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## Special Federal Payroll Tax Rules Applicable to Family Members

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Since hiring family members is common practice, it is important for business owners to understand payroll tax rules that apply to their specific situation. The IRS has defined a family member for purposes of these rules as a spouse (including legally married same sex spouses), lineal descendants (sons and daughters), and ancestors. Generally, a family employee is treated like any other employee for payroll tax purposes. Their services are subject to federal income tax withholding (FITW), social security and Medicare (FICA), federal unemployment tax (FUTA), and possibly various state and city taxes. However, there are certain circumstances that allow a family member's wages to be exempt for FICA or FUTA purposes.

Application of the family employment rules varies depending on the form of business being operated and the specific family member employed. The rules by entity type are as follows:

1. **Sole Proprietorship** – In this situation income and expenses are reported by the sole proprietor on Schedule C of their 1040. Wages paid to family members are exempt from FICA and/or FUTA in the following instances:
  - a. Lineal Descendants – wages of a son or daughter are exempt from FICA as long as they are under the age of 18 and exempt from FUTA if they are under the age of 21.
  - b. Spouse – wages of a spouse are exempt from FUTA.
  - c. Ancestors – wages of a father or mother are exempt from FUTA.
2. **Family Corporation** – In this situation, no special rules apply to family members. All employee services, including employee services by family members, are covered employment for FITW, FICA, and FUTA.
3. **Family Partnership** – In this situation, each family member is covered for FICA and FUTA unless:
  - a. the son or daughter is under the age of 18 for FICA purposes and/or under the age of 21 for FUTA purposes.
  - b. the parents are the only partners in the partnership.

Clearly, hiring family members can be more advantageous from a payroll tax standpoint than hiring someone who is unrelated. Since there are potential tax savings for both the employer and employee, the overall cost of employing

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them would be lower and their net pay would be greater. As you can see, payroll tax rules that apply to family members can be complex. Zinner & Co. LLP wants to ensure that you understand these rules so that you are not paying unnecessary payroll taxes. Please contact us for additional details and professional guidance.

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