BPAS

Cash Balance Plans

a guide for advisors

2024 Plan Year

Why Offer Cash Balance Plans?

Cash Balance (CB) plans have been around since the mid 1980's, so why are they being implemented at a greater rate than 401(k) plans? **Because they're worth it!**

A CB plan is a Defined Benefit (DB) plan that looks like a Defined Contribution (DC) plan. This IRS-qualified retirement plan is known as a hybrid. Each employee has a theoretical account balance credited annually with service credits (usually pay-based) and interest credits. These interest credits are defined and guaranteed by the employer, including plans that define the interest credit as equal to the plan's actual rate of return with a 0% minimum over an employee's career, or use a conservative fixed rate or a treasury rate. These account balances are theoretical and need not equal plan assets. Assets are pooled, and benefits are paid out in the form of a lump sum or annuity.

Contribute More

CB plans are perfect for employers who are high wage earners and are currently maximizing contributions in their existing DC plan but would like to contribute more. CB contributions are in addition to, not instead of, DC plans. When combining a CB and DC plan, an employer should expect annual contributions for employees to be a minimum of 7.5% of pay. By doing this, an employer could potentially max out their contributions. An employer can supercharge their savings and get 20 years' worth of savings in half the time, which is key as recent studies show most Americans are not saving enough for retirement.

Offset Taxes

Recent increases in Federal, State and Local taxes have cut into business profits. More CB plans are being set up to help offset rising taxes. CB contributions reduce both taxable and Adjusted Gross Income (AGI), so business owners potentially could move into a lower tax bracket. Generally, a significant portion of the tax-deferred savings will benefit the business owner. The following examples illustrate the power of the CB plan.

- A 55-year-old owner could potentially get a CB contribution of $248,000, plus $69,000 in DC contributions, plus $7,500 in 401(k) catch up contributions for a total of $324,500 annually!*
- For a high wage earner in NYS, for example, $200,000 in tax-deferred savings will lower taxes by $74,000 in Federal Taxes (Top rate 37%), $13,700 in NYS taxes deferred (top rate of 6.85% excluding "millionaire" tax), $1,800 in Obamacare Medicare taxes saved (0.9%) and, if employer is a C-Corporation, $5,800 in Medicare taxes saved (combined EE/ER rate 2.9%) for a total tax reduction of $95,300.
  - $87,700 in tax deferrals
  - $7,600 in permanent tax savings (If you retire to a state without income tax, the State tax deferrals turn into permanent savings)

** Complicated combined plan tax deduction rules apply to small professional service employers with 25 or fewer active participants. These contribution amounts are examples.*

Recruitment Tool

These CB plans are a great recruitment tool to attract and retain the best talent. The employees benefit from these plans through increased employer contributions in addition to their salary deferrals. This is more important than ever before as recent data shows the average participant does not have enough money saved for retirement. The employees do not bear the investment risk and the benefits are portable and can be rolled into an IRA upon retirement or termination of employment.

Strengthen Relationships

In addition to the tax savings and increased retirement contributions, Financial Advisors are more aware of these plans and they are presenting them to their clients. We work closely with the advisor community and we'll gladly help with these discussions. If an advisor can help their clients better understand these plans and their benefits, it can only strengthen the relationship. It's important to remember if you aren't bringing this idea to your client, most likely someone else is.

Components of Combo CB Plans

401(k)
Participant Directed

- Combination of EE and ER Money
- $23,000 deferral, $7,500 catch up
- Discretionary Match or SH Contribution
- Discretionary Profit-Sharing

Cash Balance
Pooled Trustee Directed

- 100% Employer Contribution
- Set Minimum and Maximum Funding Limits
- Guaranteed Benefit and ICR
- Portable Benefit

Combo Plan
Supercharged Savings

- 2 Separate Plans
- Combo Testing
- ERISA Protection
- Qualified Plans

Power of CB Plans

Age 62 NRA

Maximum Service Credits - 2024

Age	Maximum CB Credit	Age	Maximum CB Credit	Age	Maximum CB Credit
30	$72,000	42	$130,000	54	$236,000
31	$75,000	43	$137,000	55	$248,000
32	$79,000	44	$144,000	56	$261,000
33	$83,000	45	$151,000	57	$274,000
34	$88,000	46	$159,000	58	$288,000
35	$92,000	47	$167,000	59	$303,000
36	$97,000	48	$175,000	60	$318,000
37	$102,000	49	$184,000	61	$335,000
38	$107,000	50	$194,000	62	$352,000
39	$112,000	51	$203,000	63	$345,000
40	$118,000	52	$214,000	64	$337,000
41	$124,000	53	$225,000	65	$330,000
				Maximum Lump Sum	$3,519,144

