SCHNEIDER DOWNS
Retirement Solutions

Cash Balance
Retirement Plans

What is a Cash Balance Plan?

There are two general types of pension plans — defined benefit plans and defined contribution plans. In general, defined benefit plans provide a specific benefit at retirement for each eligible employee, while defined contribution plans specify the amount of contributions to be made by the employer toward an employee's retirement account. In a defined contribution plan, the actual amount of retirement benefits provided to an employee depends on the accumulation of contributions and the actual investment gains or losses of the account.

A cash balance plan, also known as a hybrid plan, is a defined benefit plan that provides a retirement benefit as an accumulation of annual, defined contribution amounts and guaranteed interest credits, as opposed to actual investment gains or losses. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks are borne solely by the employer.

Unlike defined contribution plans, the contribution limits applicable to cash balance plans are age-dependent, allowing older employees to receive significantly larger contribution credits than younger employees.

2021 Limits for 401(k) Profit Sharing & Cash Balance Plans*				
Age	401(k) Deferrals	Total 401(k) Contributions (EE & ER)	Cash Balance	Total
60-65	$26,000	$64,500	$281,000	$345,500
55-59	$26,000	$64,500	$230,000	$294,500
50-54	$26,000	$64,500	$179,000	$243,500
45-59	$19,500	$58,000	$140,000	$198,000
40-44	$19,500	$58,000	$109,000	$167,000
35-39	$19,500	$58,000	$85,000	$143,000
30-34	$19,500	$58,000	$66,000	$124,000

**Maximum 401(k) with Profit Sharing amounts may be reduced if compensation is lower than IRS maximum compensation limit of $290,000 and other deduction limits may apply. Maximum cash balance amounts assume 3-year average compensation of at least $230,000. Lower 3-year average compensation may reduce the amounts shown.*

What are the Tax Advantages of a Cash Balance Plan?

Cash Balance plans have become increasingly popular, especially among small business owners and high-income earners. Why? One of the effective strategies for saving money as a small business owner or high-income earner is through federal income tax deductions. Because a cash balance plan is, technically, a defined benefit plan, the federal income tax deduction limitation is determined as a function of the funding requirement necessary to provide the plan's stated benefits, as opposed to a percentage of eligible payroll.

The higher federal income deduction limits associated with cash balance plans give high-income earners, small business owners, and corporations the ability to deduct contributions from their taxable income, resulting in lower tax obligations.

Who is an Ideal Candidate for a Cash Balance Plan?

1. Principals seeking a tax deduction of more than $50,000 or making more than $250,000 per year
2. Highly profitable companies of all types and sizes
3. Successful family businesses and closely held businesses
4. CPA and law firms, medical groups and professional firms
5. Older owners who need to accelerate retirement savings during a relatively short time

Can Cash Balance Plans Be Offered in Addition to 401(k) Plans or Other Plans?
Yes, the employer can offer a combination of qualified retirement plans in order to produce a larger contribution. In fact, in most cases, a 401(k) profit sharing plan in conjunction with a cash balance plan is necessary to produce the desired owner and employee contributions.

Must Everyone Participate Equally in the Cash Balance Plan?
No. Each participant can have a different amount contributed for them.

Can Cash Balance Contributions Be Changed?
Yes, but with restrictions. Cash balance plans can be amended periodically to permit different contribution levels. Usually, any reductions must be made before any employee works 1,000 hours during a plan year. In addition, a plan can also be frozen or terminated. Certain 15- to 45-day notices are required to participants when benefits are reduced.

Is the Plan Subject to IRS Nondiscrimination Testing?
Yes, like any other qualified plan, a cash balance plan is subject to nondiscrimination testing. Employers can anticipate contributions in the range of 5% to 7.5% of pay for staff if the owners or partners receive the maximum cash balance contribution. The exact percentage required for employees depends on the number of employees included in the plan and the results of nondiscrimination testing.

What are the Distribution Options Upon Retirement or Termination?
Any vested account in a cash balance plan can be paid as a lump-sum distribution or annuity. A lump sum distribution can be rolled over to an IRA or another qualified retirement plan.

How Do Cash Balance Plans Differ From 401(k) plans?
There are four major differences between typical cash balance plans and 401(k) plans:

1. Participation - Participation in typical cash balance plans generally does not depend on the workers contributing part of their compensation to the plan; however, participation in a 401(k) plan does depend, in whole or in part, on an employee choosing to make a contribution to the plan.
2. Investment Risks - The investments of cash balance plans are managed by the employer or an investment manager appointed by the employer. The employer bears the risks of the investments. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. By contrast, 401(k) plans often permit participants to direct their own investments within certain categories. Under 401(k) plans, participants bear the risks and rewards of investment choices.
3. Life Annuities - Unlike 401(k) plans, cash balance plans are required to offer employees the ability to receive their benefits in the form of lifetime annuities.
4. Federal Guarantee - Since they are defined benefit plans, the benefits promised by cash balance plans are usually insured by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). If a defined benefit plan is terminated with insufficient funds to pay all promised benefits, the PBGC has authority to assume trusteeship of the plan and to begin to pay pension benefits up to the limits set by law. Defined contribution plans, including 401(k) plans, are not insured by the PBGC.

How are Plan Investments Handled?
Plan assets are pooled and invested by the trustee or investment manager. If the plan's investment earnings exceed the guaranteed rate, the excess will be used to reduce future employer contributions. This will not affect the amount that is credited to the participants' accounts. Conversely, if the plan's investment earnings are less than the guaranteed rate, then future employer contributions will be increased. This make-up is typically spread out over seven years. A wide range of investment vehicles can be used by the plan sponsor to achieve the interest crediting rate.

For more information regarding cash balance plans, please contact our offices or visit our website, www.sdretirementsolutions.com.

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