

Hiring Your Child: Tax-related Benefits of Hiring a Child

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Suppose that your child needs an after-school job while your company is looking to hire extra help. If you are in a position of authority, you could put your child on the payroll.

There are several tax incentives for hiring a child to work for your business. In effect, you are “splitting income,” by paying your child a salary instead of taking compensation and paying the child an allowance. In addition, your child may be in line for fringe benefits. Of course, the wages paid to the child are deductible by the business.

Here are the answers to some frequently asked questions on this topic:

Q. What about the “kiddie tax” on income earned by young children?

A. The kiddie tax generally applies to unearned income of a child younger than 19 or a full-time student younger than 24. For 2010, the income is taxed at the parent’s tax rate to the extent it exceeds \$1,900. However, this rule only affects unearned income. Earned income—such as income your child receives working for your business—is exempt from the extra tax.

Q. How old does a child have to be to work for my business?

A. There are no definite age limitations (assuming that state child labor laws are met). In fact, in one classic case, the Tax Court allowed an employer to deduct wages paid to the business owner’s seven-year-old for doing odd jobs on weekends, after school and during summer vacations. Of course, the wages you pay your child must be a reasonable amount for services actually rendered.

Q. What income tax rate can my child expect to pay?

A. Currently, the lowest federal income tax rate is 10%. However, a child can earn up to \$5,700 in 2010 before he or she has to pay any tax. If your child expects to incur no tax liability this year (and had no tax liability last year), wages may be exempted from income tax withholding on the child’s W-4 Form.

Q. What about FICA tax?

A. Wages paid to a child age 18 or older are subject to the Federal Insurance Contributions Act (FICA). But younger children are exempt from FICA if wages are paid by an unincorporated business.

Q. Can I qualify for the new HIRE Act employment tax breaks?

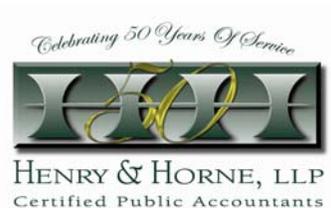
A. No. Both the employer exemption from Social Security tax and the tax credit for hiring previously unemployed workers under the Hiring Incentives to Restore Employment (HIRE) Act of 2010 are generally not available for relatives such as your children.

Q. Can I still claim a dependency exemption for my child?

A. Probably. You generally are entitled to a dependency exemption for a child younger than age 19 (or a child younger than 24 who is a full-time student) if you provide more than half of the child's support for the year. Each dependency exemption in 2010 is \$3,650. But your child cannot claim a personal exemption if he or she is eligible to be your dependent.

Reminder: You must pay your child a reasonable rate for the work actually performed. If you don't, the deduction for wages may be disallowed. If you have any questions don't hesitate to contact your Henry & Horne, LLP tax professional.

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