periods.

**Figure 1: Household Employees vs. Schedule H Filers (1998-2008)**

The number of Schedule H filers has gone down over the 10 year time span. Even with the Social Security Domestic Employment Reform Act of 1994, Figure 1 suggests that more people are avoiding paying taxes on their household employees. Using 1998’s data, the estimated
number of household employment taxes filed in 2008 should have been 535,429, but actual data showed only 218,804 filers (SOI, 2010).

One possible explanation of this decrease could be low detection risk. For example, a household hires a nanny for their child and pays him or her cash wages every week. There is no documentation that the employment occurred because there is no physical evidence that the employee provided household services and got paid for it. If the IRS investigates, the employer can deny that such an event occurred because the employment was done without any form of documentation. Also, detection and punishment are so low that some people do not find it necessary to comply. There is a less than one percent chance of getting audited and fees for penalization are equivalent to a small amount of unpaid taxes. (Alm and Sanchez, 1995). Alm and Sanchez conducted an experiment on the impact of audit rates on compliance rates and their results showed that an increase in audit rates also increased compliance rates (Alm and Sanchez, 1995). This suggests that people are more likely to comply when the possibility of getting caught is higher. This does not only put the employer in a bad position, but it also affects the household employee in the long run. “Avoiding the taxes leaves nannies devoid of a safety net, including Medicare and Social Security benefits, in an era when they may need it more than ever” (Shellenbarger, 2008). The short-term benefit is not worth the long-term cost of having no retirement funds. Apart from the risk factor, there are other possibilities that can contribute to the decrease in Schedule H filings.

Another potential explanation for non-compliance could be psychological. When people read about other people not paying household employment taxes, it makes them not want to pay themselves. Arthur Ellis had stated in his statement regarding non-compliance, “…why should I pay for something when the vast majority of people are not paying it (Lieber, 2009)?” This
mindset alone could be the reason why the United States has a low compliance rate. Some people find it unfair that they have to pay additional money out of their pockets, while other people in similar situations have been getting away with it. Two public figures have ruined their careers because of non-compliance. Zoe Baird, nominee for Attorney General by President Clinton is one of many nanny tax avoiders. Baird could have been the first female attorney general for the United States, but ended up withdrawing her nomination due to nanny tax evasions. During her nomination process, Baird had paid nearly $16,000 in taxes, penalties, and interest for her household employees to fix her tax evasion. But, on January 14 1993, the New York Times released a headline titled “Clinton's choice for justice dept. hired illegal aliens for household.” Baird had blamed her husband for not filing papers with the Labor Department sooner and added that the pressure she had to go through as a mother affected her better judgment. Non-compliance affects public figures heavily. Nancy Killefer, nominee for Chief Performance Officer by President Obama is one of the more recent public figures involved in nanny tax issues. As Zeleny quoted in his article, Citing Tax Troubles, an Obama Appointee Withdraws, Killefer wrote a letter to President Barack Obama stating:

“I recognize that your agenda and the duties facing your Chief Performance Officer are urgent. I have also come to realize in the current environment that my personal tax issue of D.C. Unemployment tax could be used to create exactly the kind of distraction and delay those duties must avoid. Because of this I must reluctantly ask you to withdraw my name from consideration. I am deeply honored to have been selected by you and you have my deep appreciation for your confidence in me. You have my heartfelt support and best wishes for success in all your endeavors.”
Killefer did not pay household employment taxes on her household employee for a year and a half. A $946.69 tax lien was placed on her home. The amount came from $298 in unpaid taxes, $48.69 for interest, and $600 in penalties (Epstein and Sasseen, 2009). Due to her nanny tax avoidance, Killefer had to withdraw as President Barack Obama’s choice for Chief Performance Officer. The influence public figures have on people can have an effect on compliance rates. Wentworth and Ricket (1985) suggest that Bandura’s social learning theory supports why people are highly influenced by public figures and why their compliance rates are affected by what they see other people doing. They imply that having public figures promote tax compliance can influence viewers’ behaviors because they will be more inclined to follow. “Such positive role models would be observed by millions who may subsequently model the desired behavior of taxpayer compliance” (Wentworth and Ricket, 1985). In Baird and Killefer’s case, their actions were negative and this could have impacted people’s tax compliance. Another potential reason for low compliance rates may be based on whom an employer hires.

