Fulbright & Fulbright, CPA, PA

Tax-Saving Tips

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Hire Your Child and Get Paid

You can pay your child to work in your business and get paid yourself for this arrangement. Sound too good to be true? The basic mechanics of this are (a) you deduct the wages and (b) your child pays zero or very little in income taxes. The three points below elaborate on this:

1. The child pays zero taxes on earnings up to the $6,350 standard deduction amount. Say you pay tax-deductible wages of $6,350. This reduces your taxes or gives you tax refunds. And the child pays no taxes.
2. The child can use the traditional IRA to avoid taxes on $5,500, for a total of $11,850 on which he or she can avoid taxes. You can pay this amount and reduce your taxes.
3. The child can use the 10 percent tax bracket, the standard deduction, and the traditional IRA so as to pay low taxes on earnings up to $21,175, while you reap the tax benefits of paying your child this much larger amount.

To get this right, you need to file a W-2 for the child, have him or her keep a time sheet, and create proof of a reasonable wage. And you will be happy to know that the IRS has approved employing children as young as seven years old.

Here's another benefit: If the child working for a parent is under age 18, both the child and the parent or parents are exempt from payroll taxes. In these cases, the parent operates a Schedule C business or both parents are the sole owners of a partnership.

Corporations are not parents. They do not qualify for this exemption from payroll taxes. Even so, corporate hires of the owner's children usually produce good tax benefits.

In summary, all business owners can achieve tax benefits by hiring their children, regardless of the type of business entity.

Claim a Tax Credit for Sending Your Child to Camp

You may be able to claim the child and dependent care credit if you pay expenses for the care of your under-age-13 child or another qualifying person to enable you (and your spouse, if filing a joint return) to work or look for work.

The tax credit is a percentage of the work-related expenses you paid during the year for the care of a qualifying person, such as your child under age 13. The cost of camps and before- and after-school programs qualifies for the credit if the camps are primarily for the protection and well-being of your child. On the other hand, the cost of overnight camps, summer schools, and tutoring programs does not qualify.

Although the credit is not large, it's free money. You would, and likely did, spend this money without regard to the credit. This means you have likely done all you need to do to claim the credit when it comes time for us to prepare your tax return.

Avoid Partnership Tax Filing with Two Little-Known Elections

You are probably aware that running a business often means filing a separate business tax return. But you may not be aware that for certain partnerships, you can avoid the separate return and report the activity directly on your individual tax return, such as for the three activities described below:

1. The qualified joint venture election is available if you and your spouse are the only partners. Under this election, you file no partnership returns and simply report the income and expenses on Form 1040, Schedule C. This does not work for spouse LLCs taxed as partnerships, except for those LLCs in community property states.
2. The Section 761(a) election is available for unrelated owners, but for only a limited set of activities, such as investment partnerships.
3. Rental properties aren't partnerships for federal tax purposes if you and your fellow owners have only to keep the property maintained, in repair, and rented or leased. This means you and your co-owners can report ownership interests on your personal tax returns without making a special tax election.

By reporting separately, you dramatically simplify your tax return filings and compliance requirements.

But keep in mind that the IRS examines more individual returns than partnership returns, so a higher chance of an audit is one potential downside to moving your activities to the individual return.

IRS Audits and Your Plan of Attack

As you grow your business and make more money, your chances of an IRS audit increase. For example, on an individual tax return, here are your chances of audit:

- One in 38 with $200,000 or more in income
- One in 10 with over $1 million in income
- One in three with over $10 million in income

So, what do you do if the IRS sends you an audit notice? First, you call us.

What will we do? This depends on whom you will face in the audit: a tax auditor or a revenue agent.

If the IRS wants you to come to its office, you likely will meet with a tax auditor. If you spend just a little time with us, you may be able to handle this by yourself, because tax auditors are not tax experts. Or if you simply don't want to talk to the IRS, we can represent you with or without your presence.

On the other hand, if the IRS wants to come to your office, expect a revenue agent. In this type of examination, you generally want us with you. We speak the same technical language as the revenue agent, and this helps ensure that you don't lose your rightful deductions.