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Tax & Business Alert

MAY 2022

HIRING YOUR MINOR CHILDREN FOR SUMMER JOBS

If you're a business owner and you hire your children this summer, you can obtain tax breaks and other nontax benefits. The kids can gain on-the-job experience, save for college and learn how to manage money. And you may be able to:

- Shift your high-taxed income into tax-free or low-taxed income, and
- Realize payroll tax savings (depending on the child's age and how your business is organized).

Plus, your kids will spend time with you.

A LEGITIMATE JOB

If you hire your child, you get a business tax deduction for employee wage expenses. In turn, the deduction reduces your federal income tax bill, your self-employment tax bill (if applicable) and your state income tax bill (if applicable). However, for your business to deduct the wages as a business expense, the work performed by the child must be legitimate and the child's salary must be reasonable.

Let's say you operate as a sole proprietor and you're in the 37% tax bracket. You hire your 16-year-old daughter to help with office work on a full-time basis during the summer and part-time into the fall. Your daughter earns \$10,000 during 2022 and doesn't have any other earnings.

You save \$3,700 (37% of \$10,000) in income taxes at no tax cost to your daughter. She can then use her standard deduction of \$12,950 for 2022 to completely shelter her earnings.

Your family's taxes are cut even if your daughter's earnings exceed her standard deduction. Why? The unsheltered earnings will be taxed to the daughter beginning at a rate of 10%, instead of being taxed at your higher rate.



HOW PAYROLL TAXES MIGHT BE SAVED

If your business isn't incorporated, your child's wages are exempt from Social Security, Medicare and FUTA taxes if certain conditions are met. Your child must be under age 18 for this to apply (or under age 21 for the FUTA tax exemption). Contact us for how this works.

STARTING EARLY MAKES A RETIREMENT GARDEN GROW

An early start on saving for retirement can be a key to wealth building. A child who has earned income from a job can contribute to a traditional IRA or Roth IRA and begin funding a nest egg. For the 2022 tax year, a working child can contribute the lesser of his or her earned income, or \$6,000, to a traditional IRA or a Roth IRA.

Depending on the details of your firm's retirement plan, your child may qualify to begin earning retirement benefits that can grow for many decades. And the money may be tapped penalty-free for certain eligible reasons, such as paying education costs and putting down up to \$10,000 on a first home.

Be aware that there's no FICA or FUTA exemption for employing a child if your business is incorporated or a partnership that includes nonparent partners. And payments for the services of your child are subject to income tax withholding, regardless of age, no matter what type of entity you operate.

KEEP ACCURATE RECORDS

Hiring your child can be a tax-smart idea. Be sure to keep the same records as you would for other employees to substantiate the hours worked and duties performed (such as timesheets and job descriptions). Issue your child a Form W-2. Contact us with questions about how these rules apply to your situation. ■

AFTER FILING YOUR TAXES, WHAT RECORDS CAN YOU TOSS?

If you've filed your 2021 tax return, you may want to do some spring cleaning, starting with tax-related paper clutter. Paring down is good. Just be careful to hold onto essential records that may be needed in the event of an IRS audit. Some documents may be needed to help you collect a future refund or assist with filing your return next year. Before you start tossing or shredding documents, read the rules to learn what must be kept — for how long — and what can be safely discarded.

THE GENERAL RULES

At a minimum, you should keep tax records for as long as the IRS can audit your tax return or assess

additional taxes. That's usually three years after you file your return. This means you potentially can get rid of most records related to tax returns for 2018 and earlier years.

However, the statute of limitations extends to six years for taxpayers who understate their adjusted gross income by more than 25%. What constitutes an understatement may go beyond simply not reporting items of income. So, to be safe, a general rule of thumb is to save tax records for six years from filing.

KEEP SOME RECORDS LONGER

You need to hang onto some tax-related records beyond the statute of limitations. For example:

- Keep the tax returns themselves indefinitely, so you can prove to the IRS that you did file a legitimate return. (If you didn't file a return or if you filed a fraudulent return, there's no statute of limitations.)
- Retain W-2 forms until you begin receiving Social Security benefits. That may seem long, but if questions arise regarding your work record or earnings for a particular year, you'll need your W-2 forms to help provide the documentation needed.
- Keep records related to real estate or investments for as long as you own the assets, plus at least three years after you sell them and report the sales on your tax return (or six years if you want extra protection).



