



EDITORIAL: JASON WHITCHURCH

## SOLE TRADER WITH WORKING SPOUSE / CIVIL PARTNER AND PENSION 2011/12

Employers and employees from all backgrounds will be beginning to feel the effect of increases in the rate of national insurance contributions (NICs). They'll also share concerns about rising state pension ages and 'pensioner poverty'. So here's an idea to help small businesses mitigate those increases, without reducing the couple's overall net income, yet providing a pension for their spouse / civil partner to help bridge that retirement gap.

A sole trader could structure the remuneration of their spouse / civil partner (who is working for them) so that an employer pension contribution can be made on behalf of the spouse / civil partner without an increase in costs to the business or a fall in the net income the couple receives.

Peter Smith is a self-employed glazier who is considering employing his wife Mary. The first column in the table below shows the amount of profit kept by Peter after deduction of tax and NIC.

The March 2011 Budget introduced different starting points for employer and employee NICs, meaning either employee or employer NICs do not have to be paid if a salary is limited to certain levels. This idea is demonstrated.

- In the second column, 'Alternative 1', which shows a suggestion of paying Mary a salary of £7,072 pa (an amount equal to the secondary threshold). This would not give rise to employer or employee NICs or income tax if this is Mary's only income.
- In the third column, 'Alternative 2', which shows a suggestion of paying Mary a salary of £7,228 pa (an amount equal to the primary threshold). This would not give rise to employee NICs or income tax if this is Mary's only income.

The salary and pension contributions for an employee are tax deductible business expenses and therefore Peter's taxable profit is lower. This will mean lower tax and NICs. Although Peter's net income will now be lower, the total disposable income of the couple is the same as 'before' when Mary's income is added back.

In addition, a pension has been provided without any effective cost to the business. The example below shows how a pension plan can be established for no additional outlay.

Mary will also benefit from the range of state welfare benefits and pensions by receiving salary at either of these nominal levels; benefits she may not have received unless she is treated as a carer. Indeed for S2P purposes she will be treated as earning £14,400, the lower earnings threshold.

'Alternative 3' is shown for illustrative purposes should Peter wish to pay his wife a higher salary and expose Mary to NIC and income tax.

	Position Now	Alternative 1	Alternative 2	Alternative 3
Profit	£50,000	£50,000	£50,000	£50,000
Less spouse / civil partner's salary	Nil	£7,072	£7,228	£10,000
NIC on employee's salary	Nil	Nil	£22	£404
Less pension contribution for spouse / civil partner	Nil	£4,267	£4,309	£3,879

Profit	£50,000	£38,661	£38,441	£35,717
Tax bill	£10,010	£6,237	£6,193	£5,648
NICs	£3,453	£2,959	£2,939	£2,694
Personal disposable profit / income	£36,537	£29,465	£29,309	£27,375
Plus spouse's income (after any tax and NIC)	Nil	£7,072	£7,228	£9,162*
Total disposable income	£36,537	£36,537	£36,537	£36,537

(\*After £505 income tax and £333 NIC). This table is based on tax rates and allowances for the tax year 2011/12.

**This idea should be considered alongside the company's ability to make dividend payments to a spouse's / civil partner's husband / wife as a shareholder.**

It should be noted that a spouse / civil partner must actually work in the business to receive a salary to be a legitimate employee – answering the phone at home is not sufficient to be treated as an employee. So, in this type of scenario the following issues are also a consideration:

- a spouse / civil partner must actually receive payment
- the salary must be justified for the work done
- the work has to be realistic in relation to the structure of the business
- the hours worked must be reasonable and there must be a realistic rate of pay

Employer pension contributions receive tax relief if they are deductible as a business expense against the profits of the business but contributions need to be made 'wholly and exclusively in the pursuit of the business or trade'. Please refer to the 'Relief effort – businesses and pension tax relief' article in the June 2011 edition of *techtalk* for further information discussing this issue.

Full time work at £5.93 per hour (the national minimum wage as at 1 October 2010 for workers aged 21 or older) would give an annual salary in the region of £10,800 (for a 35 hour week), so it is therefore very likely that the spouse / civil partner will be working part time. Any sole trader or director already employing their spouse / civil partner and paying a salary but not pensioning the salary could be asked; "I see that you are ensuring your spouse / civil partner is receiving income whilst working. What have you done to ensure the continuation of income when work stops?"

## AN IDEA FOR SPOUSES / CIVIL PARTNERS OF COMPANY DIRECTORS

There is no reason why this idea could not be applied to a spouse / civil partner employed by their husband's / wife's limited company. The same rules and principles apply, for example, the spouse / civil partner should be a legitimate employee and the employer pension contribution should satisfy the 'wholly and exclusively' test, although the calculations will be different to take into account corporation tax rather than income tax on business profits.

This idea should be considered alongside the company's ability to make dividend payments to a spouse's / civil partner's husband / wife as a shareholder. So it may be prudent to limit the spouse / civil partner's salary to where NICs begin to be paid or to the spouse / civil partner's available personal allowance.

Every care has been taken to ensure that this information is correct and in accordance with our understanding of the law and HM Revenue & Customs practice, which may change. However, independent confirmation should be obtained before acting or refraining from acting in reliance upon the information given.

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