"Does a Second Income Pay?"

[Reader: Don't miss 'Commentary' on page 2.]

August 2, 2004: 2:44 PM EDT
By Jeanne Sahadi, CNN/Money senior writer

NEW YORK (CNN/Money) - The joys of parenthood may be without number, but so, too, are its complexities. Take, for instance, the perennial dilemma: Does it pay for both parents to work when the kids arrive or for one to stay home?

There's rarely a clear answer. Staying home has its costs and benefits, but so does staying in the workforce. There are plenty of financial factors to consider. But there are also qualitative factors that can't be measured by anyone except the parents themselves.

The Potential Costs of Working

When considering whether two paychecks are worth it, figure out how much of the lower earner's salary will be eaten by expenses incurred if both parents work.

Childcare is likely to be the biggest cost. If you're planning to hire a nanny, expect to pay somewhere between $15,600 and $31,200 a year, not including employer-owed taxes such as Social Security, Medicare and unemployment. With daycare, the bill could range from $4,000 to $13,000 a year per child depending where you live.

Remember, you may be able to deduct some of your childcare costs through a dependent care plan or flexible spending plan at work. You also may be able to get a credit on your federal tax return for expenses up to $3,000 if you have one child or $6,000 if you have two kids or more.

Also, take into account the costs of going to work. The commute, the clothes, the dry cleaning, the lunches – all can add up to several thousand dollars a year. And you may not have as much time or energy to do the housework or make dinner. So you may end up hiring a housekeeper or doing take-out more often.

The Tax Question

Taxes are another consideration. Generally, the greater the disparity in incomes between two spouses, the greater the chance that the lower paycheck will cause unexpected results for joint filers come April.

That's because the tax withheld on the lower income throughout the year often does not keep pace with the tax rate on their joint income, and the lower income is often treated as the last dollars the couple earns, said Mary Mellem, an enrolled agent at Ashwaubenon Tax Professionals in Wisconsin. That means those dollars are among the most highly taxed.

Consider a couple with two pre-school kids in Skokie, Ill. One spouse earns $80,000; the other, $40,000. They have a $200,000 mortgage at 6 percent, pay $5,000 in property taxes, generate $500 in taxable interest, make $15,000 in tax-deferred retirement contributions, contribute 2 percent of their income to charity, and pay $1,200 a month for daycare. This year, the couple would owe $8,004 in federal taxes, Mellem said.

But if the lower-earning spouse hadn't worked, their family income would shrink from $120,000 to $80,000 -- a drop of 33.33 percent. Their tax bill, however, would fall to $2,635 -- a drop of 67 percent -- assuming they didn't incur childcare costs and they made a $2,000 deductible contribution to a non-working spousal IRA.

As impressive as the tax savings can be in certain scenarios, you shouldn't let the tax tail wag the dog. You may not have much left over from the second income. But it may be the critical amount you need to make your mortgage payments, pay your other bills, or fund college or retirement.

The Potential Costs of Staying at Home

Besides a potential cut in take-home pay, many of the costs of staying at home are long term.

Take retirement benefits. You can't put away as much in tax-deferred savings. At most, you can sock away $3,000 in a non-working spousal IRA versus up to $13,000 this year in a 401(k). Plus, you'll miss out on a company match, which can add up to thousands of dollars a year. Compounded over time, those lost savings opportunities can equal tens, if not hundreds of thousands of dollars.

Likewise, earning potential. The longer you're out of the work force, the more raises and advancement opportunities you forfeit. And since employers haven't shown a great proclivity toward giving 15 percent annual raises, it's hard to play catch up when you do return to work. Compounded over time, that lost income can add up to hundreds of thousands of dollars.

Lastly, you may forfeit some valuable workplace benefits, such as free or low-cost life insurance or tuition discounts.

No 'Right Answer'

If you're living paycheck to paycheck, that second salary is likely to be critical no matter how little is left over. But if you have some cushion, don't just look at the numbers. They may support one decision over another, but they may not square with what your heart and mind are telling you. After all, life is expensive, the well-being of kids is paramount and a parent's career is important not only for the money but often for a sense of identity and satisfaction.

Jeanne Sahadi writes about personal finance for CNN/Money. She also appears regularly on CNNfn's "Your Money," which airs weeknights at 5 p.m. ET.

COMMENTARY ABOUT THIS ARTICLE:

Ms. Sahadi accurately points out that significant taxes, plus expenses for child care, commuting, work clothing, additional meals and many other 'hidden' costs, combine to take a huge bite out of the gross pay of the second spouse – possibly leaving very little to show for all the effort.

This article leaves the reader with a dilemma -- but, fortunately, there is a solution to the dilemma. While producing additional income, nearly all of those 'added expenses' can be avoided, and taxes greatly reduced, if the second spouse actively engages in a legitimate home-based business.

With the right home-based business, the second spouse can make more money and stay home with the kids. Now, where's the dilemma?