One way household employers are avoiding paying household employment taxes is by hiring illegal immigrants. In some cases, household employers and illegal immigrants see this situation as one that would benefit both of them. The employer can pay the illegal immigrant less or even higher cash wages while also avoiding household employment taxes. The illegal immigrant, on the other hand, will have a job and can stay hidden from immigration authorities. Morrow (1995) suggests that payment of employment taxes would have alerted the Immigration and Naturalization Service and would cause the nannies to leave. Non-compliance may be viewed by the employer and the household employee as a win-win situation. This mindset may be accounting for a significant amount of the gap in Schedule H filings. However, Bloomquist and An (2005) suggest that undocumented workers may not cause the decrease in Schedule H
filings because families would resort to other family members for help around the household if hiring household help were to become prohibited. Bloomquist and An (2005) stated that schedule H filings would not increase even if there were no undocumented workers employed. Even so, it would be hard to find every household who employs an illegal immigrant. The benefit of the additional tax revenue is offset by the cost of enforcing the law, especially when the benefit is so small.

A lack of knowledge of the tax law may be another explanation for non-compliance. Parents who hire a nanny for a couple of nights every week might think that their only responsibility to the nanny is to pay them for their services, but they are wrong. In 2008, there were 581,670 child care workers, making child care workers 49% of household employees (Bureau of Labor Statistics, 2010). Now, add that to the amount of personal and home care aids that were hired in 2008 and compare it to the amount of people who have attached a Schedule H with their Form 1040. The results suggest non-compliance in the United States is significant. If people do not know about this tax, then they will not pay it. In addition, unwillingness to pay the tax may be a motivation for some. Regardless, ignorance is not an excuse when the IRS pursues an employer because information is public knowledge and different cabinet appointees of current and previous presidents have had issues with this tax law and their stories have made the news. Also, those who have their taxes prepared by a professional tax preparer should be aware of the rule. If people are aware of the tax law, then it is not lack of knowledge anymore, but avoidance.

As Franklin (2009) stated in her article,

"IGNORANCE IS NO EXCUSE. Geithner used tax software (but admitted the error was his fault). Rangel attributed his unreported foreign-earned income to a "language barrier." But it doesn't matter. When you sign a tax return, whether you
prepare it yourself or leave the number-crunching to a professional, you are responsible for the accuracy of your return and the consequences if you make a mistake.

Another explanation for the lack of filings may be that fewer households need household employees to help them with their child or family member (Bloomquist and An, 2005). These households could be turning to other family members to help them out around the house. By doing this, households are able to save more money because they would not have to pay wages to an employee. But it is clear that the demand for household employees have increased from 635,880 in 1998 to 1,195,860 in 2008 (Bureau of Labor Statistics, 2010). These statistics show that the demand for household employees is rising high every year. This drives tax revenue down because these households are not paying employment taxes. For 2008, there were 1,195,860 household employees, but only 218,804 household employment taxes filed. That is a 977,056 difference (SOI and Bureau of Labor Statistics, 2010). Logically, it would seem that an increase in household employees should also bring an increase in the number of Schedule H filings. The statistics show that the number of Schedule H filers in 2008 is even lower than the total number of household employees employed in 1998 (SOI and Bureau of Labor Statistics, 2010). The problem is only getting worse as the number of household employees increase every year. Even with the decrease in Schedule H filings, there is still a portion of the American population who is in compliance with the household employment tax law. Examining certain demographics, such as adjusted gross income and age can show which types of people are more likely to file household employment taxes.

