# ARE YOU READY FOR A

# CASH BALANCE PLAN?

*You've worked long, hard hours building your business. It's been your focus for many years. You've sacrificed time and money and stressed over every detail. You may have even put off saving for retirement, and now you're starting to wonder if you will ever have enough money to retire comfortably …*

**A Cash Balance Plan might be the perfect opportunity for you to build substantial retirement savings in a short time.**

A Cash Balance Plan could be a great fit for you if:

- ✓ You earn $250,000+ per year.
- ✓ You want to catch up on delayed savings.
- ✓ You are willing and able to give annual contributions to your employees in the range of 8% - 10% of compensation.
- ✓ You expect to be able to fund and maintain the plan for at least 5 years.
- ✓ You have a reliable earnings stream.
- ✓ You want a much higher tax deductible contribution than is possible in a 401(k) plan by itself.
- ✓ You want the assurance of an IRS qualified retirement plan where assets are protected from bankruptcy or lawsuits.

# FAQs: Straight Talk about Cash Balance Plans

**What is a Cash Balance Plan?** It is a tax qualified *defined benefit* plan that combines the high contribution limit of a pension plan with the **flexibility and portability** of a 401k plan. In a traditional pension plan, only employees who follow a long-term career path with one company qualify for a substantial benefit. However, in a cash balance plan, contributions are not tied to years of service and the contributions can be more consistent among employees. Contributions are determined as a specific dollar amount or percent of pay each year, and interest is credited at a set rate. These accounts are reported annually on employee statements prepared by the actuary. Unlike many traditional pension plans, the cash balance account is portable and may be rolled over to an IRA.

**How much can I contribute for myself each year?** The maximum participant cash balance contribution each year is based on age. A 50 year-old owner could get a contribution as high as $138,000; a 60 year-old could get as much as $235,000. **If the plan is in place for 10 years, you can reach the maximum opportunity -- which is an account in excess of $2 million** while employee contributions could be as low as 5% of pay.

**Those contributions are really high – is this legal?** Absolutely! The 2006 Pension Protection Act (PPA) confirmed the legality of cash balance plans and made them easier to administer.

**Where is the money invested?** The investments of the cash balance plan are usually held in a single investment pool and managed by the employer or an investment manager. **Plan participants do not direct their own investments**. The plan may be invested in stocks, bonds, mutual funds, ETFs, cash or money market options. It usually makes sense for the assets to be conservatively invested. The interest credited each year to the participant's accounts will be stated in the plan document and is usually 3% - 5%. The investments may earn more or less than this each year, which means the value of the plan assets will generally be different from the value of the cash balance benefits reported to the employees at year- end. Each year the actuary determines the funding range for the employer by considering the annual contributions as well as the value of the plan's investments. If the investments have returned more than the assumed interest credit, the employer will have a lower funding obligation to the plan. New regulations released in 2010 also now allow for plans to use the actual rate of return on the investments, rather than targeting a specific interest rate each year, which may reduce the employer's investment risk.

**How is the plan funded?** Each year, **the actuary will determine the "funding range" for the plan** and the employer can choose to fund an amount that falls within that range. This range varies from a minimum funding amount up to a maximum deductible contribution amount. The minimum funding amount is calculated based upon certain rules and assumptions prescribed by the IRS and the actuary, as well as the value of the plan assets and the ages of the participants,and takes into consideration the interest credit rate for the plan and the fact that non-owners must receive the full promised benefit when they terminate. The maximum funding amount is

the maximum amount that is deductible to the employer. The employer should contribute the decided upon amount by the due date of the business tax return (including extensions) in order to take a deduction for the contribution. The employer can also choose to fund the plan throughout the year, by making monthly or quarterly contributions to the investment account. **The plan sponsor is never required to fully fund the cash balance plan**. However, if the plan is not fully funded when it terminates, all non-owner employees must still receive their full promised benefits, and the remaining plan assets are then shared among the owners. It is also possible for the employer to "overfund" the plan in certain years, up to 150% of the value of the earned benefits.

