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Tax Checklist for Employing Your Children

Employing your children in your business can provide tax advantages while teaching them responsibility and helping them earn income. Follow this checklist to ensure compliance with IRS rules and maximize tax benefits.

1. **Determine Eligibility: Type of Business: Confirm your business structure**:
    - **Sole proprietorship or single-member LLC**: Wages paid to your children are exempt from Social Security and Medicare taxes if they are under 18.
    - **Partnerships (where both parents are partners):** Same exemption as sole proprietorships.
    - **Corporations**: Wages are subject to Social Security, Medicare, and FUTA taxes, regardless of the child's age.
    - **Age of Child**: Ensure the child is legally allowed to work (typically any age for family businesses, subject to labor laws).
    - **Real Work**: Assign your child work appropriate for their age and skill level. Tasks must contribute to the business (e.g., filing, cleaning, social media).

1. **Set Up Employment Properly**
    - **Create a Job Description**: Clearly outline the tasks your child will perform.
    - **Pay a Reasonable Wage**: Compensation must align with the tasks performed and what you would pay a non-family employee.
    - Avoid overpaying to avoid IRS scrutiny.
    - **Employee vs. Contractor**: Treat your child as an employee, not an independent contractor.
    - **Issue a W-2**: Provide your child with a W-2 form at year-end for wages paid.

2. **Maintain Documentation**
    - **Time Records**: Keep accurate records of hours worked (e.g., timecards or logs).
    - **Pay Records**: Use checks, direct deposit, or another traceable payment method. Avoid cash payments.
    - **Tax Withholding**: Withhold federal income taxes if applicable.

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3. **Take Advantage of Tax Benefits**
   - **Income Tax Exemption**: If your child earns less than the standard deduction ($13,850 for 2024), they likely won't owe federal income taxes.
   - **Social Security and Medicare Taxes**: For sole proprietorships or partnerships with both parents as partners, wages paid to children under 18 are exempt from these taxes.
   - **FUTA Tax Exemption**: Wages paid to children under 21 are exempt from FUTA taxes in sole proprietorships or family partnerships.

4. **Set Up a Roth IRA (Optional)**
   - If your child earns income, consider contributing to a Roth IRA for tax-free growth. Contributions are limited to the lesser of $6,500 or earned income for 2024.

5. **Ensure Compliance with Labor Laws**
   - Verify compliance with state and federal child labor laws, including:
     - Permissible work hours.
     - Restrictions on hazardous work.

6. **Report on Tax Forms**
   - **Employer**: Report wages paid on your business's tax return and deduct them as a business expense.
   - **Employee**: File your child's individual tax return if required (e.g., earnings above $13,850 or unearned income thresholds).

7. **Audit-Proof Your Arrangement**
    - **Real Work**: Ensure tasks are legitimate business needs.
    - **Reasonable Wages**: Pay consistent with industry norms.
    - **Document Everything**: Maintain job descriptions, timesheets, and payment records to substantiate the employment arrangement.
    - Pay your child on a regular basis, just as you would any other employee.
    - Pay via check, direct deposit, or another traceable method rather than cash.
    - Do not delay payments until the end of the year or pay your child in irregular lump sums, as this could raise IRS suspicion.

Summary of Benefits

- Deduct wages paid to your child as a business expense.
- Your child pays little or no income tax if earnings are below the standard deduction.
- No Social Security, Medicare, or FUTA taxes for children under specific conditions.
- Opportunity to teach your child financial responsibility and save for their future (e.g., Roth IRA contributions).