Statistics on Schedule H filers based on a household’s total adjusted gross income indicates a demographic effect with the tax law. From the IRS Statistics of Income, households
with adjusted gross incomes of $40,000 - $49,999 are more likely to not file a Schedule H with their Form 1040. On the other hand, households with adjusted gross incomes between $200,000 and $499,999 are more likely to file a Schedule H for their household employees. Figure 2 below shows the number of Schedule H filers per adjusted gross income in 2008. The graph gives us an idea of which adjusted gross income group is contributing significantly to the decrease in Schedule H filings.

Figure 2: Schedule H Filers by Adjusted Gross Income (2008)

Source: IRS Individual Transaction File
Higher income households may include parents who hold a career that demands a lot of their time. These parents are more likely to hire a nanny to look after their children. Higher income households can mean highly educated individuals who are aware of the household employment tax law. It could also mean that the household can afford the extra costs of hiring a household employee. Therefore, higher income individuals might be more likely to pay taxes on their household employees. Adjusted gross income data shows a lot about who files a Schedule H more. The odd part of this chart is the No Adjusted Gross Income section. One reason behind this could be caused by sole-proprietors. These sole-proprietors may not have had an adjusted gross income, but had hired a household employee for the year. Even though higher income households are more likely to pay taxes on their household employees, there is still a huge tax gap in Schedule H filings for all income levels. Whether it is due to lifestyle changes or tax evasion, a household’s total adjusted gross income does seem to have an impact on Schedule H filings because there is a pattern among income levels that are closer to each other. Age is another demographic to look into regarding Schedule H filings.

Many people who are 65 years old and over tend to need personal and home care aids. At this point in their lives, it is common for this age group to seek help from someone else because sickness or old age is preventing them from taking care of themselves. They understand that their children have lives of their own and are too busy to look after them, so they find it best to not burden their family members by asking them for help. Mulvey and Stucki (2000) state in their article that older people are taking a risk by asking help from family members instead of going to an institution meant for them. It is a stressful job for a family member to help someone in their family who is at that age. As an alternative, older people hire personal or home care aids to help them get by with every day work. In addition, new and current illnesses that require extra home
care are causing many older people to hire personal and home care aids to assist and monitor them throughout their illness. Mulvey and Stucki (2000) also state that older people are more likely than not to change their lifestyle when they are diagnosed with a chronic condition and would rather be taken care of at a place they consider their home. Also, the human life expectancy age has been increasing over the years and older people who are not sick, but are growing weaker, need extra help around the house and prefer not to ask help from family members (Mulvey and Stucki, 2000). Figure 3 below shows the total number of personal and homecare aids for the time period of 2006-2008. As the chart shows, there is a significant amount of personal home care aids hired over the three year time period, but little Schedule H filings.

**Figure 3: 65 and Over Schedule H Filers (2006-2008)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Personal and Home Care Aids</th>
<th>Number of Filers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>600000</td>
<td>100000</td>
</tr>
<tr>
<td>2007</td>
<td>650000</td>
<td>120000</td>
</tr>
<tr>
<td>2008</td>
<td>700000</td>
<td>140000</td>
</tr>
</tbody>
</table>

Source: IRS Individual Transaction File

The chart indicates that the number of filers decreased, while the number of personal and home care aids increased. A potential reason to the low compliance rate could mean that these
employers hiring personal home care aids are not paying their household employees an amount that totals up to the household employment tax threshold of $1000. The low wage amounts could be due to employers not having their household employees come as often to their house for assistance. The household employee might only come every month to check up on them. Based on all the figures that have been presented thus far, there is a high number of people in the American population that do not pay household employment taxes and many different factors could be contributing to this. Compliance rates per state are different and analyzing compliance rates between smaller and bigger states, such as California, Texas, Illinois, and Pennsylvania, in comparison to the entire United States’ will provide conclusions as to why some Americans in certain locations are paying taxes on their household employees more than others.

