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2018 Last-Minute Year-End Tax Strategies for Marriage, Kids, and Family

Are you getting married or divorced? If so, you need to know the year-end rules that apply in case you want to grab some extra tax savings this year.

If you have children under the age of 18 and file your tax return as a proprietorship or partnership, you can find big savings in the work your children do for your business.

And if you operate as a corporation, don't neglect to hire your children; there are good savings for you there, too.

In this article, you will find five year-end tax-deduction strategies that apply if you are getting married or divorced, have children who did or could work in your business, and/or have situations where you give money to relatives and friends.

1. Put Your Children on Your Payroll

Did your children under age 18 help you in your business this year? Did you pay them for their work?

You should pay them for the work—and pay them on a W-2.

Why? **First,** W-2 wages paid by the parent to the parent's under-age-18 child for work done on the parent's Form 1040 Schedule C business are both[1]

- deductible by the employer-parent, and
- exempt from federal payroll taxes for both the parent and the child.

Thus, if you operate your business as a sole proprietorship or single-member LLC taxed on Schedule C or as a spousal partnership, then you face no federal payroll taxes on the W-2 wages you pay your under-age-18 child. (And in most states, you also face no state payroll taxes.) Further, your child faces no federal payroll taxes.

If you operate as a corporation, your child and the corporation pay payroll taxes. But that does not eliminate the benefits; it simply reduces them.

To see the benefits of hiring your child in your business regardless of the type of business, see Tax Reform Increases the Tax Benefits of Employing Your Child.

Second, thanks to tax reform, your child can use the 2018 standard deduction to eliminate income taxes on up to $12,000 in wages.[2]

Third, your child can contribute up to $5,500 to either of the following:

1. **A tax-deductible IRA,** and deduct that amount from federal taxation. This is the best strategy to use if the child has more than $12,000 in W-2 wages and you want the child to have more tax-free money.[3]

2. **A Roth IRA,** which is not tax-deductible, but the child can (a) remove the contributions (money put in) at any time, tax- and penalty-free, and (b) remove the earnings tax-free after age 59 1/2.[4] This is the best strategy to use if the child has less than $12,000 in total W-2 wages and other earned income, because the child has no need for a tax deduction.

Example. Your child is age 14, and she has no earned income other than what she earns from your sole proprietorship business. You pay her, as W-2 income, $11,800 in fair market wages for work she actually does during the year. You deduct the $11,800 and pocket $4,366 because of your 37 percent federal income tax bracket.

Your daughter collects the $11,800 and pays zero taxes to the federal government because

- she is exempt from federal payroll taxes, and
- the $12,000 standard deduction eliminates the $11,800 from her taxable income.

She can then put up to $5,500 in a Roth IRA and begin saving for her retirement, college, or other financial goals.

Your family unit retains the $11,800 and also has $4,366 in additional spendable cash thanks to the tax deduction.

Key point. To avoid payroll taxes, the wages paid by the parent to the child must be on a W-2. If you use a 1099, your recipient child pays self-employment taxes on the 1099 income.

Corporation. If you operate your business as a C or an S corporation, the corporation does the hiring; therefore, both your corporation and your child pay payroll taxes. This is not a deal breaker for the strategy, but it does reduce the net family benefit.

The payroll taxes are also a negative for the corporation when you’re comparing the corporation with the proprietorship as a possible choice of business entity.

For additional insights into the benefits of hiring your child, see Get Paid: Hire Your Child. Also, see Use Business Tax Deductions to Build Your Child's College Fund for how the Roth IRA enhances this strategy when the child has no taxable income because his or her earned income is less than the standard deduction.

Kiddie-tax note. The nasty kiddie tax does not apply to the child's wages and other earned income. The kiddie tax applies to unearned income, such as dividends, interest, and rents—not W-2 income.

2. Get Divorced after December 31

The marriage rule works like this: you are considered married for the entire year if you are married on December 31.[5]

Although lawmakers have made many changes to eliminate the differences between married and single taxpayers, in most cases the joint return will work to your advantage. Thus, wait until next year to finalize the divorce if alimony is not involved.

Warning on alimony! The Tax Cuts and Jobs Act (TCJA) changed the tax treatment of alimony payments under divorce and separate maintenance agreements executed *after December 31, 2018*:[6]

- Under the old rules, the payor deducts alimony payments and the recipient includes the payments in income.
- Under the new rules, which apply to all agreements executed after December 31, 2018, the payor gets no tax deduction and the recipient does not recognize income.