Cash Balance Plan contributions are higher because…

- It's a defined benefit (DB) pension plan
- Statutory maximum is annual benefit at retirement ($275,000 payable no earlier than age 62)
- Present value of maximum benefit - maximum permitted accumulation - is nearly $3.52M
- Maximum allowable contributions are those necessary to fund this maximum age 62 accumulation over a period of not less than 10 years

Restrictions & Flexibilities

Small business owners find the large deductible contributions of CB plans very attractive but can be nervous entering into these arrangements due to the misconception they are locked into this high level contribution until retirement.

The commitment is not forever!

Restrictions

- The plan cannot be established for a short-term tax deferral for a limited number of years and then terminated without a bona fide business reason unforeseen at the time of adoption, such as a merger or the unexpected significant and permanent loss of revenue. It cannot be terminated due to the owner's change of mind.
- The employer is annually obligated to make at least the minimum required contribution under ERISA funding rules. This minimum required contribution is generally less than the total of amounts credited to participants.
- The employer cannot amend the plan with a frequency and in a manner that its pattern can be construed as a discretionary profit sharing or cash or deferred arrangement, which is then in violation of contribution limits, such as amending the plan every year or every other year to vary owner(s) contribution amounts up and down.
- The employer cannot amend the plan to reduce benefits that have already been earned.
- The employer is also annually obligated to make any profit-sharing contributions for non-highly compensated employees (NHCEs) to the extent required to satisfy nondiscrimination testing.

Flexibilities

- The employer can terminate the plan at any time for a legitimate business reason.
- The employer can contribute any amount between the ERISA minimum required contribution and the IRS maximum deductible contribution – note the contribution amounts credited to participants will generally be within this min/max range.
- The employer has the ability to amend the plan as it desires, subject to the noted restrictions. The rate of future contributions may be reduced if necessary and desired at any time during the year up until the contribution for such year has been earned by a participant, for example, before affected participants complete a 1,000-hour requirement, if applicable.
- The employer may, if plan provisions permit, manage cash flow by reducing or foregoing discretionary profit-sharing contributions for the ownership/highly compensated employee (HCE) group. This may reduce the NHCE profit sharing contributions necessary to satisfy testing.
- Individual owners may also adjust their own salary deferrals to manage personal cash flow.

Pros & Cons of Common Benchmark Interest Crediting Rates

Fixed Rate

Rate remains static, such as 3%, with maximum allowable rate of 6%.

Pros:
- Easiest to understand
- Easiest to administer
- Distributions any time with prorated interest
- Best for projected testing
- Fixed target for investment policy

Cons:
- Static – does not correlate to interest rate environment
- Using a low rate can cause meaningful benefit minimum participation failures
- Not investable – no investment that will provide fixed rate without fluctuating principal value
- Higher level of Employer investment risk depending on rate

Treasury Rate

Based on selected term, such as 1, 5, 10 or 30-year treasury securities, applies for a year using look-back month and then resets for the subsequent year. Can implement with a minimum and/or maximum rate.

Pros:
- Relatively easy to understand
- Relatively easy to administer
- Distributions any time with prorated interest
- Correlation to interest rate environment

Cons:
- Not investable
- Subject to inflation
- Higher level of Employer investment risk depending on term
- Year to year changes can impact testing results
- Historically low rates can cause meaningful benefit minimum participation failures

Rate of Return

Based on the actual rate of return earned by plan assets (but not an allocation of actual net earnings as in the PS plan), can implement with a maximum rate.

Pros:
- Relatively easy to understand
- Can facilitate close tracking of assets to account balances
- Is investable
- Lowest level of Employer investment risk – principal guarantee only

Cons:
- Most complex to administer
- Can produce wildly fluctuating testing results
- Individual participant accumulation is limited by 415
- Distribution timing limited to first quarter of year following year of retirement, death or termination – no daily or interim valuation

Other rates such as equity based, fund based, or valuation (segment rate) based are available but are less popular and provide minor variations of the above in terms of pros and cons.

