Super-Charged 401K Plan

How a properly designed retirement plan may help you *tax-defer $425,000* per year.

It begins with utilizing the additional options, along with the usual 401(k), available in the tax code and applying rigorous testing to comply with Department of Labor rules to create a "safe harbor".

A Cash Balance Benefit Plan is a type of retirement plan that belongs to the same general class of plans known as "Qualified Plans." A 401(k) is a qualified plan. These plans "qualify" for tax deferral and creditor protection under the Department of Labor's (DOL) *ERISA* (Employee Retirement Income Security Act of 1974).

In a Cash Balance Plan, each participant has an account that grows annually in two ways: first, through your contribution and second, through an *interest credit, which is guaranteed,* rather than dependent on the plan's investment performance.

Many business owners desire larger tax deductions and accelerated retirement savings for themselves. Cash Balance Plans may be the perfect solution for them. The Pension Protection Act of 2006 encourages more and more professionals and successful business owners to adopt this type of plan.

HOW DOES A CASH BALANCE PLAN WORK?

It specifies both the contribution credited to each participant and the investment earnings credited, based on those contributions. Each participant has an account that resembles those in a 401(k) or Profit Sharing Plan. The accounts are then maintained *in compliance by the plan actuary*, who generates annual participant statements.

The rate of return is guaranteed and is independent of the plan's investment performance. That rate changes each year but usually is equal to the yield on 30-year Treasury bonds, which has hovered around 3 percent in recent years. When participants terminate employment, they are eligible to receive their *vested portion* of their account balance.

CAN A CASH BALANCE PLAN BE OFFERED IN COMBINATION WITH OTHER PLANS?

Yes, an employer can offer a combination of qualified retirement plans in order to produce a larger contribution amount. Just as a Profit Sharing feature can be added to a 401(k) plan, an employer can add a Cash Balance Plan as well. In fact, a 401(k) Plan in combination with a Cash Balance Plan can be the ideal plan-design for many companies and partnerships.

HOW DO DESIGN AND ADMINISTRATIVE COSTS OF A CASH BALANCE PLAN COMPARE TO OTHER RETIREMENT PLANS?

It is more expensive to set-up and to administer a Cash Balance Plan than a 401(k) Profit Sharing Plan because the plan's funding *must be certified by the actuary* each year. However, the tax benefits of the Cash Balance plan will often significantly exceed the additional cost. Expenses will vary by size of plan and annual testing requirements.

HOW MUCH CAN YOU CONTRIBUTE TO A CASH BALANCE PLAN?

Cash Balance contributions are age-dependent. The older the participant, the higher the amount is. The reason for this difference is that an older person has fewer years to save toward the approximate $2.5 million lump sum that is allowed in a Cash Balance Plan.

Subject to IRS limits, the actual contribution is determined by a formula specified in the plan document. It can be either a percentage of pay or a flat dollar amount.

WHAT ARE THE CASH BALANCE PLAN DISTRIBUTION OPTIONS?

Cash Balance assets are *portable*. When participants terminate employment, they become eligible to receive the vested portion of their account balances, as determined by the plan's vesting schedule. The vested accounts in a Cash Balance Plan can be paid as lump-sum distributions or annuities. Lump sum distributions can be rolled over to an IRA or another qualified retirement plan.

MUST EVERYONE PARTICIPATE EQUALLY IN THE CASH BALANCE PLAN FROM YEAR TO YEAR?

No. Each participant can have a different contribution amount, which can be a percentage of pay or a flat dollar amount.

CAN CASH BALANCE CONTRIBUTIONS CHANGE FROM YEAR TO YEAR?

Profit Sharing Plans allow contributions to vary from year to year depending on profitability, but Cash Balance Plans normally *must be amended in order to change contribution levels*. And amending also must meet DOL compliance guidelines.

