

## WHY YOU SHOULD HIRE YOUR KIDS

How old were you when you got your first job? I was ten. I remember it well. I bugged my parents to let me get a paper route. I never really got an allowance, so I wanted to earn money I could spend. I quickly learned that having money didn't mean I could use it on whatever I wanted. Before I finished high school, I worked for two fast food restaurants, a snack foods company, an ice company, and ran my own lawn business, besides having had multiple paper routes.

In addition to the important learning experiences and lessons your kids can learn by working, putting them on the payroll can keep a lot of tax dollars in your pocket. By putting your kids to work for your business, you can shift income from your higher tax bracket to their lower tax bracket.

If your child doesn't earn a yearly income over \$5,350, the wages will be completely offset by his or her standard deduction. Just because you claim them as a dependent on your tax return, they are still eligible for the standard deduction when they file their own return. Depending upon the structure of your business, the wage you pay your child may also be free of social security tax.

Assume you are in a 35 percent tax bracket and own a business as a sole proprietor. If you hire your 16-year-old daughter to help with office work mostly full-time during the summer - you have to let her have some fun, right - and part-time into the fall, perhaps she can earn as much as \$5,350 during the year. Your daughter can then use the money she earns to do a multitude of things you might have done for her such as save for college, pay for her own summer camps and other vacations, purchase piano lessons and gifts for birthdays and Christmas. Maybe she'll even buy her own school clothes like I had to do soon after I got my first job.

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By employing your daughter, you would save \$1,872 (35 percent of \$5,350) in income taxes. If you were to pay her an additional \$4,000 for the year, she could shelter it by contributing to her own tax-deductible IRA, and you could save another \$1,400 (35 percent of \$4,000) in income taxes for a total savings of \$3,272. If you had more than one child on the payroll the savings accumulate quickly.

As with any tax strategy, you must follow the rules. You must provide your children with W-2s at the end of the year. You must also keep good records to prove the deduction for wages you pay your child. You should really consider putting your children on a time clock or keeping a time log and keeping track of the services they perform. They actually need to work! You should not pay them with cash, but should instead pay them by check in the same manner you would any other employee. Finally, the wage must be reasonable for the services performed.

So how old does your child need to be to go to work for your business? The U.S. Tax Court approved of deductions for wages paid to a child as young as seven years old. However, it was very strict in reducing the deduction to a reasonable value for the services performed. It would be hard to imagine that a 7-year-old, or a 13-year-old for that matter, working two hours a week for ten weeks during summer vacation would earn \$9,350 (\$5,350 standard deduction + \$4,000 IRA deduction) for filing and cleaning. That would be the equivalent of paying a cleaning person over \$467 an hour. This is definitely not reasonable no matter how clean they get your office, and would most certainly be disallowed by the IRS.

Although the income you paid your child may be tax free, your business will probably still need to withhold federal and state taxes on the child's wages. But remember, even though there may be withholding, if your child owes no taxes at the end of the year they will get a refund when their her tax return is filed.

If your business is not incorporated, you might also save social security tax dollars ("FICA"). The definition of employment for FICA doesn't include services performed by a child under the age of 18 while employed by a parent. The federal unemployment tax provides an even more liberal exemption for earnings paid to a child under age 21 while employed by his or her parent. Although the income tax savings can be created in a variety of business situations, these two employment tax exemptions generally only apply when the parent owns the business as a sole proprietor or the business is a partnership consisting solely of the parents.

Here is one more thought. If you started this strategy when your child was 15 years old, and convinced them to put \$4,000 into an IRA for the next four years before they left for college, you could make your child a millionaire. Putting \$4,000 into an IRA for only four consecutive years beginning at age 15 would

grow to be over a million dollars before age 60, assuming an annual compounding rate of 10 percent. Of course it would be subject to tax upon withdrawal, but it's a million bucks!

Hiring your teenage children to work in your business can give your kids valuable employment experience, and teach them to handle responsibility. Be creative. When given the chance, kids are capable of doing a lot of things that could benefit your business. If done properly, hiring your child can result in significant tax savings to you.

This is intended for general interest and not as specific legal or accounting advice for anyone. You should consult your tax advisor to get more information.