

Make your kid a millionaire

"Use the Tax Code to make your newborn child money tax free or at least taxed-less"

First, let's crunch some numbers.

Call it the ultimate Christmas gift for your child or grandchild: a cool \$1 million.

It's a lavish gift, but not a prohibitively expensive one. A monthly contribution smaller than your current cable TV bill, made faithfully until the child turns 18 and then left to simmer until retirement, will hit seven figures without outlandish investment choices.

A newborn has nothing but time -- and that's something this strategy exploits to the fullest. Let's say a 30-year-old manages to save up and then invest a lump sum of \$10,000. At an annual return of 8%, by the time she's 65, that \$10,000 will have grown to nearly \$150,000. Not bad, right?

But then compare it to what a 5-year-old could make from the same \$10,000. The extra 25 years of growth would give him over \$1 million by age 65. A newborn would need just \$6,700, less than the cost of a decent used car.

If you don't happen to have \$10,000 handy, not to worry. You can get the same results with a monthly investment, made even smaller if you can persuade your child to keep the contributions up over the long haul.

Take a look at what's possible in the table below. All the examples presume 8% average annual growth, a reasonable return from a diversified mix.

To accumulate \$1 million by age 65:

Starting at:	One-time contribution	Monthly contribution until age 18	Monthly contribution until age 65
Birth	\$6,721	\$56	\$38
Age 5	\$9,875	\$98	\$57
Age 10	\$14,511	\$200	\$85
Age 15	\$21,321	\$662	\$127

Pretty neat, huh? I've heard from quite a few parents excited about the possibilities. Many believe their own financial futures were stunted by not investing early enough, and want their children to avoid the same mistake.

But there's a downside. While time can help the young grow a fortune, it can also magnify any investing mistakes made along the way. If that 5-year-old's account is traded excessively, charged high fees or invested too conservatively, the nest egg may be dramatically smaller.

If our youngster eked out only a 6% annual return over time, for example, his account would be worth just \$330,000 at retirement age.

Where do taxes fit into all of this? Well, first let's list some of the sections that will be utilized.

- ❑ Section 529 plans
- ❑ Roth IRA accounts
- ❑ Uniform Gift to minors
- ❑ Hiring your kids

Let's focus on hiring kids:

Psst. Want to lower your taxes, lure great employees, save more for the future and make your small business deliver a bigger bang for your whole household?

Hire the family.

What's the catch? *There isn't one.*

Hiring your kids is A-OK with the Internal Revenue Service. And if done with some forethought, it can contribute big time to both your family's financial health and your business's bottom line.

This is welcome news to the increasing number of Americans migrating to self-employment. Usually, they receive the bad news first: those many and sundry ways in which the little guy pays proportionately more for everything while the corporate giants pay proportionately less. Hiring the family may not exactly level the playing field, but it is something you can do legally that a corporation cannot.

Got your attention? Good. Here's the lowdown on why and how you should hire your family, today if possible.

The business case for employing family

Hiring the family makes sound business sense for a number of reasons:

- **Operations:** Family members can be a ready source of dedicated, trusted and inexpensive labor during your startup phase. They'll be more inclined to work odd hours, take up the slack and cheer you on as needed. They'll also be better prepared to succeed you.
- **Payroll:** If you're a sole proprietor, or if you and your spouse are the only principals in a partnership or **limited liability company**, you may save on some federal income taxes and state unemployment taxes. If you hire your children, you are relieved from withholding income taxes and paying payroll taxes, including Social Security, until the child turns 18. Also, you need not pay federal unemployment taxes until the child turns 21. If you hire your spouse or parents, you don't need to pay federal unemployment taxes on them either, though you must withhold federal income tax and pay FICA on them. Corporations are not allowed these tax breaks.
- **Income Splitting:** Spreading income over several family members increases the amount that is taxed at the lower tax brackets. This is especially true when hiring your children. Last year, you could have paid a child up to \$4,700 without either of you incurring a tax liability. A child's earning limit is adjusted annually for inflation, and mirrors the standard deduction amount for a single filer. (Your child may have to file a return, if he or she has investment income as well as wages.) Plus, you can deduct the compensation as a business expense, thus taking it off of your gross income. The same holds true for older parents who are in a lower tax bracket than you. Just make sure the compensation is reasonable for the services provided.
- **Insurance:** You can save plenty on health insurance and other benefits when you cover your family as employees. Not only will you qualify for broader plans at better rates, but you can write off the total cost of coverage as a business expense (vs. the 70 percent the feds currently allow the self-employed) and establish a tax-deductible reimbursement plan to write off medical expenses not covered by insurance.
- **Child care:** Uncle Sam allows you a maximum \$4,800 **credit for child care costs**. Why not hire your spouse and pay him or her the full amount of your child care as a fringe benefit? That way, you can deduct the total as a business expense and it's nontaxable to your spouse.
- **Savings Programs:** Once a child earns wages, they can establish an Individual Retirement Account, meaning they can tuck away \$3,000 (or as

much as they earn if it's less than that) in a tax-deferred account. Consider a [Roth IRA](#) if the kids are likely to want to tap their account early, say for college or a first home. Since taxes are already paid on money put into a Roth, there will be no tax due if it's taken out early, penalty-free, for IRS-allowable expenses. Even if they don't use the money before retiring, the long-term tax advantages of Roth are usually better for younger savers since all distributions can be taken out tax-free after age 59½.

- **Social Security:** Because a survivor's benefits under Social Security are only half the decedent spouse's benefits, it's a good idea to build up each spouse's Social Security earnings. Hiring a spouse, especially a non-working one, helps achieve this goal.

The IRS is generally encouraging to family hiring if you follow the rules.

The easiest way to flag the taxman is to pay an inordinate amount or pay for a fictitious job or compensate a family member who clearly could not perform the task. In addition, the money you pay them must be in their control. Otherwise, it's still considered yours.

That's the long way of saying be prepared with documentation in case you're [audited](#), or your family's incomes could boomerang right back onto your gross, at your tax bracket.

The key is to be very upfront, be very businesslike, If it's going to be business, it needs to be business. And the rules and procedures and policies need to be established and everybody needs to be clear about them. If not, there is a high probability that these things will lead to additional problems."

It is suggested that you actually interview your family hires as if they were non-relatives. Discuss what the job entails, short- and long-term goals, a pay range based on industry standards. Then draw up a written contract setting out what you've both agreed to. In addition, because you're family, it's important to agree upon exit strategies (should either side want out) and a means of resolving conflict.

Even if the IRS isn't as stringent with family businesses, I think it's really important for families to be, both in teaching the next generation and learning themselves how to settle things in a fair way and make arrangements between family members where money and work are concerned.

Informality is fine, but you should never be informal where business practices are concerned. They should be spelled out.

That's the hiring part, the rules and regulations your are to follow.

What's next? Well, first since now this is a business deduction you have saved a good bundle in taxes.

With the money you saved, You can start a section 529 education savings account for your child for future college education costs. These accounts put money away for college under special IRS rules tax deferred and are tax free when used for college expenses.

Next? The earnings your child makes can then be contributed to a Roth IRA. This will be covered in a separate report, but trust me when I say this. For a young child, this is a huge tax-savings vehicle to use.

There are rules to follow, but basically all the accumulation in this Roth IRA will be tax free income when your child receives distributions in the far future.

A win/win/win strategy by using a few IRS code sections and the time value of money will compound your child into a millionaire.

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