

# Learn how you can maximize your tax deductions during tax time by employing your child.



**DECAL**  
**Thriving Child Care**  
**Business Academy**

## **Maximizing Your Tax Deductions: Employing Your Child**

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Many providers currently employ their children but will typically do it as contractors or “off the books.” The truth is, it’s simple to do legally! In this way, it becomes deductible, so you don’t have to pay payroll taxes. In fact, it’s more than just tax savings. You are shifting income that would normally be taxed at your business rate to your child, who is potentially paying very little or no taxes.

Let’s consider an example: Teresa is a sole proprietor who is in the 22% tax bracket. She pays her child \$10,000 a year to help after school and on weekends. Right now, she pays her off the books and has to pay \$3,730 in additional taxes that would go away if done legally.

You’re spending money on your children either way, so why not get a deduction on it in the process?

### **What is it that I’m doing?**

Before we get into how exactly you employ your child, it helps if we look further into what it is we’re doing.

We’re taking income taxed at your rate and shifting it to be taxed at your child’s tax rate. Your child can claim the standard deduction—the amount of earnings tax free for any and every American (the 2023 Standard Deduction is \$13,850). You get a business reduction by removing taxable income from your business and passing it on to your child, who doesn’t have to pay taxes on it (as long as it is at or below the standard deduction). As an additional bonus, if your business is not taxed as a corporation (e.g., sole proprietor) and your child is under 18, these wages are not subject to FICA, Medicare, and federal unemployment taxes.

### **How do I do it?**

The first thing you should know is, it’s fairly easy to do if you are a sole proprietorship or single member LLC. It does get a little more complicated if you’re an S Corporation, but we will look at a workaround for that a bit further down.

**Step 1:** Prepare a job description that details the responsibilities of the job. Some examples include: playing with the children, cleaning up before and after the children, preparing meals for the children, cleaning toys, and basic record-keeping. Do not include more personal activities such as shopping, mowing the lawn, running family errands, etc. In other words, don't count any work for any activity that would still be done if you weren't in business.

**Pro Tip:** *You will need an Employer Identification Number (EIN), even if you're a sole proprietor. If you do not already have an EIN, you can visit the [IRS website to apply for one](#).*

**Step 2:** Prepare a written agreement between you and your child that describes the employment arrangement: days and hours of work, pay, etc. Both parties should sign this agreement.

**Step 3:** Keep a daily record of when the work was done (Monday 9am – 10am, Tuesday 4pm – 6pm, Wednesday 2:30pm – 3:45pm, etc.). You could even take some pictures or videos of your kid working for further documentation!

**Step 4:** Maintain proof of payment. If you choose to pay your child in cash, be sure you have a system in place to log that those payments were made, just like you would with any other receipt. Alternatively, there are many other systems you could use for verifiable payments, including an ACH or check.

Whichever system you choose, be sure that the wages are paid into an account in the child's name. You cannot just transfer it into your personal account and claim you're paying them!

**Pro Tip:** *What you pay your child must be a reasonable wage for reasonable work. For example, you could not hire your child to do dishes or pay them \$300 an hour to file paperwork.*

### **What if I'm an S Corporation?**

While you can still pay directly from an S Corporation if you want, you'd have to pay them like normal employees. This means FICA and Federal Unemployment must be paid. The good news is, there's still a workaround to this process so you can still maximize your deductions!

**Step 1:** Set up a separate Sole Proprietorship or Single Member LLC.

**Step 2:** Have your S Corporation contract with the new company you set up. This way, the new company you set up can pay your children.

#### **Let's look at an example:**

Say you want to pay your child to file paperwork. You would first set up a sole proprietorship or LLC, sometimes referred to as a family management company. We'll

call it XYZ Family Management Company. This sole proprietorship or single member LLC (again, either one will work, just make sure you get an EIN for it) can now say that they are going to contract with your S Corp for file management services.

Your S Corporation pays XYZ Family Management and XYZ Family Management pays your child. This is moving your child's payment into a company that is not a corporation, which allows you to not have to withhold FICA and federal unemployment taxes.

If you do set up a family management company, make sure you have documentation. With our example, XYZ Family Management Company would send invoices to the S Corporation, and the S Corporation is sending 1099s to XYZ.

