

Cash Balance Plans for Small Businesses

For Owners of Highly Profitable Small Businesses, a Cash Balance + 401(k) Plan Offers the Highest Contributions and Tax Savings



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The Cash Balance Plan

When professional practices and small businesses achieve consistent profitability, their owners often seek effective strategies for securing long-term retirement wealth. While many initially opt for 401(k) plans, these are often limited by IRS contribution caps, making them less effective for substantial wealth accumulation.

To address these limitations, a growing number of successful small businesses and professional practices are turning to Cash Balance Plans. These plans offer significantly larger tax deductions and enable accelerated retirement savings, making them an increasingly popular choice for companies with a few employees. Cash Balance Plans provide a robust solution for owners aiming to maximize their retirement funds efficiently.

Enhancing Retirement Savings with Cash Balance Plans

A Cash Balance Plan is a powerful, IRS-approved, employer-sponsored retirement solution that falls under the category of defined-benefit pension plans. Unlike traditional defined-benefit plans, which often calculate contributions based on complex formulas involving factors such as age, compensation, and tenure, Cash Balance Plans offer a more structured approach.

Key Features of Cash Balance Plans

In a Cash Balance Plan, each participant's account receives two types of credits annually:

1. **Pay Credits:** These are contributions made by the employer, typically defined as a percentage of the employee's salary or a fixed dollar amount.
2. **Interest Credits:** These provide guaranteed annual growth on the account balance, either at a fixed rate or linked to a specific index.

These plans are particularly advantageous when paired with a Safe Harbor 401(k) and Profit-Sharing Plan, offering a robust strategy for maximizing retirement contributions.

Combining Plans for Maximum Benefit

Integrating a Cash Balance Plan with a Safe Harbor 401(k)/Profit Sharing Plan offers significant advantages:

- **Greater Flexibility and Control:** Business owners can tailor the Cash Balance Plan to selectively include key employees, offering strategic benefits tailored to their needs.
- **Enhanced Contribution Limits:** The combination allows for significantly higher retirement contributions compared to what a 401(k) plan alone can offer—often two to three times greater. This is particularly beneficial for business owners who wish to accelerate their retirement savings.
- **Substantial Tax Savings:** Contributions to both the Cash Balance Plan and the Safe Harbor 401(k)/Profit Sharing Plan are tax-deferred. This means each dollar contributed reduces taxable income in the contribution year. Depending on the total contributions, this can result in substantial tax savings—potentially \$50,000, \$70,000, or even \$100,000 annually.

Why Choose a Cash Balance Plan?

For professional practices and small businesses seeking to significantly boost their retirement savings while enjoying immediate tax benefits, Cash Balance Plans offer an ideal solution. By leveraging these plans, owners can provide competitive benefits to employees and secure their own financial future with larger, tax-advantaged contributions.

Why Are Cash Balance Plans Gaining Favor with Professional Practices and Small Business Owners?

Federal regulations now strongly favor Cash Balance plans due to several key advantages:

- **Substantial Tax Deductions:** These plans offer significant tax deductions particularly beneficial for high-income business owners.
- **High Contribution Limits for Older Participants:** Older participants can take advantage of higher contribution limits, providing a considerable advantage to business owners.
- **Flexible Structure:** Cash Balance plans are versatile and can be tailored to fit various business scenarios, accommodating different needs and situations effectively.
- **Wide Range of Investment Options:** They offer a diverse selection of investment choices, allowing owners to customize their investment strategies based on their preferences and risk tolerance.
- **Pre-Approved Prototype Plan Documents:** Use of pre-approved prototype plan documents simplifies administration requirements and reduces costs associated with creating customized plans, making them more accessible for small businesses.
- **Asset Protection:** Assets held within Cash Balance plans are safeguarded in the event of legal actions such as lawsuits or bankruptcy proceedings.

These features make Cash Balance plans particularly suitable for professional practices. Depending on age, income, and other factors, these plans can be designed to accommodate each partner in a multi-partner firm, enabling them to contribute according to their individual cash flow situations. Older owners, leveraging the plans' high age-weighted contribution limits, can make substantial catch-up contributions toward retirement savings, often exceeding what stand-alone 401(k) plans allow.

Customizing a Retirement Program to Meet Owners Goals

Customizing a retirement program begins with a comprehensive discussion about the business's outlook, employee considerations, and the specific retirement goals of the owners. Partners have the flexibility to choose contribution amounts within defined limits that align with their financial needs. For family businesses, these plans can play a crucial role in succession planning and estate management by maximizing contributions for older generations.

Plan design also addresses employee inclusion criteria, contribution levels, and vesting schedules, ensuring compliance with IRS non-discrimination tests. Flexibility is built into the plans to accommodate changes in business dynamics and employee compositions over time, typically spanning 3 to 5 years or longer. Annual reviews ensure the plans remain effective and aligned with evolving business needs and regulatory requirements.

Who Is Best Suited for a Cash Balance Plan?

Small business owners, professional practices, and partnerships increasingly opt for Cash Balance plans to expedite retirement savings and mitigate current-year tax obligations.

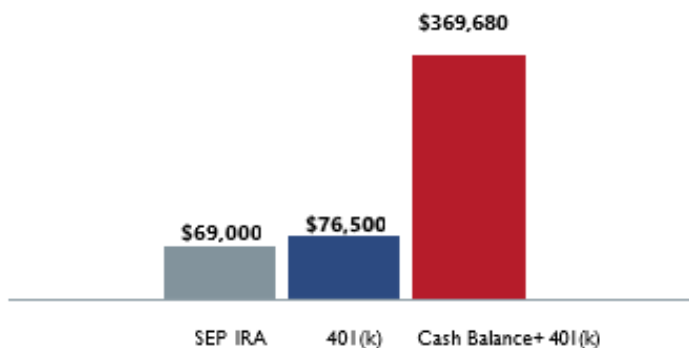
Ideal candidates for Cash Balance plans include:

- Business owners seeking to make substantial, tax-deductible contributions beyond the limits of SEP-IRA or traditional 401(k) plans.
- Owners aged 35 and above earning more than \$250,000 annually.
- Individuals anticipating stable cash flow to sustain contributions over an extended period, typically 3 to 5 years or more.
- Owners willing to make selective contributions for specific employee groups, maximizing benefits while managing costs.

