

Abstract: Small business owners may be able to hire their minor children this summer and get tax breaks and other nontax benefits. While eligible owners can save on payroll taxes and lower some costs, their kids also benefit. They gain on-the-job experience, develop practical skills and learn how to manage money. A sidebar notes that earned income can also help young workers get an early start on funding a retirement plan.

The advantages of hiring your minor children for summer jobs

If you're a small business owner and you hire your children this summer, you may be able to obtain tax breaks and other nontax benefits. The kids can gain on-the-job experience, save for college and learn how to manage money. You may also be able to shift some of your high-taxed income into tax-free or low-taxed income. In addition, you could realize payroll tax savings (depending on the child's age and your business entity). Plus, your kids will spend time with you.

A legitimate job

If you hire your child, you'll get a business tax deduction for employee wage expenses. In turn, the deduction reduces your federal income tax bill, your self-employment tax bill (if applicable) and your state income tax bill (if applicable). However, for your business to deduct the wages as a business expense, the work performed by the child must be legitimate and the child's salary must be reasonable.

Let's say you operate as a sole proprietor in the 37% tax bracket. You hire your 16-year-old daughter to help with office work full-time during the summer and part-time in the fall. Your daughter earns \$10,000 during 2024 and doesn't have any other earnings.

You save \$3,700 (37% of \$10,000) in income taxes at no tax cost to your daughter. That's because she can use her \$14,600 standard deduction for 2024 to completely shelter her earnings.

Your family's taxes are lower even if your daughter's earnings exceed her standard deduction. Why? The unsheltered earnings will be taxed to her beginning at a rate of 10%, instead of being taxed at your higher rate.

How payroll taxes might be saved

If your business isn't incorporated, your child's wages are exempt from Social Security, Medicare and federal unemployment taxes if certain conditions are met. Your child must be under age 18 for this to apply (or under age 21 for the federal unemployment tax exemption). Contact us to learn how this works.

Be aware that there's no exemption for employing a child if your business is incorporated or is a partnership that includes nonparent partners. And payments for the services of your child are subject to income tax withholding, regardless of age, no matter what type of entity you operate.

Keep accurate records

Hiring your child can be a tax-smart idea. Be sure to keep the same records (such as timesheets and job descriptions) as you would for other employees to substantiate the hours worked and duties performed. Issue your child a Form W-2. Contact us with questions about how these rules apply to your situation.

Sidebar:

Starting early makes a retirement garden grow

An early start on saving for retirement can be key to wealth building. A child who earns income from a job can contribute to a traditional IRA or a Roth IRA and begin funding a nest egg. For the 2024 tax year, a working child can contribute the lesser of his or her earned income, or \$7,000, to a traditional or Roth IRA.

What if your business has a retirement plan? Depending on its terms, your child may qualify to begin earning retirement benefits that can grow for many decades. And the money may be tapped penalty-free for certain eligible reasons, such as paying education costs and making a down payment of up to \$10,000 on a first home.