



Save Tax By Hiring Your Child

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Now that summer has arrived, many college and high school students and graduates are searching for seasonal or full-time jobs. In today's tough market, a family business may be the only place for some children to find work. If you run a family-owned business, employing your child may generate tax savings regardless of whether the child works full-time or part-time.

Business owners may be able to turn some of their high-taxed income into tax-free or low-taxed income by employing their child. The work done by the child must be legitimate and the wages paid reasonable for the services rendered. For example, a business owner in the 33% bracket hires her 17-year-old son to help with office work and he earns \$5,700 for the year, with no other income. He can use the standard deduction to offset his income and his mother saves \$1,881 in tax (33% of \$5,700). The so-called "kiddie tax," which taxes a portion of a single child's unearned income at the parent's tax rate, has no impact on his wages since it applies only to any investment or unearned income.

Additional savings are possible if a child is able to deposit excess earnings into a traditional IRA. For 2010, a child can make a deductible contribution of up to \$5,000 to his or her own IRA. The business may also be able to contribute to its retirement plan for the benefit of the child, depending on its type of plan and terms.

Other tax savings may be available in the form of education credits. For 2010, taxpayers may claim an American Opportunity tax Credit, a HOPE tax Credit or a Lifetime Learning tax Credit. Different requirements and limitations apply to the various credits and not all are refundable. Also, where a parent pays the college education expenses of a dependent child, only the parent may claim the credit, if otherwise eligible. However, if a parent is eligible to but does not claim a student as a dependent, the student may claim the education credit for expenses paid by the student or the parent. Therefore, it may pay for a parent not to claim a student as a dependent if the parent cannot claim the credit due to high income or if the student has sufficient tax liability, due to employment or other income, to be offset by the credit.

Hiring a child may also yield payroll tax savings. Employment for social security (FICA) tax purposes does not include services performed by a child under the age of 18 while employed by the parent. A similar exemption applies for unemployment (FUTA) tax purposes, which exempts earnings paid to a child under age 21 while employed by his or her parent. These FICA and FUTA exemptions apply to parents operating an unincorporated business or a partnership consisting solely of the parents. Unfortunately, in a partnership that includes non-parent partners, or in an incorporated business, these exemptions do not apply and the children are subject to the same rules applicable to all other employees.

Although some children consider working in a family business only as a last resort, doing so can ultimately be tax advantageous for both parent and child.