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6 good tax reasons to hire your spouse

If you're like most small business owners, your spouse does odds and ends around the office and pitches in when you need help. This is particularly true in the summer months when other employees take vacation leave.

Strategy: Make your spouse an official employee. Pay him or her a regular salary, withhold income tax and employment taxes, deduct contributory employee expenses—the works. While it will add a few extra paperwork hassles, you should come out way ahead tax-wise.

Want specifics? Here are six good tax reasons why you should put your spouse on the payroll today:

1. Income shifting. If you're operating as a C corporation, any compensation paid to your spouse would normally be left in the corporation. As a result, if your corporation is in a higher tax bracket than your personal tax bracket, you save tax overall by paying your spouse a salary. Otherwise, there's no real tax benefit—and possibly a drawback—if your company is in a lower tax bracket than you.

On the flip side, S corporation owners and sole proprietors don't need to worry about corporate income tax. You report your business income on your personal return whether or not you pay your spouse a salary. You'll face no income-shifting consequences.

2. Travel expenses. Your spouse probably joins you on business trips. If he or she isn't an employee, you can't deduct any travel costs attributable to your spouse.

But when your spouse is a bona fide employee and joins the trip for a valid business reason, your company can write off his or her travel costs, including air fare, lodging and 50 percent of meal expenses. The benefit is also tax-free to your spouse.

3. Education expenses. If your spouse shows interest in going back to school, hiring him or her is a tax-smart approach. *Reason:* Companies can deduct expenses paid to improve an employee's job skills, and this benefit is tax-free to the employee.

So, your firm can generally write off the cost of sending your spouse back to school on a part-time or full-time basis. That not only sharpens your spouse's skills, it adds value to your business.

4. Qualified retirement plans. Your spouse is probably already contributing to some sort of retirement plan. But if you put him or her on your payroll, your family gains an extra benefit: Your company can deduct the full

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amount it contributes to your spouse's retirement account (as long as your company retirement plan meets tax-code requirements).

Those deductible contribution limits are generous. For instance, if you have a profit-sharing plan, you can deduct contributions this year up to 25 percent of compensation or $42,000, whichever is less. The contributions accumulate tax-deferred until they're withdrawn.

If you have a 401(k) plan, your spouse can defer up to $14,000 of salary to the plan this year (plus an extra $4,000 if age 50 or over), and that amount can typically be matched by your company.

5. Health insurance. If you're already paying extra to provide health insurance for your spouse, bringing him or her on as an employee allows you to provide insurance at the company's expense. Therefore, the company can typically deduct 100 percent of the premium, just as it does with other employees.

Of course, you might also obtain health coverage for your spouse separately or as family coverage under your personal plan, but covering your spouse as an employee generally provides more favorable benefits and gives you a tax edge.

If you're self-employed, don't worry. Since 2003, self-employed people have also been able to grab the 100 percent write-off for health insurance. Before that, the IRS limited the deduction to 60 percent of premiums.

6. Fringe benefits. In general, your spouse/employee is entitled to the same fringe benefits available to other employees. That includes group-term life insurance. (The first $50,000 of employer-paid group-term coverage is tax-free, but additional coverage is taxed to your spouse, based on an IRS table.)

S corporation owners need to be aware of one catch. Generally, S corps can deduct the cost of fringe benefits, such as group-term life insurance, for any employee who owns 2 percent or more of the corporation. By extension, this rule also applies to an employee-spouse. But the fringe benefits are taxable to the spouse/employee.

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