

Spousal Employment and Spousal Pensions Funding can slash income tax bill for Sole Traders

Income Tax Saving 1: Since individualisation was introduced in the tax code, a Spouse of a Sole Trader can **earn** up to €23,800 and **pay standard rate** (20%) income tax only. This is irrespective of the earnings level of the first spouse.

Income Tax Saving 2: A Sole Trader can **establish an Executive Pension** for a Spouse they employ in the business and contribute a significant amount to the employed Spouse's pension, as an employer pension contribution.

Income Levies, and PRSI Savings: An employer contribution by a Sole Trader will **escape income tax, universal social charge (USC) and PRSI.**

For example

Scenario 1

- John is a 38 year old self employed butcher with Net Relevant Earnings of €150,000 p.a.
- John's wife Mary (age 42) is a home maker and she is not employed in the business.
- John's maximum pension contribution is €23,000 (20% of the new earnings cap of €115,000), saving €9,430 (41%) in income tax.

Total income **tax saving** in scenario 1: **€9,430**

Scenario 2

- John decides to employ Mary and pays Mary a salary of €23,800 pa.
- He then establishes an Executive Pension for Mary and contributes another €23,800 p.a. under the maximum funding rules as an employer pension contribution.
- John saves income tax of €4,998 on Mary's salary (21%) and €9,758(41%) on the pension contribution.
- John's own maximum pension contributions are now €20,480 on which he saves €8,396.80 (41%) in income tax.

Total income **tax saving** in scenario 2: **€23,152**

Universal social charge and PRSI saving on the employer contribution: **€2,618**

Total Overall Saving: **€25,770**

Notes

1. John would need to register as an employer.
2. The salary level for Mary must be justifiable.
3. Mary must be paid under Schedule E and tax and PRSI must be deducted at source.
4. Employer contributions cannot be backdated.

Nuts and bolts of Spousal Employment

For high earning sole traders, pension funding is limited in a number of ways, e.g. an earnings cap of €115,000 and no PRSI or USC relief on contributions.

Considering this, plus the indication in the National Recover Plan 2010 that tax relief on personal contributions may be reducing as low as the standard rate of tax (20%), it is now **more important than ever to use existing tax breaks** to your advantage!

One such tax break is the *re-apportioning of earnings* from the business (where justifiable) to soften the impact of reducing pension limits for an earning couple:

- Irrespective of what the first Spouse earns, the second Spouse may earn up to €23,800 and pay income tax at the standard rate (20%).
- First Spouse employs second Spouse in the business and pays up to €23,800 (which reduces the first Spouse's earnings).
- Husband and Wife are entitled to the full pensions cap individually.
- With spousal employment in place, you now have the sole trader's business paying out the same level of income, but split between two individuals.
- This results in the couple availing of enhanced tax breaks and reducing the limits on pension funding for future household income.

*employing a child in the business may also be an option – ask your Financial Advisor



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