**DATA ANALYSIS AND INTERPRETATION**

To compare, Illinois’ population in 2008 is 12,901,563 and California’s population is 36,756,666 (U.S. Census, 2008). As Figure 4 below shows, the household employment tax compliance rates are much higher in Illinois than they are in California even though it is a much smaller state.
The statistics for the 2006 – 2008 time periods are different by a few percentages. One reason could be due to illegal immigrants. California ranks number one in illegal immigrant migration. The graph shows that California has a lower compliance rate and this could be because household employers are choosing not to pay household employment taxes to save their undocumented workers from deportation. Also, Illinois is not located on the border of the United States, so it does not have to deal with high illegal immigrant migrations. Apart from hiring illegal immigrants, the employers’ lack of knowledge could also impact compliance rates. In 2008, California ranked #14 for state with persons 25 years old and over with a Bachelor’s degree or more. Illinois ranked #13 (U.S. Census, 2008). As Figure 4 shows, Illinois has a much higher compliance rate than California and this could be because it has a higher rank in terms of educated people. Even though the difference is by one, it could still be impacting compliance.
rates because it shows that those who are educated are more aware of tax regulations than those who are not. A decrease in the number of household employees is another potential cause to the decrease in compliance rates. In 2008, Illinois and California's compliance rate decreased by 1%. This percentage change could reflect a decrease in the number of household employees employed for that year. Figure 5 below illustrates statistics of total household employee changes. Even though California is a bigger state than Illinois, the percentage of household employees employed for 2006-2008 for both states are similar. The Illinois data for 2006-2008 shows a correlation between the number of household employees and the number of Schedule H filings. The increase and decrease of household employees in one year also had the same increase and decrease effect in filing rates. This is not the same for California. California had an increase in 2007 and a decrease in 2008 for filing rates, but the number of household employees increased every year. Therefore, there was no correlation to the number of employees employed.

**Figure 5: Household Employees as a % of State's Illinois and California's Population (2006-2008)**

Source: Bureau of Labor Statistics, U.S. Census Bureau, Population Division
Another factor that explains why Illinois has a better compliance rate than California could be adjusted gross income. According to the U.S. Census (2008), California ranked #9 for personal income per capita and Illinois ranked #14 in 2008. For median household income in 2008, California ranked #9 and Illinois ranked #16. Although California has more high-income filers, its compliance rate is lower than Illinois. This suggests income might not be a factor for compliance rates. One other factor to the difference in compliance rates could be the number of people 65 years old and over living in each state. California ranked #45 for residential population of 65 years old and over, while Illinois ranked #39 (U.S. Census, 2008). Although both states ranked high, California still had less people 65 years old and over living in its state. This suggests that the 65 years old and over population does not have an effect on the compliance rates for Illinois and California. There continues to be a variation in household employment filings even with states that are similar in size.

