

Rebalance 401(k) Strategic Guide to

# Cash Balance Plans



For successful business owners with steady revenue, a Cash Balance Plan can be an **excellent retirement savings vehicle.**

Though some risks should be considered, the major benefits that Cash Balance Plans offer include significant tax deductions and accelerated savings.



## Cash Balance FAQs

### Q. What is a Cash Balance Plan?

The U.S. Department of Labor has outlined two general types of retirement plans: defined benefit plans and defined contribution plans. A Cash Balance Plan incorporates elements of both a defined benefit plan and a defined contribution plan, and therefore is sometimes referred to as a “hybrid” plan. A defined benefit plan provides a specific benefit at retirement for each eligible employee.

A defined contribution plan specifies the amount of contributions to be made in an employee’s retirement account. In being a hybrid of the two, a Cash Balance Plan guarantees a specific benefit at retirement for each participant. The benefit is based on ongoing — and fixed — annual contributions. One major advantage of the hybrid format of a Cash Balance Plan is that it allows for larger tax deductions and accelerated retirement savings of a defined benefit plan. Another advantage is that it also maintains some of the flexibility and portability of a defined contribution plan.





## Q. Can you explain the benefits of a Cash Balance Plan?

With a Cash Balance Plan, business owners can accelerate their retirement savings and realize significant annual tax deductions. This is primarily due to the fact that the annual contribution limits for a Cash Balance Plan are higher than a 401(k) Profit Sharing Plan. For example, the annual maximum contribution for a 401(k) Profit Sharing Plan is limited to \$66,000 (\$73,500 for age 50 and older) for 2023, while the maximum contribution for a Cash Balance Plan can be as high as **\$324,000**. The table shows the annual maximum Cash Balance Plan contributions based on age for 2023. Cash balance contributions reduce the owner's taxable income dollar for dollar and also grow tax-deferred.

**Retirement Plan Contribution Limits for 2023**

Age	401(k) / Profit Sharing	Cash Balance	Total	Tax Savings*
60–65	\$73,500	\$324,000	\$397,500	\$159,000
55–59	\$73,500	\$249,000	\$322,500	\$128,000
50–54	\$73,500	\$192,000	\$265,500	\$106,000
45–49	\$66,000	\$150,000	\$216,000	\$86,000

\*Assumes a 40% personal tax rate.

## Q. How does a Cash Balance Plan work?

Employees have their “own” account resembling that of a 401(k) or profit sharing plan.

There are two ways in which each participant’s benefit grows annually with a Cash Balance Plan:

### 1. A contribution credit

### 2. An interest crediting rate

The employer guarantees participant benefits and is the sole bearer of investment risk.

The **contribution credit** is the amount that the employer contributes each year on behalf of the owners and the participants. The contribution is deposited the next year before business taxes are filed. This amount can either be a flat dollar value or a percentage of income; for example, \$1,000 annually per participant or 2% of a participant’s annual compensation. This contribution can vary between employees and owners as long as the plan passes compliance testing. The annual funding formula is specific for each company, depending on employee demographics and employer goals. A cash balance visual can model funding formula options for business owners to help them evaluate whether a Cash Balance Plan is a good strategy.

The **Interest Crediting Rate** is the rate at which the plan guarantees interest on accumulated contributions. This rate is typically tied to an index, such as the 30-year treasury yield. An actuary calculates the required employer contribution each year based on market growth of plan assets, plan census data, and the interest crediting rate. The actuary also oversees that the

plan passes annual compliance testing. These tests ensure that contributions made to highly compensated employees reflect a reasonable relationship to contributions made to non-highly compensated employees.