**Pro Tip:** *Employing grandchildren, nieces, nephews, etc. works the same way, but the parent of the child being paid must be the one who sets up the subcontractor company.*

### How do I report this on my taxes?

The answer to this question is, it's easy! Remember, you don't have to pay taxes, so filling out a W2 is just a formality for good record-keeping.

Your child's W2 will look similar to the one here:

22222		a Employee's social security number 123-456-789		OMB No. 1545-0008		
b Employer identification number (EIN) 123-456-78		1 Wages, tips, other compensation 13,850		2 Federal income tax withheld 0		
c Employer's name, address, and ZIP code Childcare Provider's Child 123 Childcare Lane, 12345		3 Social security wages 0		4 Social security tax withheld 0		
		5 Medicare wages and tips 0		6 Medicare tax withheld 0		
		7 Social security tips 0		8 Allocated tips 0		
d Control number		9		10 Dependent care benefits		
e Employee's first name and initial Childcare		Last name Provider		Suff.		
123 Childcare Lane, 12345		11 Nonqualified plans		12a		
		13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12b		
		14 Other		12c		
f Employee's address and ZIP code				12d		
15 State	Employer's state ID number AA 12-1234567	16 State wages, tips, etc. 13,850	17 State income tax 0	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** Wage and Tax Statement  
Copy 1—For State, City, or Local Tax Department

2023

Department of the Treasury—Internal Revenue Service

The main idea is this: when you pay your child, the payment comes out of the business. This makes it a deduction because it is payroll, but then it goes to your child and, if kept under the standard deduction for the year, you don't pay taxes on it.

## Final Considerations

A couple of other things to keep in mind while you go through this process:

1. You don't have to pay your child the federal minimum wage of \$7.25 per hour. However, you should check with your state's Department of Labor to see if you must pay any state minimum wage.
2. You should check with your state to see if you must purchase workers' compensation insurance.

## Other ways to leverage this opportunity

Maximizing your deductions come tax season is not the only way you can benefit from this practice! Certainly, it can go into your child's savings account, but since they are now employed, you could also put up to \$6,000 a year in a Roth IRA. These funds will grow tax-free, and it creates an opportunity to build their future, since it can be used for college, a home purchase, or even retirement.

Another option available to you is placing the wages in a 529 savings plan to help with future education (or current education if your child goes to a private school).

When you use a Roth IRA account or a 529 savings plan, the capital gains are tax free. In other words, this money is always tax free from start to finish.

Lastly, as an added bonus, this may also get your child interested in money management at an earlier age!

## Summing it up!

Let's review the steps you must take to properly employ your child:

- Prepare a job description and set a reasonable pay rate.
- Document the work.
- Have a place to put the money (an account in your child's name).
- Fill out a W2 at the end of the year and be sure to have an EIN (which, as a bonus, can help protect your information when you need to give it out).
- Do your child's taxes. You can use a free version of common tax preparation software for your child's taxes because they are under the standard deduction.

Many child care providers have their own children work for them, but don't pay them anything. It's okay not to pay your children! You can reward your children by giving them gifts, or their help can be considered an expected household chore. If you do this, the gifts are not a business expense.

However, there are advantages to hiring your own children (under age 18) to help you with your family child care business. They can reduce your workload by helping you care for aspects of your child care business.

By paying your children and deducting their wages as a business expense—and by keeping them from paying taxes if they stay at or under the standard deduction—you can take advantage of some big tax savings for your family.

Remember, if you want to be able to deduct the amounts you pay your children, you must follow the rules cited above. Although the process can feel intimidating, the tax benefits are real!

## Additional Resources

**If you have questions or need help, assistance is available.**

[GaPDS Website](#)

[DECAL Thriving Child Care Business Academy Website](#)

**To Find Other Study Guides:** Click on [Resources](#) on the Academy home page

**To Find Training:** Click on [Trainings](#) on the Academy home page

**To Register for Training:** Click on [Schedules & Registration](#) on the Academy home page

**To Sign Up for Study Groups:** Fill out the [Intake Assessment](#)

**For questions about coaching or study groups:** Email [GAcoaching@civstrat.com](mailto:GAcoaching@civstrat.com)

**To Find Other ECE Resources:** Visit the [DECAL Website](#)

**For General Questions about the Academy:** Email [thriving@decals.ga.gov](mailto:thriving@decals.ga.gov)

**For More Information:**

[Family Child Care Learning Home Rules and Regulations](#)

[Child Care Learning Center Rules and Regulations](#)

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