When comparing states with higher population, California and Texas are similar in size, but their household employment tax statistics tell us a different story. Figure 6 below compares the number of household employment tax filings for California and Texas.
In 2008, California had a population of 36,756,666 and Texas had a population of 24,326,974 (U.S. Census, 2008). Based on the data from Figure 6, California had a higher rate of Schedule H filers than Texas. There is one possibility as to why this might be the case. Texas is located on the southern border of the United States. Although California has the higher number of illegal immigrants migrating into its state, Texas is right behind them. According to the Department of Homeland Security, Texas had an estimated amount of 1,680,000 illegal immigrants in 2009. California had an estimated amount of 2,850,000 illegal immigrants. As mentioned earlier in the paper, employing illegal immigrants is one potential reason as to why people are not filing household employment taxes. The data shows that the number of illegal immigrants present at a state has no effect on compliance rates because California should have had a lower compliance rate than Texas because it ranked higher in terms of illegal immigrant migrations. Instead, it was doing better than Texas. Apart from illegal immigrants, lack of
knowledge regarding household employment taxes may also have an impact on why Texas’ filing rate is lower than California. In 2008, California ranked #14 for state with persons 25 years old and over with a Bachelor’s degree or more. Texas ranked #30 (U.S. Census, 2008). Based on these rankings, lack of knowledge could potentially be the main reason as to why the compliance rates differ. As mentioned earlier, some people are unaware of the household employment tax. One reason could be lack of education. A person living in California with a higher education may understand tax regulations more than a person living in Texas with less educational background or even none at all. This poses a problem when it comes to household employment taxes because lack of knowledge regarding this tax leaves it unpaid. It can also explain why Texas has a much lower compliance rate than California. The reason behind Texas’ low compliance rate for 2008 could also be due to the number of household employees that were employed. Figure 7 below shows that Texas had a significantly higher amount of household employees employed during 2008 than California. The graph helps show if Texas’ total number of household employees had a direct correlation with its compliance rates. But in this case, it did not. In 2007, Texas’ compliance rate increased, but the number of household employees decreased. The same happens in California, except it is the opposite effect. Compliance rates decreased in 2008, but the number of household employees increased. There are other factors that might explain the changes in compliance rates.
Income could be a demographic factor. According to the U.S. Census, in 2008, Texas ranked #27 for Median Household Income and California ranked #9. For Personal Income per Capita, Texas ranked #26 and California ranked #9. Higher income individuals are more likely to file for household employment taxes according to Figure 2 above. In this case, California ranked a lot higher in terms of income. This agrees with the correlation between high income levels and compliance rates because the data shows that California's compliance rates are much higher than Texas. High income level individuals might actually contribute to the differences in compliance rates. Another factor is the 65 years old and over population. Texas ranked #47 for state with residential population of persons 65 years old and over. California ranked #45 (U.S. Census, 2008). The two ranked closely together with California in the lead. As discussed earlier, the compliance rate of those who are 65 years old and over is very low, but yet the number of personal home care aids they hire is significantly high. This reason explains why Texas' compliance rates were a lot lower than California, but because California was ranked closely to
Texas, the 65 years old and older demographic does not have a significant impact on compliance rates for either state. Another comparison between smaller states, such as Illinois and Pennsylvania, shows variations as well.

Illinois, located in the Midwest, had a population of 12,901,563 in 2008. Pennsylvania, located in the Northeast, had a population of 12,448,279 in 2008 (U.S Census, 2008). Both Illinois and Pennsylvania are similar in population sizes. Figure 8 below shows the compliance rates for both states. The compliance rate between Pennsylvania and Illinois are slightly different for the years 2006 and 2007, but are similar in 2008. There are potential reasons behind the similarity in 2008 and the differences in 2006 and 2007.

**Figure 8: Household Employment Taxes Filed as a % of Illinois and Pennsylvania's Population (2006-2008)**

*The data used in this graph for Household Employment Taxes came from the IRS' Individual Taxpayers Statistical Data per State file, which had combined Household Employment Taxes with other Tax Liabilities.*

