

Reduce Taxes, Increase Savings With A Cash Balance Plan

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An increasing number of highly-compensated individuals are finding that contributions made to their 401(k) and profit sharing accounts have reached the maximum allowable amounts. However, now those highly compensated individuals can increase their contributions through the increasingly popular Cash Balance Plan.

As the fastest-growing retirement plan in the United States, 401(k) plans allow participants to contribute up to \$20,500 for 2008, depending on the participant's age. A profit-sharing plan allows employers to contribute another \$30,500 on behalf of the participant. However, once the annual maximum contribution has been reached (\$51,000 for those 50 years of age and over or \$46,000 for those under 50 years of age), then no further contributions can be made for that participant on a pre-tax basis.

On the other hand, a Cash Balance Plan contribution can be as much as \$200,000 per year, which varies by age. For individuals making in excess of \$250,000 per year and who have a need for additional tax deductions, a Cash Balance Plan provides a welcome respite from the low retirement plan contribution levels available through a 401(k) profit sharing plan.

Since 1985 when Bank of America implemented the first Cash Balance Plan, thousands of companies have followed suit. Citing predictability and ease of administration, firms oftentimes opt for Cash Balance Plans because of their portability, which is

used to attract employees, especially the young mobile workforce in high-turnover industries.

Initially, large corporations with more than 10,000 employees, such as AT&T, Bell Atlantic and IBM adopted Cash Balance Plans. However, a change in the tax law in 2001 allowed contributions to increase by as much as 60 percent, making Cash Balance Plans much more attractive to successful businesses and professional service firms. The Pension Protection Act of 2006 further cemented the future of Cash Balance Plans by allowing for substantial increases in contributions and tax savings.

As of 2006, which are the latest statistics available, nearly 70 Cash Balance Plans had been implemented in Georgia, ranging from firms with two participants to Delta Airlines with over 90,000 participants. Nearly one third of Georgia Cash Balance Plans have been installed in medical and doctors' groups.

A Cash Balance Plan is a defined benefit plan that specifies the amount of contribution to be credited to each participant. The contribution can be either a flat dollar amount or a percentage of pay. The plan credits interest on those contributions at a guaranteed rate. Each participant has an individual account which resembles the accounts in a 401(k)/profit sharing plan. All participant accounts are maintained by the plan actuary who generates annual participant statements.

The guaranteed rate of return is spelled out in the plan document and is not dependent on the plan's investment performance. The rate of return changes each year and for many plans is equal to the yield on the 30-year Treasury bond, which in recent years has been around five percent. Once participants terminate employment, they are eligible to receive the vested portion of their account balance determined by the plan's vesting schedule.

Companies that are good candidates for Cash Balance Plans

have one or more of the following characteristics:

1. Owners who desire to contribute more than \$50,000 per year

Owners may neglect their personal retirement savings while they are building their businesses. Consequently, they need to catch up on their retirement savings. In addition, many profitable businesses need tax deductions and \$50,000 is not enough. A Cash Balance Plan allows for both an acceleration of savings and a large tax deduction.

2. Owners over 40 years of age who desire increased tax deductions or wish to catch up on their pension savings

The maximum contributions allowed in Cash Balance Plans are age dependent. Therefore, the older the participants, the faster they can accelerate their savings. To determine an individual's maximum contribution to a Cash Balance plan, go to: www.CashBalanceDesign.com.

3. Companies that have demonstrated consistent profit patterns

Because a Cash Balance Plan is a defined benefit pension plan with required contributions, a consistent cash flow and profit is important.

4. Companies that are already contributing three percent or more to employees' accounts or are at least willing to do so

While Cash Balance Plans are often established for the benefit of owners and other highly compensated individuals, other employees also benefit. The plan normally provides a minimum contribution of five to seven percent of pay for the company's staff.

The types of businesses that are candidates for Cash Balance Plans include professional service businesses such as CPA and law firms, medical groups and family or closely-held businesses where there are a number of owners who are at their 401(k) and profit sharing contribution limit.

Cash Balance Plans may not be right for everyone. Due to the fact that they are a type of defined benefit plan, Cash Balance Plans require a

commitment to specific contribution level for two to three years. It is important that a company display consistent profit patterns in order to consider a plan. One should also consider company demographics and company culture. Cash Balance Plans can allow for large contributions for select employees such as the owners and executives. However, some company cultures dictate all employees are treated equally with regards to retirement plan contributions.

The advantage of the Cash Balance Plan over the traditional defined benefit plan is that owners/ shareholders know what is going into the plan on their behalf and what will come out when they leave.

Cash Balance Plans have to be amended in order to change contribution levels because they are not profit sharing plans under which contributions can vary year to year depending upon profitability. Employers can designate different contribution amounts for various

participants. However, the frequency of amendments to change benefits may be restricted in the absence of a valid business reason. For example, if a company's profit is not expected to support the Cash Balance Plan contribution, the plan can be amended. The plan can also be frozen or terminated.

Tax deductions for contributions to Cash Balance Plans are similar to other tax qualified retirement plans. Contributions by a partnership are allocated like other firm expenses (in proportion to ownership) unless the partnership agreement provides otherwise. Partnership agreements may need to be amended so that the contribution is allocated in proportion to each partner's plan benefit.

If you are working with highly-compensated individuals who are looking for additional tax deductions, or with individuals who need to catch up on their retirement contributions, you may want to suggest the Cash Balance Plan, which provides a significant opportunity to increase

contributions into a qualified retirement plan, as well as defer taxable income.

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