Recommendations

- Use a fixed rate consistent with the principal's risk tolerance and time horizon.
- Use a Treasury rate, with a 5.5% cap, if you want a rate correlated to the interest rate environment (with some inflation protection), relative stability and the ability to distribute benefits at any time with prorated interest and you are willing to assume some investment risk.
- Use the Actual Rate of Return on Plan assets, with a 5.5% cap, if you want to capture reasonable market upside and significantly limit your downside investment risk, but to do so you are willing to limit the timing of benefit distributions.

Your choice of interest crediting rate will drive your investment policy statement and the construction of the plan's portfolio. Regardless, assets should be invested relatively conservatively, and the plan viewed as your fixed income retirement asset allocation, and therefore, you may assume greater risk with more aggressive investments in your profit sharing 401(k) plan and other long-term assets.

Review of Why Offer CB Plans

- ✓ **Tax Deferrals:** Highest tax-deferred contributions of any Qualified plan
- ✓ **Tax Savings:** Retiring to a state without income tax turns state tax deferrals into permanent savings
- ✓ **Accelerated Retirement Savings:** Higher contribution limits add up!
- ✓ **Fully Portable for Employees:** Can roll funds into an IRA upon termination of employment
- ✓ **Lower Benefit Costs:** Lower cost to sponsors than a traditional Defined Benefit plan
- ✓ **Great Employee Benefit:** Employers make the contributions and professional investment advisors manage the money
- ✓ **Substantial Benefits:** High level of owner contributions ensures a continuing meaningful level of employer contributions for the rank-and-file employees, typically 7.5%-10% combined between plans
- ✓ **Combo Plans:** Work well with existing DC plans and protect against market volatility
- ✓ **No Participant Education:** Investment managers only deal with investing the money

Ideal Candidate

Owners who:

- have W2 compensation or Net Earned Income at or near compensation limit ($345,000 for 2024)
- are currently maxing out the Defined Contribution plan ($69,000 plus catch up for 2024)
- are relatively older than their employees
- are willing to contribute at least 7.5%-10% of pay for employees annually on a non-matching basis

Businesses where cash flow is sufficient and relatively stable for funding the CB plan for at least the next 3-5 years

What's the Catch?

Qualified Retirement Plan - Complex IRS Rules

- Coverage and nondiscrimination
- Maximum benefits
- Minimum eligibility, participation, and vesting

DOL (ERISA) Reporting/Disclosure Requirements

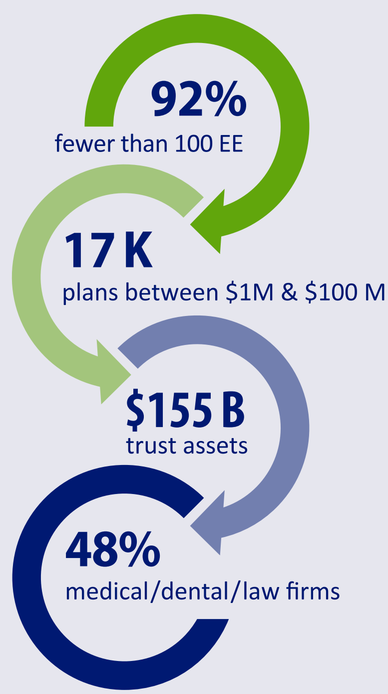
- Actuary signature required

PBGC Coverage and Premiums

- Unless exempt: plan covering professional services firm with 25 or fewer active participants at all times, or plan that covers only a sole proprietor (and employee spouse) or partners (and their employee spouses)
- 2024 flat rate of $101 per participant (plus variable rate premium if plan is underfunded)

Marketing Strategies

- ▶ **Small to Medium-Size Business and Professional Practices:** Predictable cash flow and profitability and looking for ways to reduce taxes
- ▶ **Owners Age 40 and Up:** Have not saved a meaningful amount for retirement and need to accumulate retire savings quickly
- ▶ **Business Owners Nearing Retirement:** Succession planning tool — younger owners can leverage large employer tax deferred contributions for older owners, which builds up a significant benefit that can be used to offset the cost of the final buyout
- ▶ **Businesses Looking to Recruit Talent:** Employees who value an employer funded retirement plan with protection from market volatility
- ▶ **Individuals Earning Significant Income:** People serving on board of directors or consultants who want to save this income and reduce overall taxes
- ▶ **Independent Contractors or Owner-Only Businesses:** Have steady income and want to accelerate retirement savings
- ▶ **Clients Looking for Flexibility:** Ability to have employees in different rate groups or owners/partners that want different benefit amounts



Supercharged Savings Accumulation

Most business owners have spent their careers building their companies and have not been able to save for retirement. Adding a CB plan to their existing 401(k) plan can accelerate those savings and make up for a late start. The graph below shows the accumulation of $3,335,657 in potential savings over a ten year period when adding CB plan contributions to the existing 401(k) plan.

