

CHAPTER II

CHILDREN/DEPENDENTS and TAX PLANNING

A. Can Children help to mitigate your business expenses? Yeah, baby!



No more "allowance" for you kid! You can pay your child a **tax deductible allowance**. A favorite tax-planning tactic is to have **a minor child work for the family-owned business**. Income earned by the child is taxed at the child's tax rate, which is likely to be **much lower** **Yea!** than the parents' rate. In addition, the company gets **a deduction** for the child's salary.

SAVE MONEY

In a family-owned business, **No FICA or Medicare** (aka Social Security withholding) is owed for wages paid to a child who is under 18 years old. "So far, so good." **Zero FUTA** (FUTA is another payroll tax that an Employer usually incurs) is paid by a parent (also the Employer, in this case) to a child under 21. Therefore, the child will have **paid zero tax** **Yea!** on up to \$5,350 (the **Standard Deduction**) of their **2007** earned income. Beyond that, children are taxed at their own rate starting at 10% in 2007. Please note that a taxpayer could have further increased his child's salary to \$9,350 by "encouraging" the child to contribute \$4,000 of her salary to an **Individual Retirement Account** ("IRA").

A **dramatic taxpayer** (TC 934) proved just how effective this tactic can be. In Eller, a **mobile-home park** and hired their three children age 7, 11, and 12 to work there. The children cleaned the grounds, did landscaping work, maintained the swimming pool, answered phones, and did minor repair work. The taxpayers deducted over \$17,000 that



Yea Taxpayer! **victory** (Walter E. Eller, 77 how effective this the taxpayers owned **HERE'S WHY** they paid to the children during a three-year period. But the IRS objected, and the case went to trial. The court approved over \$15,000 of the deductions claimed. Most of the deductions that were disallowed were attributable to the seven-year-old. But **even \$1,200 of his earnings was approved** by the court. **Yea!**

It is extremely important to note that **the children actually performed the work for which they were paid** and the work was necessary for the business. The taxpayers demonstrated that if their children had not done the work, **they would have had to hire someone else to do it.**

If any items in this book interest the reader, please contact your Tax Specialist or a professional at TaxOnly, LLC.