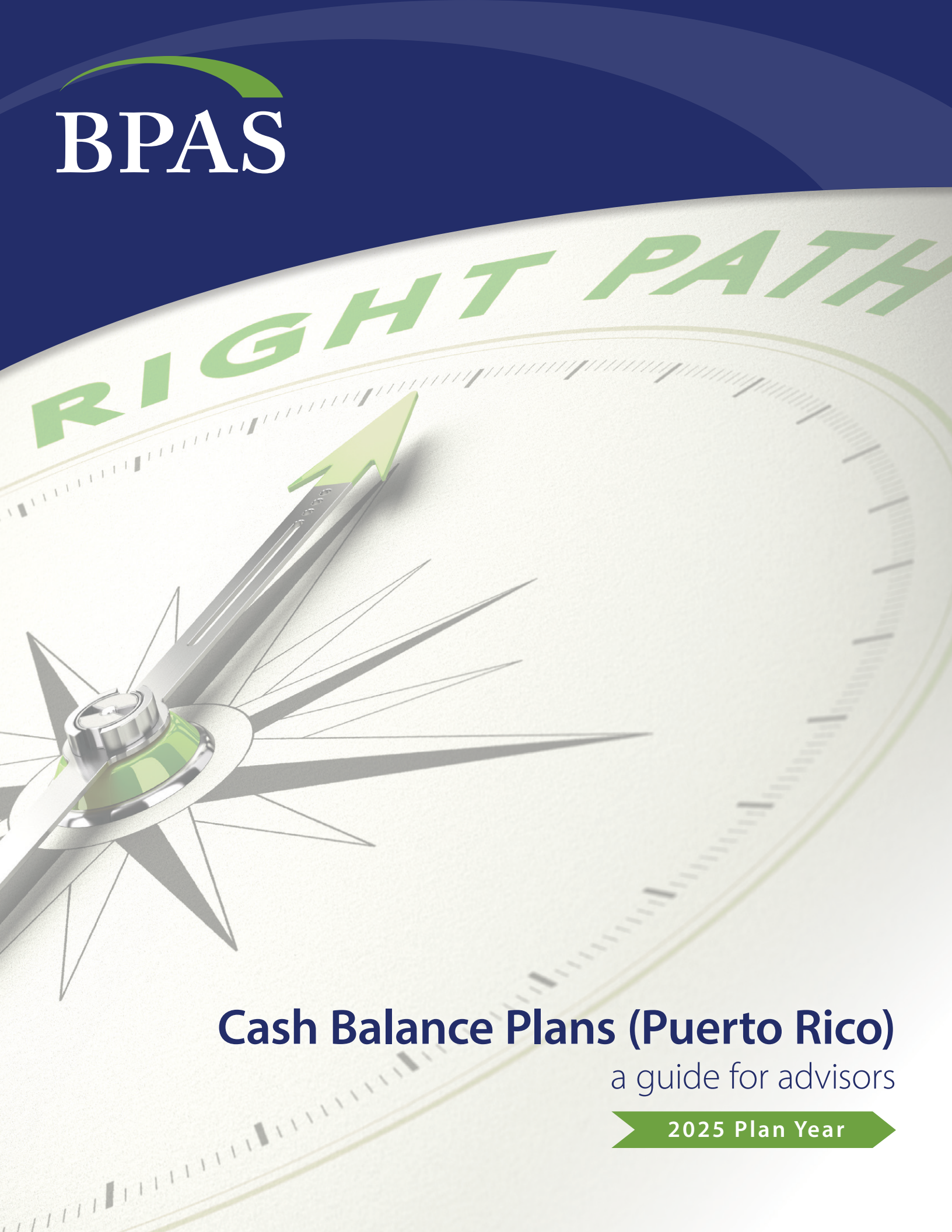


The BPAS logo features a green curved line above the letters "BPAS" in a white serif font, set against a dark blue background.

BPAS

The background of the cover features a large, stylized compass rose with a green and silver needle pointing towards the top left. The compass is overlaid on a light-colored circular path with tick marks, resembling a clock face. The words "RIGHT PATH" are written in a green, italicized, sans-serif font along the upper curve of this path.

RIGHT PATH

Cash Balance Plans (Puerto Rico)

a guide for advisors

2025 Plan Year



Offset Taxes

The enactment in 2016 of the federal law known as PROMESA (the Puerto Rico Oversight, Management, and Economic Stability Act) to allow for restructuring of government debt and achieve fiscal responsibility, will make it very difficult, if not impossible, for Puerto Rico to lower its already crushing high taxes. To compound this problem, increases in withholding and other taxes at the federal level (e.g., Social Security, Medicare) will also affect Puerto Rico and significantly burden local businesses for the foreseeable future. More CB plans are being set up to help offset this array of taxes. CB contributions reduce both taxable and Adjusted Gross Income (Ingreso Bruto Ajustado), 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. In addition, bear in mind that upon CB benefit distribution, because the CB plan is a plan qualified with the Puerto Rico Treasury Department (Hacienda), plan participants can also avail of certain preferential tax treatment (for example, treatment of a lump sum payment as capital gains, exemption - up to certain thresholds - of annuity payments from the plan, etc.) The following example illustrates the power of a locally qualified CB plan.

