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A taxing reason for hiring your children or grandchildren

July 09, 2015 - Financial Digest

Hiring your children and grandchildren can be a great way to cut taxes on your income by shifting it to someone who is taxed at a lower (sometimes zero) rate.

First the basics:

- * Your family employees must be at least seven years old.
- * The first \$6,300 of earned income is not taxed.

That \$6,300 is the standard deduction for a single taxpayer even if you claim that person as your dependent. The next \$9,225 they make is taxed at the 10% rate (which means up to a total income of \$15,275.) With a little planning and reasonable record-keeping you can shift a significant portion of your income downstream.

Legally.

Of course, you have to pay what is considered a "reasonable" wage for services performed by a family employee. The Tax Court defines a "reasonable wage" as what you would pay a commercial vendor for the same service, after making an adjustment for the child's age and experience.

That's not as hard to calculate as it might sound. For example, say currently you cut the grass at your office. You hire your son to do it. If a landscaper charges \$20 per cutting, it's reasonable to pay him the same amount.

If your son has decent math and organizational skills, you may hire him to help keep your books, organize your files, etc. Depending on the work, the skills required by a professional who provides the same service might command a higher wage. Since your son isn't a professional bookkeeper, pay him 20% less; that should easily be considered "reasonable."

Hiring your son, in these examples, accomplishes a few things. First, it takes work off your plate frees you up to do things like: Showing properties, prospecting for listings, building professional relationships - in other words, making money.

From a tax perspective, you may not be "out" some of the money you pay him in wages. While you do have to deposit the paycheck in an account registered in your son's name, you don't have to give up control of those funds. If you wish, the account could be a Roth IRA (which can earn up to 8% interest). Or, you could contribute to a 529 college savings plan. Or you could set up a custodial savings account you control until he's 21. While you can't use the money in the account for things like food, you can use funds in a custodial account to pay for things that aren't "obligations of parental support" like private or parochial school tuition. (Those aren't considered "obligations" because he can go to public school instead.) Or you can use those funds for a variety of other purposes.

Here's an example. Next year you plan to send your son to soccer camp. The cost is \$500. Normally, you'll pay the \$500 with after-tax dollars, since soccer camp expense isn't an allowed

business deduction. The cost to you is \$500, in after-tax dollars.

Now, let's say he works for you. Deposit his checks into a custodial account and when it's time to go to camp write the check. Camp just became, in effect, a business expense, and you paid for it using pre-tax dollars. If you lose 30% of your income to taxes, the camp effectively only cost \$350. And your son learned the value of hard work.

Keep in mind if your business isn't incorporated you are not required to withhold for Social Security until a child turns 18. (But you will be required to issue a W-2 so they can file taxes.) If you are incorporated you will have to withhold Social Security... but if you took the money as personal wages instead, you'd pay Social Security tax anyway.

You are also required to keep reasonable records. The simplest way is to create a timesheet and record the hours worked and the type of work performed.

You can take it a step farther by creating a written job description defining the duties involved - that way, if you're audited, you can back up the skills required to perform the job and why the wage you paid was reasonable.

So while there is a little paperwork involved, employing your family is painless compared to the taxes you'll pay if you make this common mistake. Think of tasks you currently perform that keep you from your main role - making money - and "outsource" those tasks to your family.

Who knows; working together might not just be profitable, it might also be fun.

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