

## **Hire Your Children, Then Have Them Open Roth IRA Accounts!**

### **WHY?**

If a child's total earned income is less than \$12,950 in 2022 (\$13,850 in 2023) no federal income tax return is required, and no federal tax is due. A Roth IRA can be established for children with earned income, up to the lesser of earned income or \$6,000 per year (\$6,500 in 2023). The account is managed by the custodian (normally, but not necessarily, the parent) for the benefit of the child. Funds in the account belong to the child and must be turned over to them at the age of majority in the state of residence.

The funds do not have to come from the income earned. If a high school student earns \$6,000 from a summer job in 2022 (\$6,500 in 2023) and uses all of it as spending money during the year, the parents can "gift" the teen \$6,000 in 2022 (\$6,500 in 2023) to make a Roth IRA contribution.

Children earn money (up to the limits above) and pay no federal taxes on it. The funds grow tax-free. When they are withdrawn after retirement, there is no federal tax. There aren't many tax benefits as good as this.

### **If you own a business:**

Hard to believe, but a great plan becomes better! In addition to the above benefits, you shift income out of your business and reduce your taxes by as much as 45%!

Reasonable compensation paid to a minor child for services rendered in a business reduce the taxable income of the business. You should be able to prove that the child actually performs services under the same conditions of employment that would apply to an unrelated employee. A physician could not deduct payments to his children for telephone answering services when they had no specified hours of work and performed no services beyond normal household duties, but another physician was allowed to deduct payments to his children for substantial services in handling his business correspondence. Payments to the sons of a sole proprietor for general cleaning and repair services with respect to rental property he owned were deductible.

It's important to draw up a job description for the work your kids perform and make sure what they are doing is necessary for the business. Put them on the payroll as you do with all your employees. Keep detailed time records demonstrating how much they work, and be sure to complete W-4 and I-9 forms and time sheets. Keep canceled checks or pay stubs.

### **If you operate a business as a sole proprietor:**

You thought it couldn't get any better, but it can! Wages paid by a sole proprietor to a child under 18 are not subject to Social Security or Medicare taxes. Your child is not responsible for paying FICA taxes on his or her wages, nor are you required to pay the employer's share of these taxes.

### **If you do not own a business:**

Payments made to children under age 18 for household jobs constitute earned income for the child, but are not considered earnings for Social Security, Medicare, or Federal Unemployment Tax purposes. You'll need to "dot some i's", like including Schedule H with your tax return, preparing Form W-2, and possibly filing state unemployment returns. If your child is working for someone else, they might not issue a W-2. In this case, make certain to keep records detailing the days worked, services provided, payments received, etc.

Before you pay your 6-year-old thousands of dollars for washing the family car, understand that the services are required to be rendered to you, and you are required to pay a reasonable compensation for those services. Additionally, the allowance a child receives (primarily just for being cute) does not qualify. Instead, you should make reasonable payments for specific services rendered. These might be "special" duties covered outside of their normal weekly chores.

You aggressive types - don't think that you'll get a "deduction" for the wages you pay your little one. Since the payments are for household services, and not business expenses, you won't receive any deduction when your child washes your car.