- ▶ A 55-year-old owner could potentially get a CB contribution of \$253,000, plus \$16,500 in contributions to a local 1081.01(d)/401(k) plan (\$15,000 plus a \$1,500 catch-up contribution) for a total of \$269,500 annually! Furthermore, if desired, this 55-year old would still be eligible to deduct an additional \$5,000 deposit into a Puerto Rican IRA.
- ▶ For a high wage earner in Puerto Rico, for example, \$200,000 in tax-deferred savings will lower local income taxes by about \$66,000 (top rate 33%), plus \$7,600 on Medicare taxes (including 2.90% employer and employee portion of Medicare plus 0.90% for the Obamacare ACA portion) for a total tax reduction of \$73,600.
- ▶ Upon distribution, with spousal consent, lump sums may be treated as capital gains, generally subject to a 20% tax rate.
- ▶ Distributions in the form of an annuity (up to \$15,000 annually for those age 60 and over, and \$11,000 for under age 60) are exempt from local income tax.

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.

Why Offer Cash Balance Plans?

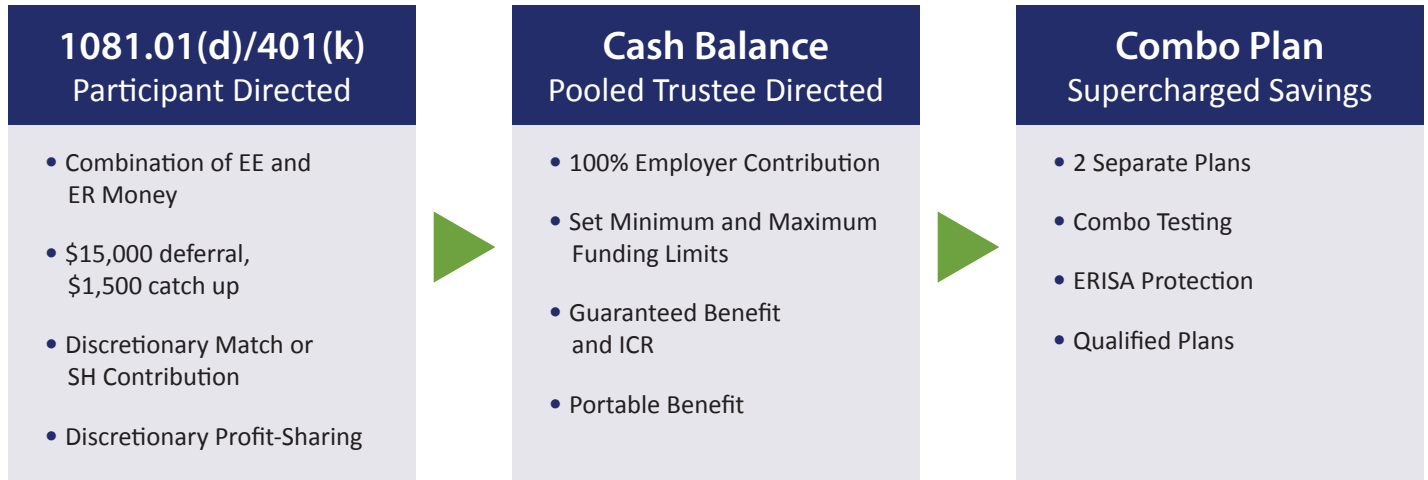
Cash Balance (CB) plans have been around since the mid 1980's, so why are they being implemented at a greater rate than 1081.01(d)/401(k) plans? **Because they're worth it!**

A CB plan is a Defined Benefit (DB) plan that looks like a Defined Contribution (DC) plan. This Hacienda-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.

Components of Combo CB Plans



Power of CB Plans

Age 62 NRA

Maximum Service Credits - 2025

Age	Maximum CB Credit	Age	Maximum CB Credit	Age	Maximum CB Credit
30	\$73,000	42	\$133,000	54	\$241,000
31	\$77,000	43	\$139,000	55	\$253,000
32	\$81,000	44	\$146,000	56	\$266,000
33	\$85,000	45	\$154,000	57	\$280,000
34	\$89,000	46	\$162,000	58	\$294,000
35	\$94,000	47	\$170,000	59	\$309,000
36	\$98,000	48	\$179,000	60	\$325,000
37	\$103,000	49	\$188,000	61	\$341,000
38	\$109,000	50	\$197,000	62	\$359,000
39	\$114,000	51	\$207,000	63	\$352,000
40	\$120,000	52	\$218,000	64	\$344,000
41	\$126,000	53	\$229,000	65	\$336,000
				Maximum Lump Sum	\$3,587,797

Cash Balance Plan contributions are higher because...

- ▶ It's a defined benefit (DB) pension plan
- ▶ Statutory maximum is annual benefit at retirement (\$280,000 payable no earlier than age 62)
- ▶ Present value of maximum benefit - maximum permitted accumulation - is nearly \$3.59M
- ▶ 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 maximum deductible contribution allowed by Hacienda – 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.
- ▶ Individual owners may also adjust their own salary deferrals to manage personal cash flow.

