



## **Combat Higher Taxes with Employer Retirement Plans**

By [Mimi N. Hackley, MPH, CFP®](#), Sharkey, Howes & Javer

Worried about higher taxes? You're not alone. Many high-earning business owners expect the next decade or so to be a high tax environment. So much so, that they are looking for ways to shield more current income from Federal and State taxation. Establishing one or more Employer Retirement Plans may be a cost-effective solution. Is such a plan the best move for you?

### **Defined Contribution Plans**

One of the first lines of defense under high tax conditions is to establish an Employer Defined Contribution Retirement Plan (DC Plan). In 2010, employers may use DC plans, such as a 401(k) plan, to shelter \$16,500 of their salary, (and if over age 50, they can contribute another \$5,500). Additionally, profit-sharing contributions can be made to bring their overall contribution to \$49,000, (plus the extra \$5,500 if they're over age 50). In order to fully maximize the employer's contribution, DC Plans also require the employer to contribute some money on behalf of their employees (a contribution which is tax-deductible). With proper planning, a DC Plan can be tailored to meet the needs of most employers without having onerous employee outlays and administrative expenses (which are frequently more than offset by the tax savings garnered under the plan).

That said, many of the small business owners with whom we work are still in the highest tax bracket even after their DC Plan contributions. Consequently, they would like to find ways of shielding more current income.

### **Tandem Plans**

Another solution are tandem plans; pairing a DC Plan with a Defined Benefit Pension Plan (DB Plan). The DB Plan allows employers to make pre-tax contributions sufficient to bring their total pension benefit to as high as \$195,000 per year during retirement. The contribution required differs from year-to-year and is determined annually by an actuary using specific assumptions such as inflation, rate of return, life expectancy, and years to retirement. Simply put, the contribution required will be equivalent to the amount needed to reach the desired pension benefit (limited to \$195,000 per year during retirement). The tax savings on DB Plans are typically much greater than in DC Plans. For example, if the employer makes a contribution of \$100,000 to the plan, the tax savings, assuming he's in the highest bracket are approximately \$40,000 per year.

As with the DC Plan, the DB Plan also requires the employer to make contributions on behalf of the other employees. However, there are strategies that can be used to weight the contribution percentages so that the lion's share goes to the employer or even to a particular class of employees, such as "dentists".

In our experience, the biggest barrier to using the tandem strategy successfully is the employers' reluctance to direct large amounts of money toward a retirement plan in lieu of spending that money today. While the idea of shielding a few hundred thousand dollars each year is certainly appealing, many business owners balk once they realize that this money is no longer available to be paid out to them as income in the current year. This strategy works best for businesses with lots of surplus cash flow as well as owners whose current lifestyle doesn't require the use of a large portion of their current income.

Ultimately, with either of these strategies, the hope is that some portion of your income will avoid high taxation now in favor of lower taxation during retirement. While we don't profess to know what will really happen with taxes now or in the future, many of our clients simply wholeheartedly believe that we are about to enter a period of high taxation (due, of course, to a myriad of factors such as high Federal deficits and ongoing "stimulus" spending to mention just a few). If you hold the same beliefs, contact your Certified Financial Planner™ to determine if a new or additional retirement plan would be the right solution for you.

*Mimi N. Hackley, MPH, CFP®, is Director of Financial Planning Sharkey, Howes & Javer is a nationally recognized financial planning and investment services firm providing objective advice to clients in Colorado and around the world. To learn more or to request a complimentary consultation, contact [Sharkey, Howes & Javer](#), located at 720 S. Colorado Blvd., Denver, CO 80246. Telephone: 303-639-5100 or toll-free: 800-557-9380.*