- Hang onto records associated with retirement accounts until you've depleted the accounts and reported the last withdrawal on your tax return, plus three (or six) years.
- Retain records that support figures affecting multiple years, such as carryovers of charitable deductions or casualty losses. These need to be saved until they no longer have effect, plus seven years.

If you're still not sure about a specific document feel free to ask us.

TO GET AN "EARLY" REFUND, ADJUST YOUR WITHHOLDING

Each year, millions of taxpayers claim an income tax refund. To be sure, receiving a payment from the IRS for a few thousand dollars can be a pleasant influx of cash. But it means you were essentially giving the government an interest-free loan for close to a year, which isn't the best use of your money.

Fortunately, there's a way to begin collecting your 2022 refund now: You can review the amounts you're having withheld and/or what estimated tax payments you're making and adjust them to keep more money in your pocket during the year.

CHOOSING TO ADJUST

It's particularly important to check your withholding and/or estimated tax payments if:

- You received an especially large 2021 refund,
- You've gotten married, divorced or added a dependent,
- You've bought a home,
- You've started or lost a job, or
- Your investment income has changed significantly.

Even if you haven't encountered any major life changes during the past year, tax law changes may affect withholding levels, making it worthwhile to double-check your withholding or estimated tax payments.

MAKING A CHANGE

You can modify your withholding at any time during the year, or even more than once within a year. To do so, simply submit a new Form W-4 to your employer. Changes typically will go into effect several weeks after the new Form W-4 is submitted. For estimated tax payments, you can adjust each time quarterly payments are due.

OTHER REASONS TO RETAIN RECORDS

Keep in mind that these are the federal tax record retention guidelines. Your state and local tax record requirements may differ. In addition, lenders, co-op boards and other private parties may require you to produce copies of your tax returns as a condition of lending money, approving a purchase or otherwise doing business with you. Contact us with questions or concerns about recordkeeping. ■



While reducing withholding or estimated tax payments will, indeed, put more money in your pocket now, you also need to be careful that you don't reduce them too much. If you don't pay enough tax throughout the year on a timely basis, you could end up owing interest and penalties when you file your return, even if you pay your outstanding tax liability by the April 2023 deadline.

GETTING HELP

One reason to consider adjusting your withholding is the passage of any new tax legislation. For example, after the Tax Cuts and Jobs Act of 2017 was enacted, the IRS needed to revise withholding tables to account for the increased standard deductions, suspension of personal exemptions, and changes in tax rates and brackets. If you'd like help determining your withholding or estimated tax payments for the rest of the year, please contact us. ■

SENDING THE KIDS TO DAY CAMP MAY BRING A TAX BREAK

Among the many challenges of parenthood is what to do with your kids when school lets out. Babysitters are one option, or you might consider sending them to a day camp. There's no one-size-fits-all answer, but if you do choose a day camp, you could be eligible for a tax break. (Note: Overnight camps don't qualify.)

DOLLAR-FOR-DOLLAR SAVINGS



Day camp can be a qualified expense under the child and dependent care tax credit. The credit is worth 20% to 35% of the qualifying costs, subject to an income cap.

As of this writing, the maximum credit for 2022 is expected to revert to the 2020 level of \$2,100 for one

child. This is much lower than for 2021, when the credit was temporarily expanded due to COVID-19.

Tax credits are particularly valuable because they reduce your tax liability dollar-for-dollar — \$1 of tax credit saves \$1 of taxes. Deductions simply reduce the amount of income subject to tax. So, if you're in the 24% tax bracket, \$1 of deduction saves you only \$0.24 of taxes.

QUALIFYING FOR THE CREDIT

Only dependents under age 13 generally qualify. Eligible care costs are those incurred while you work or look for work.

Expenses paid from or reimbursed by an employer-sponsored Flexible Spending Account can't be used to claim the credit. The same is true for a Dependent Care Assistance Program.

DETERMINING ELIGIBILITY

Additional rules apply to this credit. Contact us if you have questions about your eligibility for the credit and the exceptions. ■