Cherry Bekaert Wealth Management

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 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 participant's election). 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 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.

A well-designed Cash Balance Plan combined with a 401(k)/ Profit Sharing Plan can provide business owner's deductions in excess of $150,000 (at age 40) and $300,000 (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.

Cash Balance accounts may increase each year through an employer contribution (a flat amount or a percentage of pay) and through an annual interest credit called Interest Crediting Rate (ICR), which is written into the plan document. The most common ICR selected by Cash Balance Plan sponsors are "Fixed Rate" and "Actual Rate of Return.

What makes Cash Balance Plans so attractive?

1. **Tax Efficiency** - Cash Balance plans help business owners who seek a tax deduction for plan contributions, plus generous tax-deferred retirement contributions for themselves.

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

3. **Accelerated Retirement Savings** - Age-weighted contributions can enable business owners to double or triple the pretax deferrals possible in a defined contribution plan.

4. **Employee Attraction & Retention** - Defined benefit plans such as Cash Balance are appealing to many employees than typical 401(k) plans alone, giving employers a possible recruitment advantage.

Who are the ideal candidates to establish a Cash Balance Plan?

1. **Those with a desire to contribute above the 401(k) limit** - Business owners and partners who wish to contribute more than $56,000 in 2019 to their retirement accounts, can accelerate their savings with pre-tax contributions. Maximum amounts contributed to Cash Balance Plans are dependent on age and compensation.

2. **Those who contribute to a 401 (k) for the benefit of employees** - Cash Balance Plans are often established for the benefit of the business owners, but the business owner's staff may benefit as well. The plan

normally provides a minimum contribution between 5% and 7.5% of pay for staff in the Cash Balance Plan or a separate Profit Sharing 401(k) plan.

3. **A company that has demonstrated consistent profit patterns** - Because a Cash Balance Plan is a pension plan with required annual contributions, consistent cash flow and profit is important.

How does a Cash Balance plan work?

A Cash Balance plan specifies the employer contribution to be credited to each participant and the investment earnings to be credited (based on those contributions). Each participant has an account that resembles those in a 401(k) or Profit Sharing Plan and contributions can vary by participant. These accounts are maintained by a plan actuary. When participants terminate employment, they are eligible to receive the vested portion of their account balances.

The maximum plan contributions, in the table below, are based on the amount of benefits that can be paid to a participant in a defined benefit plan (IRS 415 limits). They also assume the business owner's compensation is at or above the compensation cap of $280,000 (2019) for the purposes of calculating maximum contributions. Actual plan contributions will vary based on client's goals and design assumptions.

Can Employer contributions change?

Profit Sharing Plans allow contributions to vary from year to year depending on profitability. For Cash Balance Plan contributions, employers can designate different contribution amounts for various participants. A Cash Balance Plan can also be frozen, terminated or modified before an employee works 1,000 hours during a plan year.

Can Employer contributions be subject to a vesting schedule?

Cash Balance contributions can vest over a schedule that can last as long as six years (similar to profit sharing contributions).

How do I 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, who has experience working with retirement plans including cash balance plans, 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 you can set up the plan investment accounts.

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. Cherry Bekaert LLP has extensive experience in the areas of retirement plan design, compliance and administration to help you navigate the complexities of a Cash Balance Plan and fulfilling your fiduciary duty.

Please refer to the case studies, included at the end of this document, to provide you sample retirement plan designs for illustration purposes.

2019 Maximum Contributions

Age	Cash Balance	Profit Sharing	Total
40	$96,665	$56,000	$152,665
45	$123,873	56,000	$179,873
50	$158,809	$62,000	$220,809
55	$203,682	$62,000	$265,682
60	$261,329	$62,000	$323,329
65	$271,284	$62,000	$333,284

Source: Cherry Bekaert LLP

Next Steps?

If you have any questions or would like an objective perspective on your 401(k) plan, accelerating your retirement savings, or larger retirement plan tax deductions - We are happy to start the conversation with you and give you some peace of mind regarding fiduciary best practices and maximizing your retirement savings.

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: 68%
- Cash Balance Plan: 98%
- Total Plan Contributions: 92%

Plan Contributions

	Age	Compensation	401(k)	Profit Sharing	Cash Balance	Total
Partner	62	$280,000	$25,000	$37,000	$267,000	$329,000
Partner	52	$280,000	$25,000	$37,000	$173,000	$235,000
Partner	47	$280,000	$19,000	$37,000	$134,000	$190,000
Partner	39	$280,000	$19,000	$37,000	$93,000	$149,000
Total Partners		**$1,120,000**	**$88,000**	**$148,000**	**$667,000**	**$903,000**
HCE (1)	48	$130,000	Elective	$3,900	-	$3,900
Staff (30)	39	$870,000	Elective	$65,250	$13,050	$783,000
Total Staff		**$1,000,000**		**$69,150**	**$13,050**	**$82,200**
Total Plan		**$2,120,000**	**$88,000**	**$217,150**	**$680,050**	**$985,200**
Partner Benefits					**98%**	**92%**

Source: Cherry Bekaert LLP and Cherry Bekaert Benefits Consulting. For illustration purposes only. Actual plan design is based on client goals, compensation, and employee demographics.

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: 76%
- Cash Balance Plan: 99%
- Total Plan Contributions: 92%

Plan Contributions

	Age	Compensation	401(k)	Profit Sharing	Cash Balance	Total
Partner	42	$280,000	**$19,000**	$37,000	$89,260	$145,260
Partner	41	$280,000	**$19,000**	$37,000	$84,010	$140,010
Partner	44	$280,000	**$19,000**	$37,000	$99,760	$155,760
Total Partners		**$840,000**	**$57,000**	**$111,000**	**$273,030**	**$441,030**
HCE (2)	33	$267,000	Elective	$8,010	-	$8,010
Staff (4)	35	$225,000	Elective	$27,800	$3,790	$31,590
Total Staff		**$492,000**		**$35,810**	**$3,790**	**$39,600**
Total Plan		**$1,332,000**	**$57,000**	**$146,810**	**$276,820**	**$480,630**
Partner Benefits					**99%**	**92%**

Source: Cherry Bekaert LLP and Cherry Bekaert Benefits Consulting. For illustration purposes only. Actual plan design is based on client goals, compensation, and employee demographics.