Cash Balance Plan

Helping you maximize retirement savings

Reducing taxes while increasing retirement savings should be an intriguing idea for high net worth business owners and partners.

Are you a business owner looking for additional tax savings? Are there executives within your organization who want to save more for retirement than the allowable limits in your current 401(k) or profit sharing plan? Or perhaps you're a small business owner looking to accelerate your retirement savings. If so, then consider a Cash Balance plan.

What is a Cash Balance plan?

It is a retirement plan that incorporates features of a defined benefit plan with a defined contribution plan to provide eligible employees with a specific benefit at retirement. Like a defined contribution plan, such as a 401(k), it provides participants with an easy to understand benefit through an annual statement of their cash balance account value.

A Cash Balance plan is designed to complement a 401(k) and profit sharing plan. Together these plans give business owners greater flexibility for recruiting, rewarding and retaining key employees.

Key features

Distinguishing features are:

- Rapid acceleration of retirement savings
- Benefits payable in lump sum
- Flexibility in benefit design
- Easily communicated benefits
- Effective use of benefit dollars

Why Cash Balance?

In addition to being a retirement plan, a Cash Balance plan can also serve as a business planning tool for your business. It can:

- Provide tax benefits
- Give business owners greater flexibility to recruit, reward and retain valued employees
- Offer a means for effective transfer of ownership interest

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Benefits of offering two plans

While the retirement benefits of a 401(k) are based on the performance of investments selected by the participant, a Cash Balance plan's investments are controlled by the plan sponsor to achieve a predetermined outcome. Both the annual Cash Balance contribution and the interest credited are guaranteed by the plan sponsor. A Cash Balance plan is a perfect complement to a 401(k) plan. If you currently don't offer a 401(k) plan, you might want to consider adopting one. A safe harbor plan design that provides a 3% non-elective employer contribution is a good option to consider. Your Ameritas financial professional can help you explore this option.

Cash Balance requirements

A Cash Balance plan requires commitment, continuity and annual contributions. The IRS requires a Cash Balance plan be permanent and ongoing. Plan termination is not recommended within the first five years unless there is a major business interruption, such as the death of an owner.

A Cash Balance plan creates a required funding obligation. Current benefit increases must be funded each year. The plan sponsor must make up investment losses over no more than seven years. Although the plan may be amended to reduce or stop future benefit accruals, any past promise must be kept and funded.

Case study

Census data			
Participant	Age	Annual plan comp	Salary deferral
Owner A	46	$ 330,000	$ 22,500[1]
Owner B	52	$ 330,000	$ 30,000[1]
Owner C	58	$ 330,000	$ 30,000[1]
Employee 1	38	$ 45,827	$ 0
Employee 2	28	$ 37,798	$ 0
Employee 3	46	$ 42,685	$ 0
Employee 4	53	$ 45,046	$ 0
Owner Total		$ 990,000	$ 82,500
Employee Total		$ 171,356	$ 0
Plan Total		$1,161,356	$ 82,500
% to owners			100%

Cash Balance plan

There are several methods of crediting employer contributions to Cash Balance plans, including a fixed percentage of earnings, and a percentage that varies by age, service and earnings. These contributions are tested for IRS compliance.

The employer contribution in a Cash Balance plan is actuarially determined each year. It may be higher or lower based upon current assets, actual investment yields, turnover and required funding minimums and maximums.

The benefits of a Cash Balance plan

The chart above shows two plans—a 401(k) and a Cash Balance—and how they work together to enable key personnel to save more for retirement.

Cash Balance plans are flexible, allowing different contribution amounts to be allocated to each participant based on their age and current salary. A Cash Balance plan can help narrow the retirement savings gap by providing a higher cash balance contribution to the older more highly compensated owners, while at the same time minimizing the overall cost to the business.

This successful small business has three owners who are seeking larger retirement benefits. At the same time, they want to keep their employee benefit costs affordable.

401(k) & profit sharing		Cash Balance plan	
3% Safe Harbor	Profit sharing[2]	Cash Balance	Grand total allocated to participants' accounts
	$ 17,325	$ 154,100	$ 193,925
	$ 17,325	$ 207,700	$ 255,025
	$ 17,325	$ 280,000	$ 327,325
$ 1,375	$ 4,583	$ 0	$ 5,957
$ 1,134	$ 1,701	$ 0	$ 2,835
$ 1,281	$ 1,921	$ 0	$ 3,201
$ 1,351	$ 2,027	$ 0	$ 3,378
$ 0	$ 51,975	$ 641,800	$ 776,275
$ 5,141	$ 10,232	$ 0	$ 15,372
$ 5,141	$ 62,207	$ 641,800	$ 791,647
0%	82%	100%	98%

Census data

A summary of employee census data is the basis for illustrating the combined value of a 401(k) and Cash Balance plan. It typically includes the names or positions of all participants, their ages and their plan compensation for determining their contributions.

401(k) and profit sharing plan

Adding a Cash Balance plan may result in changes to your existing 401(k). Monies can be contributed different ways—salary deferral, employer match, profit sharing, etc. In this example, only the deferrals of the owners are shown. This was done since salary deferrals represent no additional cost to the business owner.

It also makes it easy to see the costs and benefits for the owner in comparison to those for the employees. Keep in mind that, at a minimum, every eligible employee must be included in the plan.

Combination advantages

For participants: A Cash Balance plan, with its predetermined outcome, helps establish a solid foundation for participants. The benefits of a Cash Balance plan are assured and are not subject to economic conditions or market fluctuation. This may also allow them to seek the potential for a higher return on their 401(k) plan by assuming greater investment risk.

For business owners: A Cash Balance plan may lower employee benefit costs. When a Cash Balance plan is combined with a 401(k), an actuary can consider both benefits for compliance testing. By awarding assets inside the 401(k) plan, the employer may elect to award lower Cash Balance credits to employees.

[1] Represents maximum contribution amounts.

[2] This formula, which determines the profit sharing allocation, is specific to each plan sponsor.

Who Is a good candidate?

Good candidates have one or more of the following characteristics:

- Owners or partners who are contributing the maximum to their current defined contribution plan
- Companies with demonstrated consistent profit patterns that are comfortable with the idea of required contributions and can bear the investment risk
- Owners or partners over 45 years old who want to accelerate their retirement savings
- Companies with a new comparability profit sharing plan
- Owners who may transfer their ownership interest in the next 5-10 years

Other considerations

- Plans are subject to the minimum funding regulations
- Annual testing applies
- Certain plans are required to be covered by the Pension Benefit Guaranty Corporation (PBGC)
- Investment risk is managed by the employer
- Higher set up and on-going administration costs (Use of a Third-Party Administrator is required for a Cash Balance plan.)

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