Source: IRS Individual Transaction file, U.S. Census Bureau, Population Division
One reason for the similarity could be location. Illinois and Pennsylvania are not highly populated with illegal immigrants and neither state is a border state. Apart from location, education levels might explain the similarity in compliance rates. The similarity in 2008 could be because both Illinois and Pennsylvania residents are not aware of the household employment tax law. According to the U.S. Census (2008), Illinois ranked #13 for states with persons 25 years old and over with a Bachelor’s degree or more for 2008. Pennsylvania ranked #25. This does not have an effect on compliance rates because Illinois and Pennsylvania both dropped to 35% in 2008 regardless of its rank. Highly educated or not, the compliance rates were still the same. Another reason could be because of the number of household employees dropping in Pennsylvania. A decrease in the amount of household employees should also decrease the number of Schedule H filings. This is not entirely the case for Pennsylvania because Figure 9 below shows that the percentage of household employees in Pennsylvania decreased slightly in 2007, but went right back up in 2008. There was no correlation between the change in number of household employees and the percentage of Schedule H filings for Pennsylvania because the opposite effect occurred with the 2007 decrease and 2008 increase in household employees. As for Illinois, there was a correlation. When the number of household employees decreased for the years 2007 and 2008, the Schedule H filing percentage also decreased. The Illinois statistics show that there is a slight correlation between number of household employees and Schedule H filings, but this was not the case for Pennsylvania. Income is another factor that can contribute to differences in compliance rates.
In terms of income for 2008, Illinois’ ranked #16 for Median Household Income and #14 for Personal Income per Capita. Pennsylvania ranked #24 for Median Household Income and #19 for Personal Income per Capita (U.S. Census, 2008). As Figure 8 shows, it did not matter which state had higher income individuals because the compliance rates for 2008 remained the same. This could mean that income has no effect on compliance rates and is not a good factor to use to determine reasons behind why people are not paying household employment taxes. Another reason could be the number of people who are 65 and over. From the data earlier, those who are 65 and older who employ a household employee tend to not file household employment taxes. In 2008, Illinois ranked #39 for residential population of 65 years old and older. Pennsylvania ranked #3 (U.S. Census, 2008). Although Pennsylvania should have a slightly lower compliance rate because it had many 65 years old and over people, its compliance rate for 2008 was still the same with Illinois. This shows that even age does not influence compliance rates. A final
comparison of Illinois, California, Texas, and Pennsylvania to the United States for the year 2008 will show a bigger picture of overall compliance rates.

Figure 10 and Figure 11 below shows a comparison of these four states to the United States. Figure 10 shows household employment tax filings for the four states and the United States. Figure 11 shows total number of household employees for the four states and the United States. Using the same calculations to calculate the United States data, the two graphs show that the four states’ percentages are around the same level as the United States as a whole. This means that one or more factors mentioned could influence compliance rates and each state in comparison to the United States share some of these factors. The smaller states, Pennsylvania and Illinois have a higher compliance rate in comparison to the United States. This is surprising because it would seem that the larger the state, the higher the compliance rate. This is not the case. The larger states, California and Texas have a smaller compliance rate. This shows that size does not matter when it comes to compliance rates. The number of household employees also does not matter when it comes to size.
As Figure 11 below shows, Texas and Pennsylvania have the most household employees in comparison to the United States. Illinois and California have less. A reason behind Texas and Pennsylvania having the most could be location. As Bloomquist and An (2005) stated,

“…the southern states [are] a relic of historical and cultural factors that have traditionally viewed the hiring of household help as more socially acceptable than in other parts of the nation. …Cultural factors could also be responsible for the higher filing rates in the South.”
Throughout all these comparisons, it is clear that all the factors mentioned earlier for non-compliance do not directly lead us to the right answer as to why people are not paying taxes on their household employees.

**SUMMARY AND CONCLUSION**

The number of Schedule H filings in comparison to the number of household employees employed in the United States is significantly different. Throughout the paper, different explanations have been suggested for causes of non-compliance. Based on these factors, state-to-state comparisons have been made and the following explains the results of these findings. The first factor involved risk.

There were no statistics found for the states analyzed that showed the influence of risk on compliance rates, but the risk of getting caught in the United States overall is low. As Ron Lieber
quoted Arthur Ellis, President of the Nanny Tax Company in Chicago (2009), “the chances of getting caught are slim.” This slim chance may have a significant influence on non-compliance, but it cannot be determined without statistical data. When understanding compliance rates from a psychological stance, there were no statistics found to support this theory in the state-to-state comparisons. A strong factor found in the analysis is employing illegal immigrants.

