

For high earners and W-2 employees, finding tax-saving strategies can be a challenge. If your employer offers a Non-Qualified Deferred Compensation (NQDC) Plan, it could be a valuable tax savings machine. Here's what you need to know:

What is an NQDC Plan?

- An NQDC Plan is a vehicle that allows you to defer taxes, typically in addition to your 401(k) plan, with no IRS contribution limits (though your employer may set limits).
- Contributions grow tax-deferred and are distributed based on a pre-elected schedule, such as at retirement or over a specific period.
- Typically, these plans are only available to key employees and top-level executives.

The Benefits

- Tax Savings: Defer income you don't need today to reduce your current taxable income.
- Investment Growth: Similar to your 401(k), contributions can be invested to grow tax-deferred.
- Potential Employer Match: Some employers offer a match, further enhancing your savings.

The Risks

While NQDC Plans offer great benefits, there are significant risks:

- Unsecured Funds: Unlike a 401(k), these funds are not protected in the event of company bankruptcy.
- Real-World Example: During General Motors' 2008 bankruptcy, employees in deferred compensation plans only recovered 1/3 of their contributions.

When to Consider an NQDC Plan

If you're a high earner living on less than your current income, NQDC Plans can help you defer income you don't need today. For example:

- A family earning \$550,000 and fully funding a 401(k) and HSA could use an NQDC Plan to defer additional income, save on taxes, and possibly receive an employer match.

Planning Your Contributions and Distributions

Careful planning is essential. Contributions are typically elected a year in advance, and distributions can be set for specific events or timelines, such as:

- A lump sum at retirement.
- Spreading distributions over five years after retirement.
- A scheduled lump sum while still employed.

Real-World Strategies

- **Deferring Bonuses:** A client was anticipating a large bonus that they did not plan to live on, we elected to defer a majority of their bonus into their NQDC plan, saving substantial tax dollars.
- **Switch-A-Roo Strategy:** A client concentrated company stock risk in their NQDC Plan rather than spreading it across other holdings, reducing overall risk while maintaining the same position.

Key Considerations

- If you plan to retire early (pre-59.5), this can be a great way to have distributions in a potential lower tax bracket and save tax dollars today.
- Employer matches add value to the plan.
- Work with your financial advisor and CPA to ensure your contribution and distribution elections align with your overall financial goals.

Takeaway

Non-Qualified Deferred Compensation plans can be a powerful tool!

NQDC Plans can be a powerful tool for high earners to save on taxes, grow wealth, and receive employer contributions. However, they come with risks and require strategic planning. Be sure to consult your financial and tax professionals before making decisions.