News from the Hill

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Managing a Family Business

Many of us think of AEA and its members as one big family; which, of course, makes the AEA Annual Convention a wonderful family reunion. And like most extended families, our family is made up of smaller family units: the member companies and their employees. But many AEA member companies really are families, with the businesses being handed down from one generation to the next.

Keeping the business in the family is an excellent way to hand down skills from one generation to the next. Handled properly, this sort of approach can also help to invigorate the business with fresh ideas from the next generation. It is also an excellent way to keep the assets associated with a small avionics shop 'in the family.' This month, we talk about some of the laws that affect family businesses.

Employ Your Children

Do you employ a family member? Employing a family member can mean more than just promoting family unity. It can also reflect an opportunity for tax savings.

One obvious benefit to employing a family member is that it permits you to transfer money from your business to the family member in a tax-beneficial way. The wages you pay to a family member are generally treated as deductible business expenses for the company (just as any other wages would be treated).

But like anything else in life, there is a wrong way and a right way to do this. Wages should be objectively reasonable; for example, don't pay your child a salary of $400,000 to do the same exact thing for which someone else is paid $40,000. Unreasonable wages could be recharacterized in an unfavorable manner by the IRS.

You can hire your younger children to do work, but be sure to comply with the child labor laws. Child labor laws generally protect all workers under the age of 18 and are meant to shield minors from a variety of workplace dangers, as well as to protect the child's opportunity to obtain an education. There are both federal and state laws that apply in this area.

State laws vary, so you should be sure to check with your local state labor authority to get the details, but some common laws include

1) Minimum Age: The Fair Labor Standards Act (FLSA) sets 14 years of age as the minimum age for employment, and limits the number of hours worked by minors under the age of 16 (14 and 15-year-olds may only work 3 hours per day and up to 18 hours per week whiles school is in session, and 8 hours a day / 40 hours per week while school is out of session). Minimum age requirements do not apply to minors employed by their parents, or by a person acting as their guardian, although the minimum age requirement of 18 years old applies to hazardous jobs like logging or mining, as well as to the use of powered equipment in the shop (so keep the kids away from the band saw). There is a limited list of occupations in which 14 to 15-year-olds may work and it appears that an avionics shop may be outside the scope of that list (although your own children may work for a business that you wholly own. State law may further restrict child labor.

2) Permit requirement: some states require that minors must get a work permit - this may be issued by the school – before starting any job. Again, this may not apply to work in a parent-owned facility.

3) Hours limitations: There may be state laws limiting the number of hours per day or per week that a child can work.

4) Time limitations: There may be state laws limiting the times that a child can work (for example, a child under the age of 18 may not work past 11 pm, and a child under the age of 16 may not work past 7 pm on a school night or 9 pm on a non-school night). This usually precludes you from working your children on the third shift!

You can find information on state child labor laws on the internet at http://www.dol.gov/esa/programs/whd/state/state.htm.

Employment Taxes for Family Members

If you have decided to employ your own child in your avionics shop, then you can look forward to some other benefits, besides the family bonding and the important work experience your child will gain.

Normally, the business is responsible for paying Federal Income Contributions Act (FICA) and Federal Unemployment Tax (FUTA) payroll taxes for all employees. FICA covers the social security and medicare payments made for all workers. FUTA pays for the federal administration of unemployment programs.

There is an exception to the general rule for FICA and FUTA when you employ your own children. You do not have to pay FUTA tax for compensation paid to your child if he or she is under the age of 21. You do not have to pay FICA taxes on compensation paid to your child if he or she is under the age of 18, so long as the business is completely owned by you and/or your spouse. These exceptions DO NOT apply if you are only the part owner of the business.

Another important note concerning your child's taxes. If your child has no unearned income (dividend income or interest) then you do not have to withhold federal income taxes from the pay unless the annual pay exceeds the federal standard deduction. The standard deduction for tax year 2005 was $5,000, although this amount gets adjusted every year. Thus, children who are paid less than $5,000 (or whatever the standard deduction is, as adjusted from year to year) will not need to pay any income tax on their earnings.

This equation will change if the child has unearned income (like dividend income or interest) exceeding $250. Children with more than $250 unearned income and more than $750 total income must have their taxes appropriately withheld.

Be sure to have your child complete a W-4 employee's withholding allowance certificate. Also, if you pay your child $600 or more in one year, then you need to issue the child a W-2 for wage reporting purposes (so the government can track the earnings).

Estate Planning

If your children have grown up in the business, then there is a good chance that one or more of them may want to take it over from you when you are ready to retire. You can never start too early in engaging in estate planning.

Of course, estate planning can be particularly difficult in the current legal environment. One of the greatest impediments to passing a family business from one generation to the next can be estate taxes (known in some circles as the "death tax"). Estate taxes are currently scheduled to sunset in 2010 under the tax relief plans in place. But under current law, those same estate taxes will return to pre-tax-relief levels in 2011. Legislation extending this sunset, or even making it permanent has been stalled in Congress because of political issues associated with estate taxes.

Supporters of estate taxes suggest that only the wealthy, who can best afford to pay such taxes, will pay them. Estate tax repeal proponents cite statistics showing that a large chunk of estate taxes are actually paid by families seeking to retain a family business, and that estate taxes are a major factor in preventing family businesses and family farms from passing from one generation to the next. Whether you agree with tax proponents or repeal proponents, the fact remains that the estate tax has a murky future, and this makes estate tax planning difficult.

If you are planning for estate tax to impact your business, then strategies can include assuring adequate liquid assets to pay estate tax liabilities, maintaining insurance policies calculated to pay the estate tax burden, or ways of structuring the bequest of the business.

The best advice is to spend some time with a tax lawyer or a tax accountant who is qualified to help you make estate planning decisions. There are many fact patterns that can affect the optimal way to protect your family business. ❑