Goldleaf PARTNERS® EMPLOYER SERVICES

# CASH BALANCE PLANS

The scoop on how to maximize tax deductions and retirement contributions

## WHAT IT IS

A Cash Balance plan combines the high potential contribution of a defined benefit plan with the look and feel of a defined contribution plan. Each participant has an account balance that grows annually with an employer contribution and a stated interest credit.

## HOW IT WORKS

Employer contributions are determined by formula as a flat amount or as a percentage of pay and can be based on age and income. Plan assets are pooled and the interest rate credit is typically tied to a benchmark rate (such as the yield on 30-year treasury bonds) or a fixed rate such as 4% or 5%. Cash Balance plans can be offered in addition to other plans, including 401(k) profit sharing.

## DEDUCTION AMOUNTS

Contributions must be determined by the plan's enrolled actuary and the funding requirements are based on an expected retirement age. The less time until retirement, the larger the contribution can be. Cash balance plans can allow for additional contributions, potentially in excess of $200,000 per year for older individuals.

## TESTING

Cash Balance plans are subject to nondiscrimination testing, which compares projected benefits at retirement age as a percent of pay. Due to time value of money principles, this allows much larger formulas to be in place for older participants; a large benefit formula for an older employee will provide the same benefit at retirement age as a small formula for a younger participant.

### The best candidates

- **Business owners over the age of 40 desiring contributions over $50,000**
- **Companies already contributing 7.5% of pay or more to participants**
- **Companies with consistent profit patterns**

## CHANGES

Cash Balance plans are required to follow the IRS rules and guidelines pertaining to permanency. This means businesses that sponsor Cash Balance plans are encouraged to keep the plan in place for three to five years unless they have business reasons for shutting it down (e.g., an unexpected reduction in revenue generated by the business, a major change in the structure of the business).

Because the plan is meant to be permanent, the contribution formula put in place when the plan was set up should remain fairly constant to avoid the perception that a "discretionary profit sharing" formula is being used. However, changing the formula, freezing the plan, or ultimately terminating the plan would be considered acceptable practices if a legitimate business reason exists.

# POTENTIAL ALLOWABLE CONTRIBUTION TO COMBINED 401(K) AND CASH BALANCE RETIREMENT PLANS AT DIFFERENT AGE LEVELS

| Age | Compensation | 401(k) Profit Sharing | Cash Balance | Total | Estimated Tax Deferral |
|---|---|---|---|---|---|
| 65 | $275,000 | $61,000 | $261,250 | $322,250 | $119,233 |
| 60 | $275,000 | $61,000 | $247,500 | $308,500 | $114,145 |
| 55 | $275,000 | $61,000 | $198,000 | $259,000 | $95,830 |
| 50 | $275,000 | $61,000 | $154,000 | $215,000 | $79,550 |
| 45 | $275,000 | $55,000 | $121,000 | $176,000 | $65,120 |
| 40 | $275,000 | $55,000 | $93,500 | $148,500 | $54,945 |

*Tax deferral has been estimated at 37% for illustration purposes. Actual tax deferral may vary.*

# CASE STUDY

A successful small business recently implemented a Cash Balance plan. They were previously making contributions to a SEP-IRA. The owner was limited to the IRS maximum amount of $55,000 and was required to make employer contributions of 20% of pay, or $18,000, for the other participants.

The addition of a Cash Balance plan paired with a 401(k) profit sharing plan allowed the owner to increase her total contribution to more than $200,000 and reduce the required employer contributions for the other participants to 10% of pay, or one-half of what was required in the SEP-IRA.

| Name | Age | Compensation | 401(k) Profit Sharing | Cash Balance | Total | Estimated Tax Deferral |
|---|---|---|---|---|---|---|
| Owner | 62 | $275,000 | $40,100 | $255,750 | $295,850 | $109,465 |
| Employee | 34 | $50,000 | $3,500 | $1,500 | $5,000 | $1,850 |
| Employee | 24 | $40,000 | $2,800 | $1,200 | $4,000 | $1,480 |
| **TOTAL** | | **$365,000** | **$46,400** | **$258,450** | **$304,850** | **$112,795** |

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***CONTACT US FOR MORE INFORMATION ON UTILIZING CASH BALANCE PLANS***

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