Hiring Your Spouse

by Quenda Behler Story

Admit it: Your wife helps you run your business. I know because I've been there. For years, I answered the phone for my husband's carpentry business, kept the books, typed the estimates, and scheduled the subs. I even went to the lumberyard to pick up materials and to the site to pick up trash.

These are all tasks that you could do yourself, but that would leave you less time to bang nails or sell new jobs. The other alternative is to hire someone to perform this kind of work. In that case, you could deduct that person's salary and working expenses, which would reduce your taxable profit. But it would also increase your overhead, which could mean you'd have to raise your prices.

There may, however, be advantages to hiring your wife. The income still stays in your household, but you may gain a tax advantage, depending on your particular situation.

Cost of Doing Business

One of the biggest advantages to formally putting your wife on the payroll is that you will finally get a true picture of what it costs to run your business. Her volunteer labor keeps company overhead artificially low. If your wife were suddenly unable to continue helping out, you'd be in for a rude awakening. By paying her the going rate for the type of work she performs for the company, you will get a more accurate picture of your company's financial health.

Working Expenses

One of the first places to look for savings is your wife's working expenses. If your wife is hiring a babysitter or taking the kids to day care so she can do your books or answer the company phone, you may be able to take a credit on your tax return. The same may be true for mileage and depreciation if your wife uses the family car to run errands for the business. None of these tax credits are available, however, for volunteer work. They only apply if the money is spent as a necessary part of holding down a job.

Social Security

With your wife as an employee of the business, you'll need to pay into her social security account. True, that's money you weren't spending when your company was her favorite charity, but there's an upside when it comes time to retire. By paying social security tax on your wife's salary, you could help her to qualify for a higher social security benefit when she turns 65. This is especially important if she doesn't have a long enough working history to qualify for benefits. In any case, the two of you will have more money to live on when you retire to Florida (assuming your marriage survives the business).

Health Care

Hiring your wife could also be an opportunity to decrease the cost of insurance for your own health care plan. Even as a sole proprietor, you can set up a written employee's health care benefit plan covering your employees and their families. You only need one employee to qualify, and that employee can be your wife. Under the plan, the business could pay insurance premiums for your employee and her family — that's your wife, you, and your kids — and deduct 100% of the cost. Otherwise, the most the business could deduct is 60% of the premiums.

Remember, though, that all of your employees must be allowed to participate in the plan. Otherwise, the IRS will probably determine that your plan is just a tax dodge.

A Real Employee

If you do decide to pay your wife, make sure the work she is paid for relates to your business. You can't pay her to babysit the kids, for example, because you're not in the child care business. But you can deduct her wages if you hire her to type your estimates.

Even with your wife as an employee, she may work irregular hours. If so, it's important that she keep careful records whenever she is "on the job." If your wife drives to the hardware store, she needs to keep track of both her time and the mileage. That means separating time and mileage for groceries from time and mileage for hardware. If your wife stays at home, doing household chores while also tending to company business, she has to separate time spent typing estimates or answering the phone from time spent making school lunches or changing the laundry.

Most important, be careful about how much you pay your wife as an employee. You can pay her well, but you can't pay her beyond the upper limit of what she would earn in the open market for the same type of work. In other words, you can't make her a $40-per-hour go-fer.

All of the above applies to employees of incorporated businesses and sole proprietorships, but partnerships are different. If you and your wife become a partnership, then you are both treated as owners, not employees. This may affect the ability to take certain deductions, such as health insurance premiums, so be sure to consult with your attorney before taking this step.

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