

Hiring Family Members

Many providers hire their own family members and take advantage of IRS rules that allow them to reduce their taxes. If you hire your own children under age 18, your children will not have to pay any Social Security taxes. Wages paid to your children to do work for your business are 100% deductible. If you hire your own children who are over age 18 or if you hire your own spouse, wages paid to them are subject to Social Security taxes and federal income taxes. So there is no significant tax benefit to hiring children over age 18 or your spouse unless you set up a medical reimbursement plan and claim medical expenses as a business deduction.

Providers who do hire their own family members should be careful about keeping the proper records. The IRS is initially suspicious of these arrangements because they assume that providers are trying to claim a business deduction without meeting the requirements of an employer hiring an employee. Providers who are sloppy about their record keeping can get into trouble if they can't show that their child did the work for which they were paid.

Here are the records you should keep if you hire your own children or spouse:

- Get a taxpayer identification number from the IRS (Form SS-4 can be filled out online at www.irs.gov).
- Prepare a job description that details what are the responsibilities of the job: play with the children, clean up before and after the children, prepare meals for the children, clean toys, record keeping, etc. Do not include more personal activities such as shopping, mowing the lawn, running errands, etc.
- Prepare a written agreement between you and your family member that describes the employment arrangement: days and hours of work, pay, etc. Both parties should sign this agreement.
- Keep a daily record of when the work was done. If the work done is the same every day, simply record the days and hours worked: Monday 9am - 10am, Tuesday 9am - 10am, Wednesday 9am - 10am, etc.
- Write out a receipt for each payment, get the family member to sign it, and keep a copy: "Payment of \$25 cash for 5 hours of work January 3 - 7, 2007." It is not necessary to pay by check; you can pay with cash. Make this payment out of a separate business account if you have one.
- Payments to family members must be reasonable. If you have a \$15,000 business profit, it is unreasonable to pay your own children \$6,000 in wages. Payment of \$20 per hour to your 15 year old is also unreasonable. The test of what is reasonable is probably how much you would be willing to pay someone who is not a family member.
- If you also give your child an allowance, keep a record of when you gave this allowance and how much it was.