

Tax Advantages of Putting Your Spouse on the Payroll

Following is a review of some of the tax pros and cons of putting your spouse on the payroll.

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1. Medical insurance

If your business is operated through a sole proprietorship, putting your spouse on the payroll will allow you to fully deduct health insurance premiums. You can accomplish this by setting up a health insurance plan for all employees (e.g., your spouse). The cost of the medical insurance is a tax deduction for the business. The medical insurance covers the employee, the employee's spouse (you) and the employee's dependents (your children). Generally, a self-employed can only deduct 40% (for 1997) of medical insurance premiums. Thus, putting your spouse on the payroll increases your tax deduction for medical insurance premiums from 40% of their cost to 100% of their cost.

2. Business trips

If you take business trips, you are not allowed to deduct your spouse's expenses, no matter how vital or important he or she is to the success of the trip, unless your spouse is a bona fide employee of your business.

3. Avoid double tax

If you do business through a C (regular) corporation, paying a salary to a spouse allows you to take earnings out of the corporation without paying a double tax. For example, if money is taken out of a C corporation via a dividend, a tax is paid on the original earnings by the C corporation and a second tax is paid by the shareholder when the dividend is received. Whereas, money taken out of a C corporation as salary is taxed only once - to the wage earner.

4. Social security

If your spouse isn't currently working or is not earning the social security maximum, collecting a salary from your business will increase his or her future social security benefits.

5. Increased pensions

Generally, only the first \$160,000 (indexed for inflation) of salary can be taken into account when computing allowable contributions to most qualified retirement plans. If your salary is more than that, putting your spouse on the payroll and shifting some of your salary, in excess of \$160,000, to your spouse will increase your combined retirement contributions.

CAUTION! TAX TRAP

If you put your spouse on the payroll you have to pay payroll taxes on the additional salary. Payment of payroll taxes will offset some of the benefits gained by putting your spouse on the payroll. You can't just put your spouse on the payroll. Your spouse must perform legitimate work for the business. The IRS can challenge any salary deductions on the basis that it's not reasonable.