



WOODS  
FINANCIAL GROUP

# The Business Edition Newsletter

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## As the Owner of a Business....

You should be aware that you can save family income and payroll taxes by putting junior family members on the payroll. You may be able to turn high-taxed income into tax-free or low-taxed income, achieve social security tax savings (depending on how your business is organized) and even make retirement plan contributions for your child. In addition, employment of a child age 18 (or if a full-time student, age 19–23) may be a way to save taxes on the child's unearned income. In order for your business to deduct the wages as a business expense, the work done by the child must be legitimate and the child's salary must be reasonable.

For example, suppose a business owner operating as a sole proprietor is in the 35% tax bracket. He hires his 17-year-old daughter to help with office work full-time during the summer and part-time into the fall. She earns \$5,700 during the year (and doesn't have earnings from other sources). The business owner saves \$1,995.00 (35% of \$5,700) in income taxes at no tax cost to his daughter, who can use her \$5,700 standard deduction for 2009 or 2010 to completely shelter her earnings. The business owner could save an additional \$1,750 in taxes if he could keep his daughter on the payroll for a longer period and pay her an additional \$5,000. She could shelter the additional amount from tax by making a tax-deductible contribution to her own IRA. Family taxes are cut even if the child's earnings exceed his or her standard deduction and IRA deduction. That's because the unsheltered earnings will be taxed to the child beginning at a rate of 10%, instead of being taxed at the parent's higher rate.

Keep in mind that bracket-shifting works even if the child is subject to the kiddie tax. The kiddie tax only causes a child's investment income in excess of \$1,900 for 2009 or 2010 to be taxed at the parent's marginal rate. It has no impact on the child's wages and other earned income, which can be sheltered by the child's standard deduction. The kiddie tax applies to a child who is age 18 or a full-time student age 19 through 23, if the child's earned income for the year doesn't exceed one-half of his or her support. Thus, employing a child age 18 or a full-time student age 19–23 could also help to avoid the kiddie tax on his or her unearned income. For children under age 18, there is no earned income escape hatch from the kiddie tax. But in all cases, earned income can be sheltered by the child's standard and other deductions, as noted above, and earnings in excess of allowable deductions will be taxed at the child's low brackets.

**Social Security tax savings too.** If your business is not incorporated, you can also save some self-employment (i.e., social security) tax dollars by shifting some of your earnings to a child. That's because employment for FICA tax purposes doesn't include services performed by a child under the age of 18 while employed by a parent. For example, let's say a sole proprietor who usually takes \$120,000 of earnings from the business pays \$5,700 to her 17-year-old child in 2009 or 2010. The sole proprietor's self-employment income would be reduced by \$5,700, saving her \$165.30 (the 2.9% HI portion of the self employment tax she would have paid on the \$5,700 shifted to her daughter). This doesn't take into account a sole proprietor's income tax deduction for one-half of his or her own social security taxes.

A similar but more liberal exemption applies for FUTA, which exempts earnings paid to a child under age 21 while employed by his or her parent. The FICA and FUTA exemptions also apply if a child is employed by a partnership consisting solely of his parents. Note that there is no FICA or FUTA exemption for employing a child if your business is incorporated or a partnership that includes non-parent partners. However, there's no extra cost to your business if you're paying a child for work you'd pay someone else to do, anyway.

**Retirement benefits.** Your business also may be able to provide your child with retirement benefits, depending on the type of plan it has and how it defines qualifying employees. For example, if it has a simplified employee pension, a SEP contribution can be made for the child up to 25% of his or her earnings but the contribution cannot exceed \$49,000 for 2010 (and 2009). The child's participation in the SEP won't prevent the child from making tax-deductible IRA contributions as long as adjusted gross income (computed in a special way) is below the level at which deductions for IRA contributions begin to be disallowed. For 2010, that figure is \$56,000 for a single individual (\$55,000 for 2009).

If you have any questions about how these rules apply to your particular situation, please don't hesitate to call. Also keep in mind that some of the rules about employing children (such as the maximum amount they can earn tax-free) change from year to year, and may require your income shifting strategy to change, too.

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## Ohio: 2011 minimum wage increase

Ohio's minimum wage is set to increase by 10 cents per hour to \$7.40 at the beginning of 2011. Officials at the Ohio Department of Commerce said, that the increase is part of a constitutional amendment voters approved in 2006, which says minimum wage will increase each year at the rate of inflation. The \$7.40 rate applies to workers 16 and older who don't get tips. The wage for tipped employees will be \$3.70 per hour, a five cent increase. The wage will be required by employers who gross more than \$271,000 annually, up from the current \$267,000. For employees at smaller companies, and for 14 and 15-year-old workers, the minimum wage is set to match the federal minimum wage, currently \$7.25 per hour.

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## New 1099 reporting requirement

Despite major efforts from the Ohio Society of Certified Public Accountants and many leaders in Washington, D.C., Congress is not likely to repeal the overly burdensome 1099 requirements contained in health care reform. The requirement remains that businesses and rental property owners must provide 1099 forms to any payments to contractors for services or vendors for products purchased in the amount of \$600 or more for the year 2011. You will need to provide a W-9 form to all of your contractors and vendors before making any payment to them in 2011. Contact our office to obtain the address of your congressman and senator along with a sample letter, so that you can write to encourage them to enact legislation to repeal this burdensome record keeping requirement.

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## Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010

On December 17, 2010, President Obama signed new legislation that changed your payroll withholding for all employees. Effective with any payroll checks issued in 2011 (regardless of when the pay was earned) the employee portion of the FICA liability will be reduced from 6.2% to 4.2%. This will only apply to the employee share, not the employer share of the FICA. The Medicare percentage will remain at 1.45% for both the employee and employer. If you are currently calculating your own 941 deposit amounts you will need to remember that for 2011 you can no longer double the FICA withholding in your calculation. You may wish to consider having our firm prepare your payroll checks in 2011.

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## Why is 100% Correct Important?

If 99.9% is good enough, then....

- ✦ 12 newborns will be given to the wrong parents daily.
- ✦ 14,500 mismatched pairs of shoes will be shipped this year.
- ✦ 18,322 pieces of mail will be mishandled this year.
- ✦ 2,000,000 documents will be lost by the IRS this year (probably more).
- ✦ 2.5 million books will be shipped with the wrong covers.
- ✦ Two planes landing at Chicago's O'Hare airport will be unsafe every day.
- ✦ 315 entries in the Webster's Dictionary will be misspelled.
- ✦ 20,000 incorrect drug prescriptions will be written this year.
- ✦ 880,000 credit cards in circulation will turn on to have incorrect cardholder information on their magnetic strips.
- ✦ 103,260 income tax returns will be processed incorrectly during the year.
- ✦ 5.5 million cases of soft drinks produced will be flat.
- ✦ 291 pacemaker operations will be performed incorrectly.
- ✦ 3,056 copies of tomorrow's Wall Street Journal will be missing one of the three sections.

**In summary, if you don't have time to do it right, when will you have time to do it over?**

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## Have you told your business networks about your accountant?

Effective July 1, 2010, we have implemented a Business Referral Program at Woods & Woods Associates, Ltd. If you refer a business to our firm for accounting or payroll services you will receive a gift card with an amount equal to their first monthly or quarterly service fee as a token of our appreciation. But it does not stop there! We will continue to recognize the referral every year for the next 5 years your referral associate remains with our firm. When you mention our firm to an associate, please give us a call to let us know the name of the person you referred. We want to make certain you get the credit you deserve.

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