Assets within a Cash Balance Plan are pooled and come solely from the employer. Investments are directed by the plan trustee rather than individual participants. Typically, investments within the plan seek returns that are consistent with the interest crediting rate to minimize risk for the employer. **To maximize benefits to the business owner and increase the chance of passing compliance testing, Cash Balance Plans are generally used in conjunction with a 401(k) Profit Sharing Plan.**





## Who is eligible for a Cash Balance Plan?

A Cash Balance Plan can be designed to provide different levels of benefit to different employees, as long as annual non-discrimination requirements are satisfied. For example, in some cases a plan could provide \$100,000 per year to business owners and 2% of compensation to other eligible employees. At the minimum level, a Cash Balance Plan must cover the lesser 40% of employees or 50 employees.

### Q. Can you explain the risks of a Cash Balance Plan?

Yes. Rebalance acts as a Fiduciary for our clients, which means that we act only in the client's best interest. To that end, we will provide balanced information on every aspect of a Cash Balance Plan. This is the best way to help business owners make the right decision for their business. While the benefits of a Cash Balance Plan can seem attractive to business owners, there are also risks that should be considered.

The business owner, or employer, bears all investment risk. The employer guarantees that the assets within the plan will grow by the stated Interest Crediting Rate, regardless of actual market performance. For example, if the beginning of year (BOY) balance is \$100,000 and the interest crediting rate is 4%, the end of the year (EOY) balance should be \$104,000. If, due to market performance, the EOY balance is only \$50,000, the employer takes responsibility to fully fund the \$54,000 shortfall in addition to the planned contribution credit. If the contribution credit is \$100,000, the employer's contribution requirement is \$154,000. The shortfall funding requirement can be amortized over seven years to help manage market volatility.

Conversely, if, due to market performance, the EOY balance is \$124,000, the employer's contribution requirement would decrease by \$20,000. Rather than contributing \$100,000, the employer must contribute \$20,000 less, or \$80,000, which decreases the employer's tax deduction for that year. **Assets within a Cash Balance Plan typically seek returns consistent with Interest Crediting Rate, since market volatility affects the predictability of annual ongoing contributions. Rebalance manages the investments on our clients' behalf with that as the goal.**



For more information about Cash Balance Plans, please visit [rebalance360.com](https://rebalance360.com).





## **Q: What is involved in establishing a Cash Balance Plan within a business?**

Rebalance will collect census information from the business owner, and lead them through an in-depth analysis of if a Cash Balance Plan solution makes sense for them.

Rebalance will ensure the plan is tailored to your firm's unique goals, and ensure it complements your existing 401(k) plan, and vice-versa.

Rebalance will work with our Actuary and Recordkeeping partners to implement the plan, and provide and deliver materials for the business owner and employees to ensure understanding of this retirement benefit.

## **Q. Is a Cash Balance Plan set in stone?**

A Cash Balance Plan should only be established if the employer intends for it to be “permanent.” One caveat is the employer could possibly lower the amount of future contributions to the Cash Balance Plan, pending certain conditions are met. This can be done by either amending the plan document or “freezing” the benefit accruals. It is not impossible to terminate a Cash Balance Plan, however, this is a lengthy process and can be costly to the employer.

This underscores the importance of the consultation that Rebalance will provide in exploring the Cash Balance Plan, so that the expected annual Employer Contribution is well within expected income levels for the foreseeable future (at least three to five years).



## Q. Where do the funds for a Cash Balance Plan come from?

All assets within a Cash Balance Plan come from company coffers. In many cases, a minimal amount is contributed on behalf of employees, while the majority of the assets are contributed for the business owners and key employees. Often, business owners will use the Cash Balance contribution to reduce their taxable income. For example, a 50-year-old doctor who earns \$500,000/year might choose to reduce her salary to \$350,000 and take \$150,000 as an annual Cash Balance Plan contribution. Since money in the Cash Balance Plan is tax-deferred, this **directly reduces the dentist's tax burden.**

This can get complicated when there are multiple business owners involved. Each business owner will need to decide the amount he or she wants to put toward the Cash Balance Plan and will need to adjust his or her compensation accordingly. Rebalance can facilitate conversations with the actuaries and the business owners tax processing CPA's to ensure that each business owner's unique goals are incorporated in the Cash Balance Plan design.

