

Hire Your Children and/or Parents

By [Gina L. Gwozdz, CPA](#)

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If you are self-employed and considering hiring some part-time help you should consider hiring either your children or your retired parents. Depending on their abilities and skills your family members can clean your office, file papers, answer phones, design or update your business website, mow the lawn outside your office or just about anything that relates to your business. No matter who you hire, you need to do it properly in order to get the deductions you deserve.

First, make sure that you **pay them reasonable compensation** for the work you are having them do. The courts already have ruled that you can deduct taxes for any "reasonable wages" that you pay your children ages 7 or older to perform duties related to your work. If you previously had someone else doing this same work pay your family members what you were paying them. If this is a new position then a place like [salary.com](#) may be useful in determining what the current pay level is for these types of services. *Document the job description and how the salary was determined.*

NOTE: Child labor laws vary from state to state, so before you hire a child review your state's child labor laws. The [federal labor law](#) applies in all states; if the state and federal law differs, the stricter one must be followed. You can see a summary of the Texas Child Labor Law here: [The Texas Child Labor Law](#).

Have all your employees, including your children and parents, **complete forms W-4 and I-9**. Form W-4 will tell you how much you have to withhold from their paycheck. Form I-9 provides proof of their eligibility to work in the United States. Both of these form can be downloaded from the [IRS website](#).

All your employees should be either using a time clock, punching in and out or writing their time down on a time sheet. **Pay all your employees with a business check**. Your children can always endorse the check over to you for cash to replace their allowance or accumulate the money for college tuition. At the end of the work year, **file a form W-2 with the IRS for each employee**.

Okay, so where are the tax benefits?

If your business is unincorporated (a sole proprietorship or a LLC taxed as a sole proprietorship) and your children are under age 18, *you will not have to pay Social Security or Medicare tax and, normally, no state unemployment or disability taxes, either*. Assuming this is your children's only source of income, the wages you are paying them are considered "earned income," which means that **the first \$5,150 received by each child in 2006 is tax-free**.

So, let's say I have three children, ages 12, 14 and 16. I hire each one to work for me in my unincorporated business and pay each one \$9,150 in 2006. Because they are all under 18, I pay no Social Security, Medicare or state unemployment/disability taxes. Because of the standard deduction, in 2006, the first \$5,150 earned by each child is not taxed, but could be saved to help pay for their

college education (or buy their first car). The next \$4,000 could be sheltered by setting up IRAs for each child.

The net result is that I have paid my children a total of \$38,600 (\$9,150 x 3) that I can deduct from my business income and is tax-free to my children. If I am in the top marginal tax bracket of 35%, I've just saved \$13,510 each year in federal taxes alone.

Okay, but are there tax benefits to hiring my parents?

Certainly. If you employ a parent, his or her wages are subject to income tax withholding, Social Security and Medicare taxes, but *not Federal or State unemployment taxes*. The wages you pay your parents are still deductible to you; therefore you will save on your federal taxes the same way you did in the above example with your children.

NOTE: If your parents were born January 2, 1941, through January 1, 1942, their full retirement age for retirement insurance benefits is 65 years and 8 months. If they work and are full retirement age or older, they may keep all of their Social Security benefits, no matter how much they earn. If they are younger than full retirement age, there is a limit to how much they can earn and still receive full Social Security benefits. If they are younger than full retirement age during all of 2006, they will deduct \$1 from their benefits for each \$2 they earned above \$12,480. If your parents attain full retirement age during 2006, they will deduct \$1 from their benefits for each \$3 they earn above \$33,240 until the month they attain full retirement age.

Hiring your children or parents doesn't increase your chances of being audited, and it has the potential to increase family wealth substantially.

Gina L. Gwozdz is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.