

Personnel and Compensation Tax Info Sheet (2010)

EMPLOYMENT LAWS

Any new employer will need to become familiar with a multitude of labor laws and regulations, including:

- Immigration Reform and Control Act of 1986.
- Civil Rights Act (Title VII on employment discrimination).
- Equal Employment Opportunity Act.
- National Labor Relations Act.
- Fair Labor Standards Act.
- Employee Retirement Income Security Act (ERISA), Pension Reform Act of 1974.
- Consolidated Omnibus Budget Reconciliation Act (COBRA).
- Occupational Health and Safety Act.
- Right-to-Know Chemical Act.
- Federal Rehabilitation Act of 1973.
- Age Discrimination in Employment Act.
- Drug Free Workplace Act of 1988.
- Vietnam Era Veterans Readjustment Assistance Act of 1974.
- Worker Adjustment and Retraining Notification Act of 1988.
- Americans with Disabilities Act of 1990.
- Family Medical Leave Act of 1993.
- Equal Pay Act.
- Fair Minimum Wage Act of 2007.
- Section 3001 of the American Recovery and Reinvestment Act of 2009—premium assistance for COBRA benefits (and subsequent extension of benefits under the 2010 Defense Act and the Continuing Extension Act of 2010).
- Hiring Incentives to Restore Employment (HIRE) Act.
- Patient Protection and Affordable Care (Health Care) Act.

The Department of Labor website (www.dol.gov) includes a wealth of information for employers. It also includes information on various state labor laws.

New business owners should consider conferring with an employment lawyer for advice on the many labor laws and regulations.

ADVANTAGES OF HIRING CHILDREN IN THE FAMILY BUSINESS

Income Shifting. The business owner deducts reasonable compensation paid to the child and the child receives and reports earned income from compensation, which is often taxed at a lower rate than the business income would have been. A child claimed as a dependent is entitled to a standard deduction equal to the greater of \$950 or earned income plus \$300, up to a maximum of \$5,700 for 2010.

Fringe Benefits. The child-employee may be eligible to participate in employer-sponsored fringe benefit arrangements (that is, health and disability insurance, employer-provided vehicle for business travel).

Payroll Tax Exemption. Wages and compensation paid by a sole proprietorship (or partnership, if the parents of the child are the only partners) to the proprietor's (or partner's) child who is under age 18 are exempt from FICA payroll taxes. Similarly, this compensation is exempt from federal unemployment tax if the child of the proprietor (or partner) is under age 21. However, federal income tax withholding will apply unless the child can claim an exemption from withholding.

Individual Retirement Account (IRA) Opportunity. Earned income paid to the child enables the child to fund an IRA contribution [up to the lesser of \$5,000 (for 2010) or 100% of earned income]. Usually, the child will qualify to make a deductible contribution to a traditional IRA since he is either not covered by an employer retirement plan or his income is beneath a certain level. A Roth IRA, which potentially allows all earnings to be tax-free, may be another attractive option for a child, due to the child's long horizon for saving. The ability to compound income either tax-deferred or tax-free for many years is a powerful way to build wealth.

ADVANTAGES OF INDEPENDENT CONTRACTOR STATUS

By hiring independent contractors, rather than employees, a business:

- Would not have to withhold federal, state or local income taxes;
- Would not have to withhold and pay matching FICA taxes;
- Would not have to pay federal and state unemployment or disability taxes;
- Would not have to meet federal and state overtime or minimum wage laws;
- May exclude the workers from retirement plans and fringe benefits; and
- May exclude the workers from workers' compensation coverage.

EMPLOYER STOCK OPTIONS

A stock option is a contractual right granted an employee to purchase shares of the company's stock under a formal plan. The plan normally specifies how many options may be granted, who may participate, the option price, the form of payment, the periods for exercising options and making payment, and other matters.

Stock Option Terminology

Grant Date	The date on which an employee receives an option.
Exercise Date	The date when the employee exercises the option to buy stock.
Strike Price	The price at which the stock can be purchased under the terms of the option.
Bargain Element	The difference between the fair market value (FMV) of the stock and the strike price.
Even-Money	When the strike price equals the FMV of the stock.
In-the-Money	When the strike price is less than the FMV of the stock.
Under Water	When the strike price is greater than the FMV of the stock.
Vested	No restrictions on transferability.
Vesting	Attaining the right to exercise options because service or other requirements have been met.
Incentive Stock Options (ISOs)	Also called qualified stock options, they must meet certain statutory requirements. Generally, an ISO benefits the employee by allowing for capital gains taxation on the future appreciation of the underlying stock.
Nonqualified Stock Options (NQSOs)	Not subject to any specific statutory rules. They generally create compensation income for the employee and an offsetting deduction for the employer upon exercise.

Tax Implications of Incentive Stock Options (ISOs)

- Neither the grant nor the exercise of an ISO creates compensation income to the employee, but the employee may have an alternative minimum tax adjustment upon exercise.
- The exercise price becomes the purchase price and the employee's basis in the acquired stock.
- The employee recognizes taxable income or loss when the stock acquired through the option's exercise is disposed of.
- The character of the income (ordinary versus capital gain) from the sale of the ISO shares depends on whether the sale is a qualifying or disqualifying disposition.