## Q. What are the roles and responsibilities associated with a Cash Balance Plan?

Rebalance partners with an independent actuary to help business owners evaluate their financial needs, goals, and circumstances. Each role in a Cash Balance Plan is described in the chart below.

Role	Responsibility
<b>Employer / Business Owner</b>	<ul style="list-style-type: none"><li>• Select and monitor service partners</li><li>• Provide and fund the plan</li><li>• Allocate assets among plan investment options</li></ul>
<b>Rebalance / Plan Administrator</b>	<ul style="list-style-type: none"><li>• Select, monitor, and update the investment options available in the plan as an ERISA 3(38) Investment Manager</li><li>• Support the employer in selecting and monitoring service providers</li><li>• Facilitate communication between plan sponsor and service provider</li></ul>
<b>Plan Actuary and Recordkeeper</b>	<ul style="list-style-type: none"><li>• Create plan documents</li><li>• Determine annual actuarial calculations</li><li>• Oversee annual compliance testing</li><li>• Prepare IRS form 5500 for the Plan</li></ul>







## Q. Who is the ideal candidate for a Cash Balance Plan?

A Cash Balance Plan may be a good fit for a business if some of the following are true:

- A business owner or business partners want to accelerate their rate of retirement savings
- A business consistently produces steady revenue
- A business owner or business partners have personal annual income greater than \$275,000 and are seeking an annual tax deduction of \$73,500 or more
- A company has fewer than 15 employees per one owner
- A business owner or business partners are generally older than their employees
- A business owner already funds an employer contribution of 5% or more of employee compensation or is interested in doing so (this could include a Profit Sharing Plan or Safe Harbor 401(k))

# Are you ready for a comprehensive review of your 401(k) plan and to see if a Cash Balance Plan is right for you?

→ Please feel free to schedule time with David Ranney, VP of Sales at Rebalance, at [dranney@rebalance360.com](mailto:dranney@rebalance360.com)



## Glossary

**Cash Balance Plan:** A type of defined benefit plan where the benefit amount is based on annual ongoing employer contributions and therefore acts similarly to a defined contribution plan.

**Contribution Credit:** The annual amount that an employer must contribute to a Cash Balance Plan on behalf of the participants. This can be a dollar value or a percentage of the participant's income.

**Defined Benefit Plan:** Otherwise known as a traditional pension plan, this plan guarantees the participant a specified monthly benefit at retirement. The employer is responsible for determining how the plan's assets are invested and bears all risk if the plan's assets are insufficient to cover the promised benefit. Often, factors such as salary, age, and the number of years of employment form the basis of this benefit.

**Defined Contribution Plan:** The employee and/or the employer contribute to the employee's individual account under the defined contribution plan. The employee often decides how his or her account is invested and bears all investment risk. The amount in the account at distribution includes the contributions and investment gains or losses, minus any investment and administrative fees. A popular type of a defined contribution plan is the 401(k) plan.

**Interest Crediting Rate:** The annual rate at which the sponsor of a Cash Balance Plan guarantees interest on the accumulated contributions credits. This rate is typically tied to an index such as the 30-year treasury rate.

**Inflexible Funding:** Contribution credits are required annually and cannot be modified from year to year. Before implementing a Cash Balance Plan, the employer should be sure that it can commit to the ongoing annual funding requirements. A Cash Balance Plan is not a favorable option if a business is unable to sustain cash flow sufficient to fund the plan over the long term.

**Administrative Expense:** Typically, it is more costly to administer a Cash Balance Plan than a 401(k) Profit Sharing Plan, because a Cash Balance Plan requires ongoing actuarial work.

**Administrative Complexity:** In the majority of cases, a Cash Balance Plan is more complex than a 401(k) Profit Sharing Plan. Since this benefit is more sophisticated, it requires ongoing administrative support, additional decision-making, and associated costs.