**What happens if I can't afford to fund the plan for a particular year?** **The plan can be amended to freeze or lower the allocations** for a particular year, as long as the amendment is made before any employee works 1,000 hours in the year.

**Can I give key employees a higher allocation than the rest of my staff?** Yes, the plan can easily provide for different levels of benefits and contributions for key individuals.

**Can I exclude some of my employees from the allocation?** It is possible to exclude some employees but the plan must cover the smaller of 50 employees or 40% of the workforce.

**Can I have a vesting schedule on the accounts?** Yes, **the plan can require the employee to work for the employer for at least 3 years in order to be vested** in the account. If a participant terminates without a vested benefit, his benefit is removed from the next valuation and will reduce the amount necessary to fund the plan's benefits.

**What happens when an employee becomes entitled to a distribution from the plan?** When the employee terminates, he may choose to take an annuity from the plan based on his current vested balance, or he may choose to take a lump sum benefit equal to the current vested balance.

**Should I terminate my 401(k) plan and just have a Cash Balance Plan?** No, **a Cash Balance Plan actually works best when paired with a 401(k) plan.** This combination often provides a much more favorable cost design than a Cash Balance Plan by itself. Very few firms have a stand-alone cash balance plan.

**Are there any extra fees with a Cash Balance Plan?** Some cash balance plans are subject to coverage by the Pension Benefit Guaranty Corporation (PBGC), which is a government agency that guarantees the benefits provided by pension plans. Plans covered by the PBGC must currently pay an annual fixed rate premium of $57 per participant, which is subject to increase in future years.

# Planning for Your Future

The following is an example of an annual allocation for a company where the owner and spouse have maximized their contributions and a large cash balance contribution was given to the office manager.

| Cash Balance Example: | birth date | pay | 401k | 3% safe harbor | profit sharing | cash balance | Total employer cost |
|---|---|---|---|---|---|---|---|
| Owner 1 | 1958 | 260,000 | 24,000 | 7,800 | 0 | 211,000 | 218,800 |
| Owner 2 (spouse) | 1961 | 33,710 | 16,855 | 1,011 | 0 | 23,000 | 24,011 |
| | | | | | | | **242,811** |
| Office Manager | 1965 | 76,765 | 3,421 | 2,303 | 3,761 | 14,000 | 20,064 |
| Employee 1 | 1969 | 648 | 32 | 19 | 32 | 0 | 51 |
| Employee 2 | 1984 | 32,797 | 608 | 984 | 1,607 | 820 | 3,411 |
| Employee 3 | 1947 | 34,079 | 0 | 1,022 | 1,670 | 852 | 3,544 |
| Employee 4 | 1952 | 30,314 | 21,557 | 909 | 1,485 | 758 | 3,152 |
| Employee 5 | 1981 | 39,592 | 716 | 1,188 | 1,940 | 990 | 4,118 |
| Employee 6 | 1965 | 52,998 | 2,492 | 1,590 | 2,597 | 1,325 | 5,512 |
| Employee 7 | 1981 | 29,116 | 1,424 | 873 | 1,427 | 728 | 3,028 |
| | | | | | | | **42,880** |

## Hypothetical Growth of Account for 50-year old business owner with maximum annual contribution and 4% Interest Credit Rate:

| Year | Account Balance Jan. 1 | Interest Credit | Cash Credit | Account Balance Dec. 31 |
|---|---|---|---|---|
| **Year One – age 50** | $0 | $0 | $138,000 | $138,000 |
| **Year Two – age 51** | $138,000 | $5,520 | $145,000 | $288,520 |
| **Year Three – age 52** | $288,520 | $11,541 | $153,000 | $453,061 |
| **Year Four – age 53** | $453,061 | $18,122 | $162,000 | $633,183 |
| **Year Five – age 54** | $796,283 | $31,851 | $171,000 | $836,034 |