The location of a state strongly affects compliance rates. California and Texas are both located on the United States border and are the top two states with high illegal immigration levels according to the Department of Homeland Security. When comparing Texas and California to states not located on the border, such as Illinois and Pennsylvania, Figure 10 shows that Texas and California ranked the lowest in comparison to the other two states and the United States. This analysis shows that location is a factor and compliance rates are much lower in places located on the border of the United States. When it comes to knowledge of household employment taxes, education levels were used to figure out if this factor had an influence.

In the state-to-state comparison, this held true, but other times it was not. The analysis showed that states ranking high in education level had better compliance rates, but when it came to the smaller state comparison, educational level had no impact. Illinois had ranked #13 and Pennsylvania had ranked #25, but the results showed compliance rates were the same for 2008. In comparison to the United States, Figure 10 showed Illinois rating higher and California rating lower. Pennsylvania had ranked #25, but it had the highest compliance rate in comparison to the other states and the United States. These findings show that knowledge on household employment taxes has no effect on compliance rate. Another factor was to find a correlation between the number of household employees increasing or decreasing.
For Illinois, a correlation was found. Illinois had increased in 2007 and decreased in 2008 for both compliance rates and household employment tax filings. For Texas, California, and Pennsylvania, there were no correlations. The United States also had no correlation based on the data from Figure 1. Therefore, this factor does not have a direct impact on compliance rates and Illinois was just an exception. In regards to adjusted gross income, median household income and personal income per capita were used to test this.

When comparing a bigger state to a smaller state, income had no impact. Illinois ranked lower than California, but it still had a better compliance rate. In a big state comparison, there was an impact. California ranked higher than Texas and also had a better compliance rate. In a small state comparison, there was no impact. Illinois ranked high and Pennsylvania ranked very low, but both states had the same compliance rate. As a whole, income has no direct impact because Pennsylvania ranked #24 for income level, but ranked the highest in compliance rate against the other states and the United States. Texas ranked #27 for income levels and was ranked the lowest. California ranked the highest at #9, but was second to the lowest in compliance as compared to the other states and the United States. This concludes that income has no effect on compliance rates because it varied per state. The last factor considered was age and data on people 65 years old and over were used to analyze this.

When a bigger and smaller state was compared, California had less of this age group than Illinois, but this did not impact its filing rate because it was still lower than Illinois. The same result happened with the California and Texas comparison. California had more of this age group, but its compliance rate was still higher than Texas. This test showed no impact in the small state comparison. Illinois had ranked high at #39, while Pennsylvania ranked #3. Pennsylvania should have shown a low compliance rate, but instead, its compliance rate was the
same as Illinois for 2008. The comparison to the United States shows that where a state ranked impacted its filing rate. The order of rankings for the 65 years old and over population from low to high was Texas, California, Illinois, and Pennsylvania. When all states were compared with each other, the compliance rate ranking from worst to best was Texas, California, Illinois, and Pennsylvania. This shows that the 65 years old and over age group has a strong effect on compliance rates. The results of all these factors have led to a final conclusion.

The compliance rate for filing household employment taxes is low, while the number of household employees in the United States is increasing every year. Several factors were tested to compare Illinois, California, Pennsylvania, and Texas to the United States' overall compliance rate. These factors included hiring illegal immigrants, people's lack of knowledge about household employment taxes, decreases in household employees affecting compliance rates, compliance rates based on income, and compliance rates based on persons age 65 years old and over. The analysis concluded that employing illegal immigrants and compliance rates based on persons age 65 years old and over have a potential impact on overall compliance rates. The analysis also concluded that lack of knowledge about household employment taxes, the decrease in household employees, and compliance rates based on income had no direct effect on compliance rates. Although the study presented risk and psychological theories, there were no statistical data found to do a state-to-state comparison. Even without this, the other factors that were used to compare the four different states to the United States was sufficient enough to show a better picture of what sort of factors influence compliance rates. Overall, a majority of Americans are not paying the nanny tax and the IRS will need to find a better way to collect taxes from household employers if they want to decrease this tax gap.
BIBLIOGRAPHY