Year	Age	DC Contribution	CB Contribution	Total Contribution	Year End Value
2024	52	$51,200	$214,000	$265,200	$265,200
2025	53	$51,200	$214,000	$265,200	$543,660
2026	54	$51,200	$214,000	$265,200	$836,043
2027	55	$51,200	$214,000	$265,200	$1,143,045
2028	56	$51,200	$214,000	$265,200	$1,465,397
2029	57	$51,200	$214,000	$265,200	$1,803,867
2030	58	$51,200	$214,000	$265,200	$2,159,261
2031	59	$51,200	$214,000	$265,200	$2,532,424
2032	60	$51,200	$214,000	$265,200	$2,924,245
2033	61	$51,200	$214,000	$265,200	$3,335,657

Assumptions

- 5% Annual rate of return — actual returns may be higher or lower than the 5% annual rate shown
- Table applies the 2024 IRS Limits on qualified plans in future years, no increases in contribution amount
- Assuming comp limit of $345,000, maximum salary deferral and catch-up plus 6% profit sharing

Investing Across the Spectrum of Vehicles

<table>
<tr><th></th><th>Totality of Vehicles</th><th>Cash Balance Plan</th><th>401(k) Plan</th><th>IRA</th><th>Outside of Tax-Qualified Plan</th></tr>
<tr><td>Accumulations</td><td></td><td>Cap on Lump Sum</td><td colspan="2">No Maximum Lump Sum</td><td>No Maximum Accumulation</td></tr>
<tr><td>Investment Options</td><td></td><td>Pooled Investments</td><td>Individual Direction Limited by Plan Options</td><td>Individual Direction with some Statutory Restrictions</td><td>Individual Direction</td></tr>
<tr><td>Taxability</td><td></td><td>Distributions Taxed as Ordinary Income</td><td colspan="2">Distributions Taxed as Ordinary Income</td><td>Potential for Favorable Capital Gains Tax Treatment</td></tr>
<tr><td>Common Investment Approach</td><td></td><td colspan="4">Conservative ▷ ▷ ▷ ▷ ▷ ▷ ▷ ▷ ▷ Aggressive</td></tr>
<tr><td>Risk Seeking Assets</td><td>40-80%</td><td>20-50%</td><td colspan="2" rowspan="2">Depends on Appetite for Risk</td><td>60-100%</td></tr>
<tr><td>Fixed Income</td><td>20-60%</td><td>50-80%</td><td>0-40%</td></tr>
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Frequently Asked Questions

How does the annual interest credit work?

The annual interest credit is a guaranteed incremental adjustment to the participant's cash balance account and is, for the most part, independent of the plan's investment performance. Historically, the interest credit rate has usually been tied to the 30-Year Treasury Rate (as defined by the IRS annually), or some other Treasury benchmark that may or may not have included a margin. The 30-Year Treasury has been running 3% or less in recent years and is currently less than 2%. Treasury benchmarks were used primarily to avoid whipsaw, a situation where the actuarial lump sum present value of the accrued plan benefit exceeded the value of the cash balance account. The Pension Protection Act of 2006, generally effective beginning in 2008, changed that by allowing other interest crediting rates including fixed rates up to 6% or the actual rate of return on plan assets.

How are plan assets invested?

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 create an actuarial gain and serve to lower required future employer contributions. This will not impact the interest credited to participants. Conversely, if the plan's investment earnings are less than the guaranteed rate, then the plan experiences an actuarial loss which serves to increase required future contributions. Note these losses are not required to be made up dollar for dollar the next year, they are made up typically over seven years (although new pension relief appears to expand that to 15 years). All types of qualified investment options can be used to achieve the interest crediting rate.

