

EMPLOYED FAMILY MEMBERS COME UNDER SCRUTINY

Recent changes in pension law are making it more attractive than ever for a business owner to employ his or her spouse or children. Under the new rules, an employee can make an elective deferral to a section 401(k) plan of up to the lesser of \$15,500 or 100% of compensation. If a spouse is placed on the payroll, paid at least \$15,500, and committed to participate in a section 401(k) profit sharing plan, it may be possible for the family to contribute another \$15,500 to the retirement plan without any increasing the cost of benefits for rank-and-file employees.

There is certainly nothing wrong with employing family members and providing them with reasonable compensation. However, compensation is only deductible if reasonable and is for services actually rendered. The Internal Revenue Service has stated that it will closely scrutinize payments of compensation to family members. Therefore, we recommend to all of our clients who employ family members to carefully document the nature and amount of work performed by the family members.

At a minimum, time records should be maintained. While such records are generally not required with respect to employees who serve any management position, records should nevertheless be kept for family members regardless of the nature of their duties. Additionally, a written log of the services performed by the family member, if prepared on a contemporaneous basis, will provide good evidence to refute an unreasonable compensation claim.