

HILLBERG NEWSLETTER

INCOME TAX, ACCOUNTING, CONSULTING AND BUSINESS ADVISORY SERVICES

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TAX PLANNING

Angelina Chavez

Tax Benefits of Hiring Your Child

Would you like to get your children involved in the family business, add valuable work experience for your children, and start saving for your children's future at an early age? This situation can be possible by hiring your children. It may also be beneficial to the business by saving on payroll and income taxes.

Payments for the services of a child under the age 18 who works for his or her parent in a trade or business are not subject to payroll taxes if the trade or business is a sole proprietorship or a partnership in which each partner is a parent of the child. The business is not required to withhold and pay FICA taxes (Social Security and Medicare), federal unemployment, state disability insurance nor state unemployment taxes. This means your business incurs no payroll taxes for your children and they get to keep more of what they earn.

With the earnings the next benefit is to start saving for your children's future, by contributing to an Individual Retirement Account (IRA) or a Roth IRA. For 2011, a child can have up to \$5,700 in earned income with no income tax liability. By opening a traditional IRA, a child can earn an additional \$5,000 of income and defer paying the tax. The maximum is the smaller of \$5,000 or the amount of your taxable compensation. A Roth IRA is beneficial if your child may need to tap the account early, for college or a first home. Taxes are already paid on the money put into a Roth so there will be no tax bill and no penalties on contributions withdrawn early for IRA allowable expenses. If your children use the money for retirement, Roth IRA's are usually better for younger savers, since all withdrawals after 59 ½ are tax-free.

Before hiring your child there are a few guidelines that should to be followed. Work performed must be necessary to the business. By necessary it would be reasonable to pay someone else to perform the work that the child is performing. Another guideline is the rate you pay your child must be reasonable and consistent with what you would pay an outsider to do the same work. Also, be sure to pay your child with a check on a regular basis. To an IRS auditor, one large payment at the end of the year may look more like an attempt to cut your tax bill than a

legitimate effort to employ your child. The last rule of thumb would be to treat the child just as you would any other employee. This may mean they would need to punch a time clock, fill out a timesheet, or attend training classes. This also allows you to keep good records in case of an audit; you would have documents to provide that shows the work that was performed by the child.

By hiring your children you can help them learn responsibility, career skills, and valuable money management lessons. If you have any questions or if we can provide additional advice on how hiring your children can benefit your business please give our office a call at 209-667-2406.