An Introduction to Cash Balance Plans

Typical retirement plans are subject to relatively low contribution limits. Professional firms and businesses looking for larger tax deductions and accelerated retirement savings, may find Cash Balance Plans an important alternative to consider.

What makes Cash Balance Plans so attractive?

A well-designed Cash Balance Plan combined with a 401(k)/Profit Sharing Plan can allow business owners to make annual tax-deductible retirement plan contributions for themselves in excess of $180,000 at age 40 and over $380,000 at age 60, as detailed in the table below. Non-highly compensated employees typically receive much smaller contributions since the plan design is flexible to accommodate the individual needs of the business owner.

2023 Maximum Contributions

Age	Cash Balance	Profit Sharing	Total
40	$114,000	$66,000	$180,000
45	$146,000	$66,000	$212,000
50	$188,000	$73,500	$261,500
55	$241,000	$73,500	$314,500
60	$309,000	$73,500	$382,500
65	$321,000	$73,500	$394,500

Source: IRS.gov

What is the difference between a 401(k) Plan and a Cash Balance Plan?

A 401(k) Plan is a Defined Contribution Plan that meets the Employee Retirement Income Security Act of 1974 (ERISA) guidelines. A participant's balance is determined by contributions made to the plan and the performance of plan investments (based on the participant's selections). The plan sponsor is not required to make contributions, as is usually the case with a pension plan. With a 401(k), an employee can choose to make contributions to the plan.

A Cash Balance Plan is also an IRS-qualified retirement plan and is considered a hybrid Defined Benefit-Defined Contribution Plan, since it is a Defined Benefit Pension Plan with a 401(k) twist. The promised benefit is stated as a 401(k)-style account balance, rather than as a monthly income stream (for a Defined Benefit Plan). The plan is designed to optimize benefits, minimize costs and provide high tax- deductible contributions for the plan sponsor.

Advantages of Cash Balance Plans

1. **Accelerated Retirement Savings**
   Age-weighted contributions can enable businessowners to make pretax deferrals that are significantly greater than allowed in a standalone 401(k) or other defined contribution plan.

2. **Tax Efficiency**
   Cash Balance Plans help businessowners who seek a tax deduction for plan contributions, plus generous tax-deferred retirement contributions for themselves.

3. **Asset Protection**
   As with any IRS-qualified retirement plan, Cash Balance assets are protected in the event of a lawsuit or bankruptcy.

4. **Employee Attraction & Retention**
   Cash Balance Plans are more appealing to many employees than just 401(k) plans alone, giving employers a possible recruitment and retention advantage.

Case Studies

Case Study #1

Background

Business Owner Goal: Maximize Partner Retirement Contributions

Employee Demographics:

- 4 Partners
- 1 Highly Compensated Employee (HCE)
- 30 Staff Employees

Benefits for the Partners:

- 401(k)/Profit Sharing Plan: 71%
- Cash Balance Plan: 98%
- Total Plan Contributions: 93%

Plan Contributions

	Age	Compensation	401(k)	Profit Sharing	Cash Balance	Total	Tax Savings
Partner	62	$330,000	$30,000	$43,500	$341,000	$414,500	$165,000
Partner	52	$330,000	$30,000	$43,500	$207,000	$280,500	$112,200
Partner	47	$330,000	$22,500	$43,500	$161,000	$227,000	$90,800
Partner	39	$330,000	$22,500	$43,500	$108,000	$174,000	$69,800
Total Partners		*$1,320,000*	*$105,000*	*$174,000*	*$790,000*	*$1,096,000*	*$437,000*
HCE (1)	48	$150,000	Elective	$4,500		$4,500	
Staff (30)	39	$870,000	Elective	$65,250	$13,050	$78,300	
Total Staff		*$1,020,000*		*$69,750*	*$13,050*	*$82,800*	
Total Plan		*$2,340,000*	*$105,000*	*$243,750*	*$803,050*	*$1,178,800*	
Partner Benefits				*71%*	*98%*	*93%*	

Case Study #2

Background

Law Firm Goal: Maximize Partner Contributions

Employee Demographics:

- 3 Partners
- 2 Associates (HCE)
- 4 Staff Employees

Benefits for the Partners:

- 401(k)/Profit Sharing Plan: 78%
- Cash Balance Plan: 99%
- Total Plan Contributions: 93%

	Age	Compensation	401(k)	Profit Sharing	Cash Balance	Total	Tax Savings
Partner	42	$330,000	$22,500	$43,500	$126,000	$192,000	$76,800
Partner	41	$330,000	$22,500	$43,500	$207,000	$120,000	$74,400
Partner	44	$330,000	$22,500	$43,500	$161,000	$139,000	$82,000
Total Partners		*$990,000*	*$67,500*	*$130,500*	*$385,000*	*$583,000*	*$233,200*
HCE (2)	33	$300,000	Elective	$9,000		$9,000	
Staff (4)	35	$225,000	Elective	$27,800	$3,790	$31,590	
Total Staff		*$525,000*		*$36,800*	*$3,790*	*$40,590*	
Total Plan		*$1,515,000*	*$67,500*	*$167,300*	*$388,790*	*$623,590*	
Partner Benefits				*78%*	*99%*	*93%*	

What's needed to set up a Cash Balance Plan?

The first step is to gather demographic information, including the date of birth, date of hire, hours worked, and compensation for all owners, partners, and employees. A retirement plan consultant will design a proposal based on the specific goals of the firm. Once the appropriate plan design is completed, a plan document is prepared. This plan document will list all assumptions of the plan and ensure compliance with all IRS rules and regulations. It will also be submitted to the IRS for approval and is necessary before the plan can be funded.

On-going plan administration is required for Cash Balance Plans, including annual reporting forms (as required by the IRS and Department of Labor), as well as, allocation and actuarial reports in support of allowable and required contributions. There are penalties for not filing required forms and the pension plan could be disqualified for non-compliance.

Next Steps

Cash Balance Plans are complex, and it's important that you work with a firm that's experienced in the design, implementation, and on-going management of these plans. Let us know if you would like one of Choreo's retirement plan experts to help you determine if a Cash Balance Plan could benefit your clients.