

Hiring your spouse

Q. I have a professional services firm and am considering hiring my wife to help out with some of the administrative tasks in the office. I don't think we'll have a problem working together but I would like to have more information about the tax aspects of such an arrangement before I make the leap. What are some of the tax advantages of hiring my spouse?

A. Small business owners have long adhered to the practice of hiring family members to help them run their businesses -- results have ranged from very rewarding to absolutely disastrous. From a purely financial aspect, however, it is very important for you as a business owner to consider the tax advantages and potential pitfalls of hiring -- or continuing to employ -- family members in your small business.

Keeping it all in the family

Pay your family -- not Uncle Sam. Hiring family members can be a way of keeping more of your business income available for you and your family. The business gets a deduction for the wages paid -- as long as the family members are performing actual services in exchange for the compensation that they are receiving. This is true even though the family member will have to include the compensation received in income.

Some of the major tax advantages that often can be achieved through hiring a family member -- in this case, your spouse -- include:

Health insurance deduction. If you are self-employed and hire your spouse as a bona fide employee, your spouse -- as one of your employees -- can be given full health insurance coverage for all family members, including you as the business owner. This will convert the family health insurance premiums into a 100% deductible expense.

Company retirement plan participation. You may be able to deduct contributions made on behalf of your spouse to a company sponsored retirement plan if they are employees. The tax rules involved to put family members into your businesses retirement plan are quite complex, however, and generally require you to give equal treatment to all employees, whether or not related.

Travel expenses. If your spouse is an employee, you may be able to deduct the costs attributable to her or him accompanying you on business travel if both of you perform a legitimate business function while travelling.

IRA contributions. Paying your spouse a salary may enable them to make deductible IRA contributions based on the earned income that they receive, or Roth contributions that will accumulate tax-free for eventual tax-free distribution.

"Reasonable compensation"

In order for a business owner to realize any of the advantages connected with the hiring family members as discussed above, it is imperative for the family member to have engaged in bona fide work that merits the compensation being paid. Because this area has such a high potential for abuse, it's definitely a hot issue with the IRS. If compensation paid to a family member is deemed excessive, payments may be reclassified as gifts or as a means of equalizing payments to shareholders.

As you decide on how much to pay your spouse working in your business, keep in mind the reasonable compensation issue. Consider the going market rate for the work that is being done and pay accordingly. This conservative approach could save you money and headaches in the event of an audit by the IRS.

Hiring your spouse can be a rewarding and cost effective solution for your small business. However, in order to get the maximum benefit from such an arrangement, proper planning should be done. For additional guidance, please feel free to contact the office.