



**April 2018**

## Tax Reform Increases the Tax Benefits of Employing Your Child

The recent tax reform eliminated personal exemptions for taxable years after December 31, 2017, and before January 1, 2026.<sup>1</sup> This makes your child worthless to you on your Form 1040.

But there is a way to get even or, perhaps, much more than even.

Let's set the stage first. For taxable years after December 31, 2017, and before January 1, 2026, the standard deduction for a single taxpayer begins at \$12,000 in 2018 and increases every year for inflation.<sup>2</sup>

The 2017 standard deduction for a single taxpayer was only \$6,350.<sup>3</sup>

The new standard deduction means that a single taxpayer such as your child can earn up to \$12,000 in W-2 wages and pay not a penny in federal taxes.

As the owner of a business, you have the advantage of being able to hire your child to work in your business, and that creates tax-saving opportunities for both you and your child.

### ***Self-Employed Businesses***

The big dollar benefits of hiring your child go to the Form 1040, Schedule C taxpayer and the husband-and-wife partnership because such businesses are exempt from FICA when they employ their children who are under age 18.<sup>4</sup>

The parental proprietorship and partnership hiring rules also exempt wages paid to a child under the age of 21 from unemployment taxes.<sup>5</sup>

Keep in mind that the single-member LLC that did not elect corporate tax treatment is taxed as a sole proprietorship for federal tax purposes.

**Example.** You employ your 9-, 11-, and 13-year-old children to work in your proprietorship. You pay them a fair market wage for the work they perform, and that just happens to equal \$12,000 per child and total \$36,000 for the year.

**Children's federal taxes.** Zero! The \$12,000 standard deduction zeroed each of the children out of federal income taxes for the year.

**Your federal taxes.** You claim the \$36,000 W-2 wages deduction on your Schedule C, where it reduces both your income taxes and your self-employment taxes. If you are single with Schedule C income and taxable income of \$120,000, you save at the 38.13 percent rate, for a total of \$13,127.<sup>6</sup>

Of course, your tax rate is likely higher or lower than the example above, but you get the idea of how this works to your benefit. No taxes to the child and tax savings to you. Yes, you are having your cake and eating it, too.

## ***S and C Corporations, Non-Spouse Partnerships, and Self-Employed Taxpayers with Children Age 18 and Over***

When you hire the child under age 18, the Form 1040, Schedule C business and the partnership with only the child's parents are exempt from Social Security, Medicare, and federal unemployment taxes.

The S and C corporations and the non-spouse partnerships do not qualify for this benefit. They have to pay the payroll taxes on all employees—period. There is no parental benefit.

(Similarly, the self-employed individual or the spouse-only partnership with a child age 21 or over does not qualify for any employment tax breaks.)

This obviously changes the game. Let's look at the three children above and apply the payroll taxes. Here's how:

- \$2,754 employer FICA taxes on the \$36,000 in wages paid to the three children
- \$2,754 employee FICA taxes extracted from the three children's \$36,000 in wages
- \$1,200 in state and federal unemployment (this could be a little higher or lower depending on the employer's experience with unemployment and the unemployment condition of the state where the business resides)

The payroll taxes above have left the pockets of either the children or the business entity. But the bottom line is that the money is now with the governments.

All is not lost, and in most cases, this actually works out pretty well.

The business does get a tax deduction for its FICA and unemployment taxes. Let's say this is your business and you operate it as an S corporation, so the net income passes to you. The tax deduction for hiring your three children is the \$36,000 of wages paid, plus the \$2,754 in FICA and the \$1,200 in unemployment taxes, for a total of \$39,954.

If you are in the 35 percent tax bracket, you save \$13,984 on your \$39,954 deduction.

Remember, the children pay no income taxes, although they did suffer the \$2,754 in FICA taxes.

Here's the tally for the family:

Cash received from the government	\$13,984
Corporate cash paid out for FICA	-\$2,754
Corporate cash paid out for unemployment taxes	-\$1,200
Children's cash paid out for FICA	-\$2,754
<b>Net cash benefit to the family</b>	<b>\$7,276</b>

You can see that payroll taxes take a toll, but they by no means kill the strategy. You, as the owner of this S corporation that hired the children, just put \$7,276 in the pockets of the family. And you are going to do this for a number of years, so this one corporate strategy could be worth a lot of money to you.

Of course, it's unlikely that your savings will equal the calculation above. You might save more or less. Use the example above with your tax rates to calculate your exact savings.

## ***Just a Glimmer***

In this article, we examine the increased benefits of the new standard deduction when you hire your children.

But actually, you have multiple strategies available to you when you hire your children. Here are two articles that you should examine for further enlightenment on the benefits of hiring your child and the pitfalls to avoid:

- [Get Paid: Hire Your Child](#)
- [Beware When Children Use IRAs and/or Savings to Pay for College](#)

## ***Takeaways***

If you can hire your children, the recent tax reform did you a big favor with the new \$12,000 standard deduction.

The biggest benefits accrue to the Form 1040, Schedule C business or the spouse-only partnership when such a business can hire the under-age-18 child of the parent (or parents, in the case of the partnership). Why? Because with such a business, both the business and the parents are exempt from FICA taxes.

But every business where the owner can employ his or her children likely produces a nice financial benefit for the family. Make sure to review the tax savings in this article to see how you can come out ahead.

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1 IRC Section 151(d)(5) 2018.

2 IRC Section 63(c)(7) 2018.

3 Rev. Proc. 2016-55.

4 IRC Section 3121(b)(3)(A); Reg. Section 31.3121(b)(3)-1.

5 IRC Section 3306(c)(5).

6  $\$36,000 \times 38.13 \text{ percent} = \$13,127$ . To find the 38.13 percent, add the 24 percent federal income tax rate and the 14.13 percent self-employment rate. The 14.13 percent self-employment rate comes from multiplying the 15.3 percent self-employment tax rate by 93.25 percent which is the percentage actually taxed on Schedule SE of your tax return.