

Husband and Wife Businesses

One of the advantages of operating your own business is hiring and/or working with family members. However, the employment tax requirements for family employees may vary from those that apply to other employees. Below, the IRS points out some issues to consider when operating a "Husband and Wife Business."

HOW SPOUSES EARN SOCIAL SECURITY BENEFITS

OTHER KEY ISSUES: Employee or Partner? File a Schedule C or a Form 1065?

A spouse is considered an **EMPLOYEE** if there is an employer/employee type of relationship, i.e., the First spouse substantially controls the business in terms of management decisions and the Second spouse is under the direction and control of the first spouse.

If such a relationship exists, then the second spouse is an employee subject to Income Tax and FICA withholding.

However, if the second spouse has an equal say in the affairs of the business, provides substantially equal services to the business, and contributes capital to the business, then a **PARTNERSHIP** type of relationship may exist and the business's income would be reported on Form 1065, "U.S. Return of Partnership Income." (However, read the following...)

IF BOTH SPOUSES CARRY ON THE SAME BUSINESS...

The Small Business and Work Opportunity Tax Act of 2007 (effective for all tax years beginning on or after Jan. 1, 2007) changed the treatment of "Qualified Joint Ventures" of married couples *not* treated as business *Partnerships*. Here's what's new...

The provision generally permits a **Qualified Joint Venture** whose only members are a husband and wife filing a joint return not to be treated as a partnership for Federal tax purposes. A **Qualified Joint Venture** is a joint venture involving the conduct of a trade or business, if:

1. the only members of the joint venture are a husband and wife,
2. both spouses materially participate in the trade or business, and
3. both spouses elect to have the provision apply.

IMPORTANT CHANGE created by this Act:

A **Qualified Joint Venture** conducted by a **Husband and Wife** who file a Joint Tax Return is **NOT** treated as a **PARTNERSHIP** for Federal tax purposes.

All items of Income, Gain, Loss, Deduction and Credits are divided between the spouses in accordance with their respective interests in the venture.

i.e., If the spouses agree that the First spouse did 70% of the work, and the Second spouse did 30%, the First spouse would account for 70% of all Income, Gain, Losses, Deductions and Credits on the First spouse's Schedule C, and the Second spouse would account for the other 30% on a *separate* Schedule C, and both are filed with their Joint Tax Return.

To determine net earnings from self-employment, each spouse's share of income or loss from a Qualified Joint Venture is taken into account, the same as for Federal income tax purposes (i.e., in accordance with their respective interests in the venture).

This generally does not increase the total tax on the return, but it does give each spouse credit for social security earnings, on which retirement benefits are based (unless either spouse exceeds the social security tax limitation).

For more information on **SELF-EMPLOYMENT TAXES**, refer to **Publication 553, Highlights of 2007 Tax Changes**.

For more information on **QUALIFIED JOINT VENTURES**, refer to **Election for Husband and Wife Unincorporated Businesses**

IF ONE SPOUSE IS EMPLOYED BY THE OTHER...

If your spouse is your **EMPLOYEE**, *NOT* your **PARTNER**, you must pay Social Security and Medicare taxes for him or her. The wages for the services of an individual who works for his or her spouse in a trade or business are subject to income tax withholding and Social Security and Medicare taxes, but not to FUTA tax. (See Pub 15, Circular E, 'Employer Tax Guide')