Does a Cash Balance plan have to be combined with a 401(k) Profit Sharing plan?

No. A CB plan can be a stand-alone plan; however, the total contribution amounts available to a business owner are higher when combining with a Defined Contribution plan.

What are the Distribution options upon separation from the company?

When participants terminate employment, they are eligible to receive the vested portion of their account balances. Vested accounts in a CB plan are usually paid as a lump-sum distribution. However, as a defined benefit plan, an annuity is the default form of payment and must be waived by the participant (and spouse, if married) to receive the lump-sum. A lump-sum distribution can be rolled over into an IRA or another qualified retirement plan.

Can the CB contribution be changed?

Yes, but there are restrictions. Although contributions are required on an annual basis, plans can be amended periodically to permit different contribution levels. Any reductions must be made before any employee becomes entitled to a benefit accrual, typically working 1,000 hours during the plan year, and advance notice to affected employees is required. Also, the CB plan can be frozen or terminated. See Cash Balance Plans Obligations & Flexibility Concerns section above for more detail.

Does each participant have to get the same benefit in the CB plan?

No, each participant can have a different contribution amount, but contribution benefit levels must be defined in the plan document and not subject to employer discretion.

Is this plan subject to IRS nondiscrimination testing?

Yes. Like other qualified plans, a CB plan is subject to coverage and nondiscrimination testing and other complicated and related requirements such as minimum participation, top-heavy, and gateway allocations. The required level of contributions for employees depends on the plan demographics and all the aforementioned related testing issues. Employers can anticipate annual non-elective/non-matching contributions to their retirement program (profit sharing 401(k) and CB) for their rank-and-file employees in the range 7.5% to 10% of pay.

Can sole proprietors or partners with no W2 income participate in a CB plan?

Yes. Sole Proprietors and Partnerships are eligible to participate in CB plans in the same manner they are allowed to contribute to DC plans. This is through Earned Income on Schedule C or K1 as there is no W2 income. This does NOT apply to Subchapter S Corporation shareholders; they must also be employees and only their W-2 compensation can be considered. General rule – if the pay is subject to FICA and Medicare (or SECA) taxes then it can be included as compensation for retirement plan purposes.

How are tax deductions and plan contributions handled for Sole Props and Partnerships?

Tax deductions for contributions made on behalf of non-partner employees are taken on a Partnership or Sole Proprietors' tax return. Tax deductions for contributions made on behalf of partners and the sole proprietor are taken on their personal or corporate tax return. The Partnership agreement or internal policy should assure each partner is allocated an appropriate share of the costs.

How do the fees of a Cash Balance plan compare to a Defined Contribution plan?

Cash Balance plans appear to be more expensive to set up and administer than Defined Contribution plans, however, they are typically more cost effective. CB plans ultimately help employers and participants save more money with significantly higher tax-deferred contribution limits and larger tax deductions.
In addition, there are no asset-based fees for the CB plan administration. Excluding the Investment Management fees if they are asset based, as the plan assets grow the administration fees do not grow along with them.

Is this a Qualified Plan and protected from Creditors?

Yes, a Cash Balance plan is an IRS-qualified plan, and all contributions to a qualified plan are tax-deductible expenses. Like all qualified retirement plans, the assets are protected from creditors.

How will participants receive their benefit statements?

Benefit statements are posted to the client website for the plan sponsor to download and distribute on an annual basis. This is a secure server so the plan sponsor will need to log in to retrieve the statements.

How will the plan sponsor receive their plan specific reports?

We prepare annual reports posted to the client secure website. This includes the annual valuation and governmental filing forms including the Form 5500, AFTAP and Schedule SB.

What regulatory notices should be provided to the plan participants?

The Summary Plan Description and Beneficiary Forms are provided shortly after the plan is adopted. They are located on the secure website under the Plan Documents section. These should be provided to all employees before they are eligible to enter the plan. Most plan sponsors include these forms in the New Hire package.

Should the Plan Sponsor keep beneficiary forms on file?

Yes, in addition to storing on the secure client website, the plan sponsor should keep these in the participant's personnel file.

How do I get started?

To learn more about Cash Balance plans, or to **get a complimentary plan illustration**, contact your Regional BPAS Sales Director, email TrustSales@bpas.com or call 866-401-5272.

Learn More

For videos and other resources,
visit our website at bpas.com,
and BPAS University at u.bpas.com.

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