Key Wealth Institute

Six Smart Strategies to Defer Taxes and Boost Retirement Savings

Looking to trim your tax bill? Contributing the maximum amount to your 401(k) can help lessen your taxable income. But if you've already reached maximum contributions and find yourself looking for additional solutions, there are several things to consider — some of which could boost your overall retirement savings.

1. Traditional IRAs

Regardless of whether you participate in a qualified plan, you may set up a traditional IRA and contribute up to $7,000 for 2025. The $7,000 limit may be adjusted annually for inflation in $500 increments. If you happen to be 50 or older, you can make additional "catch-up" contributions of up to $1,000 (also eligible for inflation adjustments in $500 annual increments).

Married? Setting up a spousal IRA could also be an option, allowing you to contribute up to the annual limit on his or her behalf.

How they help in retirement

While your income level likely won't allow for traditional IRA contribution deductions from an income tax perspective, it still allows you to make after-tax contributions and lets your earnings grow tax deferred.

2. Non-Qualified Deferred Compensation (NQDC) Plans

Some employers offer NQDC plans in the form of contractual commitments that promise to provide compensation at a future date. When plans are properly structured, the employee should not recognize taxable income at the point of commitment — instead deferring tax payment at the future date when compensation is received. One advantage of deferring the recognition of income is that you may be in a lower tax bracket at the time the deferred compensation is paid (once in retirement, income is usually lower).

You determine the deferred amount each year from your salary, bonus, or other forms of compensation. You do not pay income taxes on that portion of your pay in the year you defer it (you pay only Social Security and Medicare taxes), so it has the potential to grow tax-deferred until you actually receive it.

One disadvantage is that you are unable to take loans from an NQDC Plan, and you can't roll the money into an IRA or other retirement account once the amount is paid to you. Also, unlike a qualified plan where benefits are separated from the employer's general assets, your deferred compensation in the NQDC remains the employer's general asset and is subject to potential loss.

How it helps beyond retirement

It's important to note that NQDC plans are not just for retirement savings. Many plans allow you to schedule distribution over the course of your career to cover shorter-term goals, like paying for a child's college tuition.

3. Life insurance

Though the premiums are paid with after-tax dollars, insurance-related products can effectively defer taxes on accumulated earnings. The primary purpose of life insurance is to provide income for the policy holder's beneficiaries upon death. Certain types of life insurance can also function as tax-preferred investment vehicles. The cash value of a life insurance policy grows tax deferred until withdrawn or distributed.

How beneficiaries can benefit

Beyond the investment and tax savings described above, certain life insurance benefits can also be paid to beneficiaries tax free. No matter how big the death benefit is, your beneficiaries won't be required to pay any income tax on what they receive (unlike IRAs and annuities, which may require that your beneficiaries pay up to 37 cents on every dollar).

4. Annuities

With an annuity, you pay a premium to an insurance company (or financial institution) in exchange for a stream of income (composed of a return or premium plus interest) over a future period. You could potentially defer the payment of taxes on the interest earnings until the funds are disbursed. Because the payments are made at a future date, many are presumably in a lower tax bracket by the time their distribution period comes along. During distribution, the interest component of annuity payments is taxed at ordinary income rates.

How they help in retirement

With more guaranteed returns, annuities can complement your overall mix of retirement investments nicely. There's also added peace of mind for some in the case of premature death. With some annuity products, your beneficiaries are guaranteed a minimum return of the principal you invested, even if your portfolio took a dip.

5. Employee stock options

Employee stock options and certain other forms of equity-based compensation can be excellent tools for income tax deferral. There are several forms of equity-based compensation, including incentive stock options and non-qualified stock options.

Incentive stock options (ISOs) offer one of the most favorable tax treatments from an employee standpoint. If an employee stock option qualifies as an ISO, you won't recognize any taxable income when you exercise the option. Instead, you recognize taxable income or gain only when a disposition occurs (when the stock is sold, generally). The tax treatment of this disposition depends on meeting certain holding period requirements.

Non-qualified stock options (NQSOs) are less statutorily restrictive than the ISOs described above. With NQSOs, there are no income tax consequences when granted. When they vest and are exercised, you recognize compensation income on the excess of their fair value over the option cost. When you eventually sell the stock, the income counts as a capital gain (to the extent the sales price exceeds the sum of the income recognized and option price paid).

How they help in retirement

If you're lucky enough to have an employee stock option at your disposal, they can not only help defer income taxes while working, but they can also help supplement retirement income when exercised down the road.

6. Health Savings Accounts

While typically used to help meet healthcare costs, HSAs can also be used in a tax-advantaged way to pay for future medical expenses. HSA contributions are pre-tax (either tax-deductible if contributed directly, or excluded from income if contributed by an employer). The accounts can accumulate and grow tax-free as long as they are used for qualifying medical expenses.

How they can help now

According to recent Gallup polls, the cost of health care is Americans' top financial concern. Using an HSA can help you reach your tax deferment goals while providing peace of mind around future healthcare costs.

While your tax deferment strategy may shift from year to year, having the right mix of investment strategies can ensure your money is working as hard as possible for you. The right financial professional can help structure your approach to meet today's goals while working toward your ideal future state.

For more information, please contact your advisor.

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