

Abstract: Business owners may be able to hire their minor children this summer and get tax breaks and other nontax benefits. While owners save on payroll taxes and lower some costs, the kids also benefit. They can gain on-the-job experience, learn practical skills and at the same time learn how to manage money. A sidebar notes that earned income can help young workers get an early start on funding a retirement plan.

Hiring your minor children for summer jobs

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, 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, and
- Realize payroll tax savings (depending on the child's age and how your business is organized).

Plus, your kids will spend time with you.

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.

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 2022 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. She can then use her standard deduction of \$12,950 for 2022 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 for the FUTA tax exemption). Contact us for how this works.

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.

Keep accurate records

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. Contact us with questions about how these rules apply to your situation.

Sidebar: Starting early makes a retirement garden grow

An early start on saving for retirement can be a key to wealth building. A child who has earned income from a job can contribute to a traditional IRA or Roth IRA and begin funding a nest egg. For the 2022 tax year, a working child can contribute the lesser of his or her earned income, or \$6,000, to a traditional IRA or a Roth IRA.

Depending on the details of your firm's retirement plan, your child may qualify to begin earning retirement benefits that can grow for many decades. And the money may be tapped penalty-free for certain eligible reasons, such as paying education costs and putting down up to \$10,000 on a first home.

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