



Should Your Child Be Your Summer Intern?

WITH THE SCHOOL YEAR having recently ended, owners of agencies may benefit by employing their children during the summer or part-time during any part of the year. As the owner of a business, you should be aware that you can save income and payroll taxes by putting junior family members on the payroll. You may be able to turn high-taxed income into tax-free or low-taxed income, achieve social security tax savings (depending on how your business is organized) and even make retirement plan contributions for your child. Here are the key considerations.



Turning high-taxed income into tax-free or low-taxed income

You can turn some of your high-taxed income into tax-free or low-taxed income by shifting some of your business earnings to a child as wages for services performed by him or her. The work done by the child must be legitimate, and the amount you pay the child must be reasonable for your business to deduct the wages as a business expense.

For example, suppose an agent operating as a sole proprietor is in the 35% tax bracket. They hire their 17-year-old daughter to help with office work full-time during the summer and part-time into the fall. She earns \$5,000 during the year (and doesn't have earnings from other sources). The agency owner saves \$1,750 (35% of \$5,000) in income taxes at no tax cost to their daughter, who can use her \$5,000 standard deduction for 2005 to completely shelter her earnings.

An additional \$1,400 in taxes savings could be realized if the daughter was kept on the payroll for a longer period and paid an additional \$4,000. She could shelter the additional amount from tax by making a tax-deductible contribution to her own IRA.

And family taxes are cut even if the child's earnings exceed his or her standard deduction and IRA deduction. That's because the unsheltered earnings will be taxed to the child beginning at a rate of 10%, instead of being taxed at the parent's higher rate.

Keep in mind that bracket-shifting works even if the child is under age 14 (although you'd probably be paying less for a younger child's labor).

Social security tax savings, too

If your agency is not incorporated, you can also save some self-employment (i.e., social security) tax dollars by shifting some of your earnings to a child. That's because employment for FICA tax purposes doesn't include services performed by a child under the age of 18 while employed by a parent.

Note that there is no FICA exemption for employing a child if your business is incorporated or an LLC that includes non-parent partners. However, there's no extra cost to your business if you're paying a child for work you'd pay someone else to do, anyway.

Retirement benefits

Your agency may also be able to provide your child with retirement benefits, depending on the type of plan it has and how it defines qualifying employees. For example, if it has a simplified employee pension, a SEP contribution can be made for the child up to 15% of his or her earnings. The child's participation in the SEP won't prevent the child from making tax-deductible IRA contributions as long as adjusted gross income (computed in a special way) is below the level at which deductions for IRA contributions begin to be disallowed. For 2005, that figure is \$50,000 for a single individual.

If you have any questions about how these rules apply to your particular situation, please don't hesitate to call. Also keep in mind that some of the rules about employing children (such as the maximum amount they can earn tax-free) change from year to year, and may require your income shifting strategy to change, too. Enjoy the summer.

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