If alimony is on the table in your pending divorce, it may be too late to do any planning. But just in case, read this article now: Divorce? Alimony? Tax Reform Says Get Divorced Now—Don't Wait.

Forgetting about alimony, the only way to know the true impact of being married before or after December 31 is to run the taxes in a before-and-after scenario. True, that's an inconvenience, but it can produce a most worthwhile result.

And if you are married on December 31, don't file in April as married, filing separately. In most cases, this is a sure way to overpay your taxes.

3. Being Single to Increase Mortgage Deductions

Two single people can deduct more mortgage interest than a married couple, as we explain in Do New Rules Allow You to Double Your Mortgage Interest Deductions?

If you own a home with someone other than your spouse, and you bought it on or before December 15, 2017, you individually can deduct mortgage interest on up to $1 million of a qualifying mortgage.

For example, if you and your unmarried partner live together and own the home together, the mortgage ceiling on deductions for the two of you is $2 million. If you get married, the ceiling drops to $1 million.

If you bought your house after December 15, 2017, then the reduced $750,000 mortgage limit from the TCJA applies. In that case, your maximum deduction goes down to $1.5 million.[7]

4. Get Married on or before December 31

Remember, if you are married on December 31, you are married for the entire year.

If you are thinking of getting married in 2019, you might want to rethink that plan for the same reasons that apply in a divorce (as described above). The IRS could make big savings available to you if you are married on December 31, 2018.

Again, you have to run the numbers in your tax return both ways to know the tax benefits and detriments for your particular case. A quick trip to the courthouse may save you thousands.

5. Make Use of the 0 Percent Tax Bracket

In the old days, you used this strategy with your college student. Today, this strategy does not work with the college student, because the kiddie tax now applies to students up to age 24.[8]

But this strategy is a good one, so ask yourself this question: Do I give money to my parents or other loved ones to make their lives more comfortable?

If the answer is yes, is your loved one in the 0 percent capital gains tax bracket? The 0 percent capital gains tax bracket applies to a single person with less than $37,650 in taxable income and to a married couple with less than $75,300 in taxable income.[9]

If the parent or other loved one is in the zero capital gains tax bracket, you can get extra bang for your buck by giving this person appreciated stock rather than cash.

Example. You give Aunt Millie shares of stock with a fair market value of $20,000, for which you paid $2,000. Aunt Millie sells the stock and pays zero capital gains taxes. She now has $20,000 in after-tax cash to spend, which should take care of things for a while.

Had you sold the stock, you would have paid taxes of $4,284 in your tax bracket (23.8 percent times the $18,000 gain).

Of course, $6,000 of the $20,000 you gifted goes against your $11.18 million estate tax exemption if you are single.[10] But if you're married and you made the gift together, you each have a $15,000 gift-tax exclusion, for a total of $30,000, and you have no gift-tax concerns other than the requirement to file a gift-tax return that shows you split the gift.

Takeaways

If you have children under the age of 18 and you operate your business as a Schedule C sole proprietor or as a spousal partnership, you absolutely need to consider having that child on your payroll. Why? First, neither you nor your child would pay payroll taxes on the child's income. Second, with a traditional IRA, the child can avoid all federal income taxes on up to $17,500 in income.

If you operate your business as a corporation, you can still benefit by employing the child even though you and the child have to pay payroll taxes.

If you are getting divorced or married, make sure to consider the mortgage ceiling available to singles co-owning homes as well as the new alimony rules that take effect after December 31, 2018. Keep December 31 front of mind. If you are married on that date, you are married for the year, and being married affects your taxes.

To know for sure what dollar effect marriage has, positive or negative, run the numbers through a tax return or have your tax professional do this for you.

The fifth strategy in this article asked you to look at family and friends to whom you give money and explained how, in the right circumstances, you can give those recipients stock and have them take advantage of their zero capital gains tax bracket.

Client Letter on This Article for Use by Tax Pros. Click Here.

1 IRC Sections 3121(b)(3)(A); 3306(c)(5).
2 IRC Section 63(c)(7)(A)(ii) 2018.
3 IRC Section 219(b)(5)(A); Notice 2017-64.
4 IRC Section 408A; Notice 2017-64.
5 IRC Section 7703(a).
6 Public Law 115-97, Sec. 11051(b)(1)(B), (c); IRC Sections 71, 215.

7 IRC Section 163(h)(3)(F)(i)(II).
8 IRC Section 152(c)(3)(A)(ii).
9 Rev. Proc. 2015-53.
10 IRC Section 2503(b) and IRC Section 2010, both of which were adjusted for inflation by Rev. Proc. 2018-18.