DANA CONSULTING GROUP

memorandum

Innovative Design and
Administration of Retirement Plans

CASH BALANCE PLANS

The Pension Protection Act of 2006 (PPA) removed the legal obstacles to employers maintaining cash balance plans. The PPA made other changes targeted to closely held companies that are profitable and seek to provide substantially higher annual contributions for their owners and other key employees than are presently available under a profit sharing plan (including a 401(k) plan). This memorandum explains some of the benefits of a cash balance plan and describes the issues that an employer should consider in determining whether a cash balance plan may be appropriate.

What is a cash balance plan?

A cash balance plan is a defined benefit plan that looks like a profit sharing plan. Each employee has a hypothetical account in the plan that is credited with contributions and a fixed rate of income. Like a "traditional" defined benefit plan, a cash balance plan can be designed to provide substantially higher contributions for older employees than are available under a profit sharing plan (including a 401(k) plan). New rules became effective in 2006 under the PPA that permit an individual (such as a sole proprietor) who is as young as age 30 to make deductible retirement plan contributions of up to $70,000 by using a cash balance plan.

What are the advantages of a cash balance plan over my existing profit sharing plan?

The biggest advantage is that higher contributions are typically available for owners and other favored employees than under a profit sharing plan, and if the employer maintains a combination cash balance plan and profit sharing plan (including 401(k) plan), substantially higher contributions can be available.

What are the advantages of a cash balance plan over a "traditional" defined benefit plan?

As indicated above, a cash balance plan looks like a profit sharing plan to employees, so it is easier for them to understand. Like New Comparability profit sharing plans, cash balance plans permit employees to be grouped into different classes with different contribution levels. These classes can be coordinated with the employee classes created under the employer's existing New Comparability profit sharing plan.

Can I maintain a cash balance plan if I already maintain a profit sharing plan (including a 401(k) plan)?

Yes. An employer can maintain a cash balance plan and a profit sharing plan (including 401(k) plan) at the same time. Employees who participate in the cash balance plan may continue to make 401(k) contributions and, under certain circumstances, may receive employer contributions to the profit sharing plan.

Are there any disadvantages to a cash balance plan?

A cash balance plan shares several of the same characteristics of a traditional defined benefit plan, such as:

1. The employer is obligated to make annual contributions to the plan.
2. Certain employers are required to make annual premium payments to the federal Pension Benefit Guaranty Corporation.

Under the PPA, new cash balance plans cannot use a vesting schedule that exceeds three years. In addition, cash balance plans are typically more expensive to administer than a profit sharing plan (including 401(k) plan).

Do all of my employees have to participate in the cash balance plan?

A cash balance plan generally has to cover at least 40% of an employer's "non-excludable employees" or, if less, at least 50 employees. Like all qualified retirement plans, cash balance plans may not discriminate in favor of "highly compensated employees."

If the employer already maintains a 401(k) plan, there are a variety of options. For example, perhaps all employees are eligible to participate in both plans. Alternatively, some of the employees will participate in the cash balance plan, and the remaining employees will participate in the 401(k) plan. Under either approach, all employees who are participating in the cash balance plan can be permitted to make 401(k) contributions to the 401(k) plan.

How are the assets of a cash balance plan invested?

Assets of a cash balance plan are deposited into a single financial account and invested by the trustee, with the assistance of the trustee's financial advisor. Employees do NOT direct the investments of their hypothetical accounts in a cash balance plan like they often do in a 401(k) plan.

What changes have to be made to my existing 401(k) plan if my company adopts a cash balance plan?

If the employer adopts a cash balance plan to increase annual contributions for owners and other key employees and perhaps to lower contributions for other employees, amendments will be required to the 401(k) plan to reflect the new contribution levels. Under IRS guidelines, these amendments will need to be adopted before the end of the year in which the cash balance plan is adopted.

What kinds of employers are the best candidates for a cash balance plan?

The best candidate is an employer that has predictable profits who can afford to make the annual required contributions to the plan. Another characteristic is the employer whose owners or other favored employees are older than the other employees.

What services can Dana Consulting Group, Ltd. provide for an employer who wants to establish a cash balance plan?

Dana Consulting Group, Ltd. (and its affiliated, Jennings Law Firm) is an alliance of knowledgeable and experienced retirement plan associates and attorneys who provide comprehensive and coordinated legal and consulting services for sponsors of qualified retirement plans and their advisors. We are NOT investment advisors, and we sell no investment products or offer any investment advice.

How do I determine if my company should establish a cash balance plan?

Our firm will review your existing plan at no cost and discuss with you how a cash balance plan would benefit your company. If you do not presently have a plan, we can discuss how a qualified retirement plan can benefit your company.

A tax qualified retirement plan is one of the best tax shelters available to the owner of a business. Properly established and maintained, the IRS will never disallow the deduction for contributions, and all earnings will be tax deferred until distributed.

If you would like additional information about retirement plans in general or cash balance plans, please call Lee T. Jennings at (630) 802-7644.