Employy Child Family Members

Paying wages to a child can be an effective income-shifting strategy for a taxpayer who owns a business or income-producing property.

- Income may be taxed at a lower rate, or escape tax altogether.
- The child's contributions to a retirement plan can enhance the tax benefits.
- If a child earns enough from the family business during college years, the child may be able to claim the American Opportunity or Lifetime Learning credit that the parent looses because of AGI limitation. (Only when the child claims themselves as dependent.)
- Earned income is not subject to kiddie tax regardless of age.

A child's wages are deductible by a parent-employer only if:

1) The work is done in connection with the parent's trade or business (or income-producing property), and
2) The child actually renders the services, and
3) The payments are actually made. The payments must be reasonable in relation to the services rendered. Records must be maintained showing services performed and wages paid.

Example #1:

Phil is in the 35% tax bracket and owns rental property. Phil pays his 17-year-old son $5,000 during the year to help manage and maintain the property. The deduction for wages reduces Phil's tax by $1,750. Since Phil's son has no other income, his standard deduction reduces his taxable income to zero.

Example #2:

Shannon is a sole proprietor in the 35% tax bracket. Shannon pays her daughter $8,000 in wages during the year for services rendered. The deduction for wages reduces Shannon's tax by $2,800. Shannon's daughter contributes $3,000 to a deductible IRA, which brings her taxable income to zero when combined with the standard deduction.

*This information should be used as a guideline. Specific questions regarding this "Biz Facts" should be directed to a Business by Design tax professional.