Pros & Cons of Common Benchmark Interest Crediting Rates

Fixed Rate	Treasury Rate	Rate of Return
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	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	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 §1081 of the Puerto Rico Code • 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 1081.01(d)/401(k) plan and other long-term assets.

Review of Why Offer CB Plans

- ✓ **Tax Deferrals:** Highest tax-deferred contributions of any Qualified plan
- ✓ **Accelerated Retirement Savings:** Higher contribution limits add up!
- ✓ **Fully Portable for Employees:** Can roll funds into another locally qualified plan or 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 (\$350,000 for 2025)
- are currently maxing out the Defined Contribution plan (\$70,000 for 2025)
- 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 Federal ERISA and Hacienda Rules

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

DOL (ERISA) Reporting/Disclosure Requirements

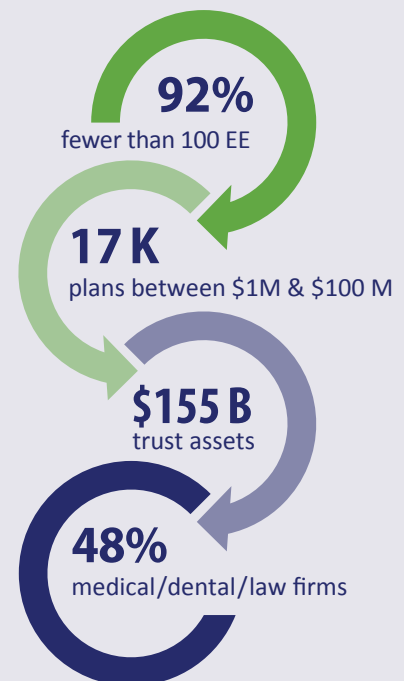
- Actuary signature required

PBGC Coverage and Premiums

- Locally qualified plans with local trust are exempt from PBGC premiums

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 1081.01(d)/401(k) plan can accelerate those savings and make up for a late start. The graph below shows the accumulation of \$2,949,516 in potential savings over a ten year period when adding CB plan contributions to the existing 1081.01(d)/401(k) plan.

Year	Age	DC Contribution	CB Contribution	Total Contribution	Year End Value
2025	52	\$16,500	\$218,000	\$234,500	\$234,500
2026	53	\$16,500	\$218,000	\$234,500	\$480,725
2027	54	\$16,500	\$218,000	\$234,500	\$739,261
2028	55	\$16,500	\$218,000	\$234,500	\$1,010,724
2029	56	\$16,500	\$218,000	\$234,500	\$1,295,761
2030	57	\$16,500	\$218,000	\$234,500	\$1,595,049
2031	58	\$16,500	\$218,000	\$234,500	\$1,909,301
2032	59	\$16,500	\$218,000	\$234,500	\$2,239,266
2033	60	\$16,500	\$218,000	\$234,500	\$2,585,729
2034	61	\$16,500	\$218,000	\$234,500	\$2,949,516

Assumptions

- ▶ 5% Annual rate of return — actual returns may be higher or lower than the 5% annual rate shown
- ▶ Table applies the 2025 Puerto Rico Tax Code §1081.01 Limits on qualified plans in future years, no increases in contribution amount
- ▶ Assuming comp limit of \$350,000, maximum salary deferral and catch-up plus \$16,500 (\$15,000 + \$1,500)

Investing Across the Spectrum of Vehicles

	Totality of Vehicles	Cash Balance Plan	1081.01(d)/401(k) Plan	Outside of Tax-Qualified Plan
Accumulations		Cap on Lump Sum		No Maximum Accumulation
Investment Options		Pooled Investments	Individual Direction Limited by Plan Options	Individual Direction
Taxability		Distributions subject to preferential tax treatment	Distributions subject to preferential tax treatment	Generally taxed as regular income
Common Investment Approach		Conservative ▷ ▷ ▷ ▷ ▷ ▷ ▷ ▷ ▷ Aggressive		
Risk Seeking Assets	40-80%	20-50%	Depends on Appetite for Risk	60-100%
Fixed Income	20-60%	50-80%		0-40%

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 fifteen 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 1081.01(d)/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 1081.01(d)/401(k) 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. Bear in mind that lump sum distributions may be treated as capital gains for purposes of the applicable tax. Furthermore, distributions in the form of an annuity (up to \$15,000 annually for those age 60 and over, and \$11,000 for under age 60) are exempt from local income tax.



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 Hacienda nondiscrimination testing?

Yes. Like other Puerto Rico qualified plans, a CB plan is subject to coverage and nondiscrimination testing and other complicated and related requirements such as minimum participation, 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 1081.01(d)/401(k) and CB) for their rank-and-file employees in the range 7.5% to 10% of pay.

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 Hacienda-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 Héctor Gaitán, email: hgaitan@bpas.com, 787.936.2253 or Adrián Robles, email: arobles@bpas.com, 787.936.2250.



Learn More

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



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Ready to learn more? Let's talk.

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