Rochester Wealth Strategies

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An Overlooked Tax Strategy

By Dominic Garcia

For many W-2 employees, it is common to suggest reducing your taxable income by making contributions to your employer retirement plan, IRAs, and Health Savings Accounts. For 1099 employees, you may have the ability to deduct 20% - 25% of your income (up to $57,000) by contributing to a SEP IRA. Another option could even be starting a Solo 401(k) plan. However, for some, you may be able to take it a step further.

If you are self-employed and maintain an income above $285,000, it could be beneficial to start looking into a retirement plan called a Cash Balance Plan. These plans are used by businesses looking for maximum tax deductions and large retirement funding for owners, partners, and key employees. When combined with a profit-sharing plan, the overall deduction could be as high as $340,557.

A Cash Balance Plan is a Defined Benefit Plan with characteristics similar to a Defined Contribution Plan. Contributions are made by the employer based on a pre-defined formula. However, unlike the common 401(k) plan, deduction limits are based on actuarial funding rather than a fixed dollar limitation. This allows the employer to make larger contributions and receive increased deductions.

The demographics of the company will ultimately dictate how much can be tucked away. Although the plan usually favors an employer that is much older than his or her employees, it can also benefit employers who have much greater income than their employees. The plan tends to be more ideal for business owners with fewer employees. This would also include doctors, attorneys, and highly-compensated professionals with small to mid-size practices. It can even be a great option for a younger entrepreneur who is looking to put a large amount away so that they can retire earlier than the norm.

It is important to note that these plans offer great flexibility and can be designed in various ways. For example, even if there is a business with 100 employees, there is still the ability to target certain employees. If there is more than one partner at a firm, they can each contribute a different percentage of their salary. Business owners can terminate the plan at any time and simply rollover their funds into an IRA. Cash Balance Plans are also protected from creditors as it is defined as a qualified plan under ERISA.

To incorporate this type of plan into your overall retirement strategy, the first step is to speak with a financial advisor who has the experience in utilizing Cash Balance Plans within their practice. The advisor not only manages the funds within the plan, but he or she will also coordinate with the actuary to make certain that all funding requirements are met and abide by all regulations governing Defined Benefit Plans.

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