Cash Balance Plans: Add to Your Retirement Nest Egg

Supplement your 401(k) with more tax-deferred and tax-deductible savings.

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Kerri Goldsmith is a Financial Advisor in the HBKS® Wealth Advisors office in Fort Myers, Florida and has been with the firm since 2009. She specializes in helping her clients fulfill their dreams through personalized financial planning, investing, and risk management services. Her assistance helps her clients plan for their own future, their children's or grandchildren's education, or passing their wealth onto future generations or charitable causes.

Ms. Goldsmith also works with businesses to provide qualified retirement plans and financial education for their employees. She takes great pride in providing individualized, hands-on client solutions with strategic vision and problem-solving creativity that offer unique perspectives on financial planning.

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The retirement plan landscape is getting crowded – so many plans and nuances of plans. Where once there was the company pension plan, there are now many formats to mull over: defined benefit and defined contribution plans, 401(k)s and 403(b)s, IRAs and Roth IRAs, and on and on. More than confusing, it can be mystifying.

Here's another one to add to the list: Cash Balance Plans. But before you throw your arms up in protest over yet another entry to consider, take a closer look at this one. There's a lot about this latest-generation plan that is more appealing than perplexing.

As an owner of a closely held business, you probably have a company-sponsored retirement plan in place, most likely a 401(k) plan. They are popular with many employers due to their simplicity, flexibility and portability. But they have restrictions, including limits on how much you can stow away each year, which can leave you and some of your highly compensated employees, especially those nearing retirement age, short on retirement savings. A cash balance plan as a supplement to your 401(K) allows you to stash away additional savings tax-deferred and tax-deductible – and in so doing, possibly even move you to a lower tax bracket.

A cash balance plan is a new twist on a defined-benefit or the old-fashioned pension plan. As employer, you and employees you include in the program, contribute to your cash balance accounts a set percentage of your yearly compensation plus interest on plan balances. You set the eligibility requirements as well as the contributions formula. The investments made with plan funds must be professionally managed. The amount of contributions and the eventual benefits to be paid out are pre-determined through actuarial calculations.

Under U.S. tax regulations, a cash balance plan is considered a "qualified" plan, so contributions to a cash balance plan are tax deferred. There are other advantageous nuances: under ERISA they enjoy a high level of protection against creditors, yours or your company's; and due to 2010 and 2014 updates to the Pension Protection Act of 2006, investment options are much broader than previously.

No wonder cash balance plans are so popular. According to a recent study by Kravitz, Inc., more than 29 percent of existing defined benefit plans are now cash balance plans and total assets are in excess of $1 trillion nationwide.

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Summarizing the advantages of supplementing your defined contribution plan with a cash balance defined benefit plan:

Limited participation, unlimited contributions: You determine the plan participants, typically yourself as owner and some of your higher compensated employees you want to help maximize retirement savings. Older employees nearing retirement benefit from a plan provision that factors age into the contribution formula.

- The total contribution limit to a 401(k) plan for an employee is $18,000; with employer matching and profit sharing, $54,000 – plus a $6,000 catch-up contribution. As a defined benefit, a cash balance plan allows you to set aside an amount that will produce an eventual benefit of up to $215,000.

Income tax savings: Contributions are tax deductible against ordinary income, dollar for dollar, and invested dollars grow tax-deferred. • Cash balance plans typically offer a lump-sum payment equal to the participant's hypothetical account balance as a distribution option, meaning the employer no longer has the expense of administering the benefit.

- The current highest income tax bracket is 39.6 percent, plus a net investment income tax and Medicare surtax added by the Affordable Care Act. The most desirable deductions, including qualified retirement plan contributions, are "above the line" as they serve to reduce your adjusted gross income.

Asset protection: As an ERISA plan, both 401(k) and cash balance plans receive a high level of protection from company and participants' creditors, unlike the dollars piling up in your company bank account. • Funds can generally be rolled over to another employer's retirement plan or to an IRA, allowing them to remain in a tax-deferred environment.

Cash balance plans are most appropriate for:

- Company owners (and highly compensated employees) who want to contribute more than $54,000 per year to their retirement accounts
- Company owners (and other participants) who are over 40 and wish to catch up on their retirement savings
- Companies that can demonstrate a consistent level of profitability,

ideally over $250,000 per year, with no expectations of downward changes in that level as contributions are mandatory, not discretionary

- Owners with excess income to invest
- Companies that already contribute 3 to 4 percent in matches to employee defined contribution plans, or are willing to do so

Cash balance plans aren't for everyone. Aside from the list above, consider:

- To qualify for favorable tax treatment as a qualified plan, cash balance pension plans must remain in effect for several years, at least three but the longer the better. There can be consequences, such as excise taxes and penalties, if a plan is not funded to its minimum level on a timely basis each year, or if the plan is terminated early. It is critical to work with a plan design specialist and be confident of favorable cash flows before implementing a cash balance pension plan.
- There is also a cost consideration. There are administrative fees involved with establishing the plan, actuarial reports, recordkeeping and tax filings, as well as terminating the plan if it is discontinued. However, in most cases, the tax savings and other advantages associated with a plan more than outweigh cost considerations.

Is a cash balance plan right for you and your business? We can help you make that determination. Contact HBKS for a complimentary plan design consultation. If you decide on a cash balance plan, we'll work with you to design and implement the plan, fund it, ensure investments are prudently handled and reporting requirements are met, and keep plan participants educated and updated on an ongoing basis.☐

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