

# Hiring your children is good business

from the: MNCPA

It's only July and the kids are already bored. Why not put them to work? When you pay your children reasonable wages to work in your family business, you provide your offspring with valuable knowledge and get a few special tax breaks in the process. If you're a business owner, you'll want to read what the Minnesota Society of CPAs (MNCPA) has to say about hiring your children.

## **The tax implications:**

In 2006, you can pay your child up to \$5,150 without either of you incurring a tax liability. That's because reasonable wages you pay to your minor child to work are fully deductible as a legitimate business expense, lowering your gross income. For your son or daughter, the standard deduction eliminates all of the tax on the child's income. And since the money was earned, the "kiddie tax" doesn't apply even if your child is under age 18.

Here is an example of how much you can save. Suppose you're in the 35 percent tax bracket and you pay your 15-year-old daughter \$5,000 over the course of a year to perform office-related tasks. Assuming that the \$5,000 would have otherwise been part of your business earnings, and taxed at 35 percent, you save \$1,750 (35 percent of \$5,000). Since your daughter's earnings are within the standard deduction, the wages she earns are protected from income taxes.

Even if the child were to earn more than his or her standard deduction, it could still pay off. Since the child is most likely in a lower tax bracket, the earnings would be taxed at 10 percent or 15 percent rather than 35 percent. So, in effect, you've converted high-taxed income (yours) into tax-free or lower-taxed income (your child's).

## **Savings for unincorporated businesses:**

If your business is unincorporated, hiring your children who work in your business can reduce payroll taxes as well. Under current law, wages paid to a child under age 18 are not subject to FICA taxes (Social Security and Medicare taxes). In addition, wages paid to a child under 21 are exempt from Federal Unemployment taxes. Both the FICA and FUTA tax exemptions also apply if the child is employed by a partnership in which each partner is a parent of the child.

## **Know the requirements:**

To properly qualify for the deduction, there are requirements you must meet. First and foremost, the work that your children perform must be necessary for the business, and the wages you pay them must be reasonable for the type of work performed. For example, paying your 11-year-old \$30 an hour to file papers in your office during the summer months is not likely to pass the scrutiny of the IRS. There's no age limit for employing your child, but it may be difficult to justify wages paid to a five-year-old.

Treat your children the same as you would any other employee, and be sure you keep good records. Have your child punch a time clock or write his or her hours down on a timesheet.

You should pay your child by check at the same intervals that you pay other employees. At the end of the year, issue a W-2 form to each of your children who worked in the business and send a copy to the IRS.

**Caveat for college-bound children:**

When employing your children, one factor you should keep in mind is that money held in your child's name may reduce the amount of financial aid available. That's because under the financial aid formula used to determine federal aid eligibility at every college and university, students are expected to contribute at least 35 percent of their assets, while parental contributions are capped at 5.6 percent.

**Consult with a CPA:**

Everyone's financial situation is different. A CPA can help you identify the right course of action for your business and your family.

The MNCPA is committed to serving the public interest with programs that advance the highest standards of ethics and practice within the CPA profession. Information and resources are available to the public on the MNCPA Web site ([www.mncpa.org](http://www.mncpa.org)) including state and federal tax forms and information and financial planning information for individuals and small businesses. A free CPA referral service is also available on the Web site or by calling 800-331-4288.

Founded in 1904, the 9,200 member professional organization includes CPAs working in public accounting, business and industry, government, and education. The MNCPA is part of the national 360 Degrees of Financial Literacy campaign to help Americans' improve financial literacy; information and resources are available at: [www.360financialliteracy.org](http://www.360financialliteracy.org).

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