

Hiring your minor children this summer? Reap tax and nontax benefits

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If you're a business owner and you hire your children this summer, you can obtain tax breaks and other nontax benefits. The kids can gain on-the-job experience, spend time with you, save for college and learn how to manage money. And you may be able to:

- Shift your high-taxed income into tax-free or low-taxed income;
- Realize payroll tax savings (depending on the child's age and how your business is organized); and
- Enable retirement plan contributions for the children.

A legitimate job

If you hire your child, you 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.

For example, let's say you operate as a sole proprietor and you're in the 37% tax bracket. You hire your 16-year-old daughter to help with office work on a full-time basis during the summer and part-time into the fall. Your daughter earns \$10,000 during 2021 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, who can use her 2021 \$12,550 standard deduction to completely shelter her earnings.

Your family's taxes are cut even if your daughter's earnings exceed her standard deduction. Why? The unsheltered earnings will be taxed to the daughter 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 FUTA taxes if certain conditions are met. Your child must be under age 18 for this to apply (or under age 21 in the case of the FUTA tax exemption).

Be aware that there's no FICA or FUTA exemption for employing a child if your business is incorporated or 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.

Begin saving for retirement

Your business also may be able to provide your child with retirement benefits, depending on the type of plan you have and how it defines qualifying employees. Because your child has earnings from his or her job, your child can contribute to a traditional IRA or Roth IRA and begin to build a nest egg. For the 2021 tax year, a working child can contribute the lesser of his or her earned income, or \$6,000, to an IRA or a Roth.

Keep accurate records

As you can see, hiring your child can be a tax-smart idea. Be sure to keep the same records as you would for other employees to substantiate the hours worked and duties performed (such as timesheets and job descriptions). Issue your child a Form W-2. Please contact us if you have questions about how these rules apply to your situation.

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