Employers can designate different contribution amounts for various participants, but there is a restriction on the frequency of amendments unless a valid economic reason exists. For example, if a firm's profits are not expected to support its Cash Balance Plan contribution, then the plan can be amended. Any reductions must be made before any employee works 1,000 hours during a plan year. For increases, the plan must be amended within two and a half months following the end of a plan year.

In addition, a Cash Balance Pension Plan can also be frozen or terminated before an employee works 1,000 hours during a plan year.

TAX DEDUCTIONS

Tax deductions are hard to come by, especially those that directly reduce ordinary income dollar for dollar.

Contributions to Cash Balance Plans have the same tax effect as a deduction that reduces ordinary income dollar for dollar!

With Federal income tax marginal rates as high as 43.4% in 2015, the tax savings from the contributions and the subsequent earnings on these contributions can be quite significant.

For example, one single contribution of $240,000 earning 3% a year for 30 years, would be worth $582,543 at the end of 30 years. However, if the $240,000 had been taxed in the year contributed so that an “after tax” amount was invested and if subsequent earnings on this contribution had also been taxed in each year (assuming the highest tax rates indicated above), then at the end of 30 years the total value would be $397,960; 32% less than the original amount calculated above!

Cash Balance Plans are part of a group of plans called “qualified plans,” indicating their tax-favored status with the IRS. Tax advisors generally agree that these plans should be funded to their maximum before other tax-efficient strategies are explored.

In summary, contributing to a Cash Balance Plan can provide tremendous tax benefits. These benefits apply to both the amount contributed and the subsequent earnings on those contributions. Furthermore, do not forget that the investment earnings on the contribution will compound enabling it to grow to a very significant amount.

TAX DEDUCTIONS AND ALLOCATIONS FOR PARTNERSHIPS

Tax deductions for contributions made on behalf of non-partner employees are taken on the partnership tax return. Tax deductions for contributions made on behalf of partners are taken on their personal or corporate tax returns.

To be sure that the amount deducted for tax purposes by a partner as shown on Schedule K-1 is the same as the amount contributed on behalf of the partner, the partnership agreement must permit this method of allocation.

Most partnerships that adopt Cash Balance Plans do not want the partners’ contributions allocated like most other firm expenses in proportion to ownership. Either the partnership agreement or internal policy should assure that each partner is allocated an appropriate share of the plan’s cost.

CREDITOR PROTECTION

Qualified plan assets are protected from creditors in the event of bankruptcy. The anti-alienation provision of ERISA states that “each pension plan shall provide that assets provided under the plan may not be assigned or alienated.” This means that the assets in a qualified plan are not available to creditors.

Since professionals and business owners often consider asset protection a premium, it is advantageous to accrue retirement savings in an asset-protected vehicle like a qualified plan.

These plans provide a means for business owners and partners to move assets from their businesses to a pension plan. Once in the qualified plan, these assets are then protected from creditors as a “nest egg” for retirement or to pass on to heirs.

CASE STUDY – A SURGICAL GROUP PRACTICE

The Pension Protection Act of 2006 allowed this medical group to redesign their existing retirement plans to allow for materially larger contributions. The doctors are now enjoying contributions totaling $4,325,000 with a cost for all other participants of only $175,000. That is *over 96% of the benefits accrues to the benefits of the “owners.”*

This plan was combined with the plan the group had in place at the time. While not all physicians are in the plan, those that are have seen their contributions in the Cash Balance Plan and the 401(k) Profit Sharing Plan boosted by over 100%.

CASE STUDY – A SMALL ACCOUNTING FIRM

The Pension Protection Act of 2006 allowed a seven partner law firm to redesign their retirement plans with materially larger contributions. The seven partners are now enjoying contributions totaling $725,000. This is over $100,000 per partner in the Cash Balance plan alone.

While the employees enjoy an enhanced 401(k) benefit package because of the Cash Balance Plan, this redesign of their plan did not cost the firm anything in additional employee contributions (percent to partners: 92%).

Call us today at 866-977-2252 to see how you can qualify for greater tax deferral. We are here to help.

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