

# Add a Cash Balance Plan for Tax Savings and to help Improve Participant Outcomes

## What is a Cash Balance Plan?

A cash balance plan is a “hybrid” retirement plan that combines features of both defined benefit and defined contribution plans. While a traditional defined benefit plan provides for a specific benefit at retirement, often using a complex formula, a cash balance plan provides the benefit at retirement as an account balance (referred to as a hypothetical account), similar to a defined contribution plan.

## What Type of Organization Might Benefit from a Cash Balance Plan?

Cash balance plans may best suit organizations with a predictable cash flow and consistent profits. These could include, but are not limited to:

- Professional groups, including lawyers, doctors, dentists, engineers, architects, and accountants
- Family and closely held businesses
- Sole proprietors
- An organization that is already maximizing its contribution limits through an existing defined contribution plan

While it’s true that defined contribution plans continue to eclipse defined benefit plans by an ever-widening margin, at least one particularly bright spot can be found in the defined benefit world: cash balance plans, which can offer the best of both defined contribution and defined benefit worlds.

## Plan combinations Provide the Most Flexibility

Employers can raise contribution limits by offering a combination of qualified retirement plans.

For example, if a cash balance is combined with a 401(k) profit sharing plan, a 60-year old could contribute nearly \$300,000 in a single year, as the highlighted row in the table shows.

Age	401(k) Only	401(k) with Profit Sharing		Cash Balance		Total Annual Contributions	Potential Employer Tax Savings
60	\$24,000	\$60,000	+	\$235,000	=	\$295,000	\$121,500
55	24,000	60,000	+	180,000	=	240,000	96,750
50	24,000	60,000	+	140,000	=	200,000	78,750
45	18,000	54,000	+	110,000	=	164,000	65,250
40	18,000	54,000	+	85,000	=	139,000	54,000
35	18,000	54,000	+	65,000	=	119,000	45,000

2016 contribution limits. 401(k) limit includes annual catchup contributions for participants ages 50 or older. Actual results may vary depending on the actual plan design, participant compensation, employee demographics and projected retirement age.

\*Based on assumed combined federal and state tax rate of 45%. Calculations uses “Total Annual Contributions” excluding 401(k) contributions

## How does a Cash Balance Plan work?

In a cash balance plan, participants have a hypothetical account to which the plan sponsor contributes a flat dollar amount or percentage of compensation (“pay credit”) and interest credit each plan year.

And while it’s true that a cash balance plan may have higher administrative costs than a 401(k) plan, largely because the cash balance plan’s funding must be certified by an actuary each year, a cash balance plan’s tax benefits can offset this additional administrative cost.

## Benefits of a Cash Balance Plan

For **employers**, a cash balance plan:

- Is easier for employees to understand, which means they may appreciate it more than a traditional defined benefit plan
- Permits them to contribute either a percentage of pay or a flat-dollar amount
- Can work well in combination with a defined contribution plan
- Makes it easier to boost benefits for owners and other key employees, and to control the cost of benefits for others
- Offers greater control over investment strategy

## Benefits of a Cash Balance Plan

For **plan participants**, a cash balance plan:

- Is easier to understand than a traditional defined benefit plan
- Is more portable; upon separation from service, accounts can be distributed or rolled over to an IRA or another employer-sponsored plan
- Permits higher contribution limits for key employees and older participants
- Involved little or no investment risk, depending on the plan design

IRS Retirement Plan Limits	2017	2016	2015
Cash Balance Maximum Lump Sum <sup>1</sup>	\$2,600,000	\$2,600,000	\$2,600,000
Cash Balance/Defined Benefit Annuity <sup>2</sup>	\$215,000	\$210,000	\$210,000
DC Plan Annual Additions Limit <sup>3</sup>	\$54,000	\$53,000	\$53,000
Maximum Compensation <sup>4</sup>	\$270,000	\$265,000	\$265,000
401(k) Plan Deferral Limit <sup>5</sup>	\$18,000	\$18,000	\$18,000
Catch-up Deferral Limit <sup>5</sup>	\$6,000	\$6,000	\$6,000
Highly Compensated Compensation <sup>6</sup>	\$120,000	\$120,000	\$120,000
Social Security Taxable Wage Base	\$127,200	\$118,500	\$118,500

1 Payable at retirement age 62

2 Based on the year in which the limitation ends

3 Based on the year in which the Limitation Year ends

4 Based on the year in which the Plan Year begins

5 Applies to the calendar year

6 Based on the year in which the preceding plan year begins