Architects	Dentists	Financial advisors
Attorneys	Designers	Franchisees
Consultants	Engineers	IT consultants
Contractors	Entrepreneurs	Marketers
CPAs	Farmers	Physicians

COMPARE RETIREMENT PLANS

For a 60-year-old business owner earning \$350,000 in W-2 income



*2024 plan maximum contribution for a 60-year-old, including "catch-up" contribution of \$7,500 for 401(k)

Cash Balance Plan Roles

Plan Funding and Management by the Business: The business is responsible for funding the retirement plan, making investment decisions, paying associated fees, and managing the investment risks. This means that the company directly influences how the plan’s assets are allocated and bears the consequences of any investment gains or losses.

Investment Account Setup and Management: A financial advisor assists the business owner in establishing one pooled trust investment account for the Cash Balance plan and individual investment accounts for each participant in the 401(k) Profit Sharing plan. Typically, the advisor oversees and manages the assets within the Cash Balance plan, while also advising the owner on investment options for the 401(k) profit-sharing accounts.

Plan Design and Administration: The Third-Party Administrator (TPA), in collaboration with the financial advisor, business owner, and CPA, designs and administers the retirement plans. The TPA provides ongoing consulting and actuarial services to ensure the plans remain compliant with IRS regulations and fulfill their intended benefits.

Defined Benefits and Portability in Cash Balance Plans: Participants in the Cash Balance plan are guaranteed a specific benefit upon termination or retirement, presented as a 401(k)-style account balance. Once vested, this benefit is fully portable. Participants can transfer the lump sum into an IRA, maintaining tax-deferred growth even after leaving the company or retiring.

Cash Balance Plan Growth Over 10 Years
 Annual Pay Credit: \$100,000
 Interest Credit: 4%

YEAR	BEGINNING BALANCE	INTEREST CREDIT
1	---	---
2	\$100,000	\$4,000
3	\$204,000	\$8,160
4	\$312,160	\$12,486
5	\$424,646	\$16,986
6	\$541,632	\$21,665
7	\$663,298	\$26,523
8	\$789,829	\$31,593
9	\$921,423	\$36,857
10	\$1,058,280	\$42,331

Case Study : Medical Practice

Cash Balance Plan Illustration Prepared For : XYZ Radiology Clinic

Annual Contribution Schedule

Name	Age	Retirement Age	Annual Salary	401(k)	Profit Sharing	Cash Balance	Total Contribution	Tax Savings*
Owners								
Owner 1	62	70	\$317,000	\$30,500	\$100	\$330,000	\$360,600	\$144,240
Owner 2	54	65	\$285,000	\$30,500	\$100	\$225,000	\$255,600	\$102,240
Owner 3	69	75	\$325,000	\$30,500	\$100	\$300,000	\$330,600	\$132,240
Owner 4	48	65	\$265,000	\$23,000	\$100	\$140,000	\$163,100	\$65,240
Spouse	59	70	\$130,000	\$30,500	\$100	\$100,000	\$130,600	\$52,240
Sub Total			\$1,322,000	\$145,000	\$500	\$1,095,000	\$1,240,500	\$496,200
Employees								
7 Eligible Employees			\$670,000	\$0	\$46,460	\$122,329	\$168,789	\$67,516
Total			\$1,992,000	\$145,000	\$46,960	\$1,217,329	\$1,409,289	\$563,716

Percent of Contribution to Owners		88%
Projected Cash Balance Account Value : Owner 1	\$3,352,505	Projected Cash Balance Account Value : Owner 3
Projected Cash Balance Annual Benefit : Owner 1	\$276,778	Projected Cash Balance Annual Benefit : Owner 3
		\$238,626
Projected Cash Balance Account Value : Owner 2	\$3,193,206	Projected Cash Balance Account Value : Owner 4
Projected Cash Balance Annual Benefit : Owner 2	\$226,180	Projected Cash Balance Annual Benefit : Owner 4
		\$232,188

Assume 40% tax rates.

Examples are based on specific assumptions and used for illustration only.

Case Study : Sole Owner Medical Practice

Cash Balance Illustration Prepared For : Sole Owner Medical Practice

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Annual Contribution Schedule

Name	Age	Retirement Age	Annual Salary	401(k)	Profit Sharing	Cash Balance	Total Contribution	Tax Savings*
Owner								
Owner	49	62	\$265,000	\$23,000	\$100	\$200,000	\$223,100	\$89,240
Sub Total			\$265,000	\$23,000	\$100	\$200,000	\$223,100	\$89,240
Employees								
2 Employees			\$152,000	\$0	\$11,400	\$5,756	\$17,156	\$6,862
Total			\$417,000	\$23,000	\$11,500	\$205,756	\$240,256	\$96,102

Percent of Contribution to Owner	94%
Projected Cash Balance Account Value : Owner	\$3,417,264
Projected Annual Benefit from Cash Balance Plan : Owner	\$221,693

Assume 40% tax rates.

Examples are based on specific assumptions and used for illustration only.

Case Study : Sole Owner Dental Practice

Cash Balance Illustration Prepared For : Sole Owner Dental Practice

Annual Contribution Schedule

Name	Age	Retirement Age	Annual Salary	401(k)	Profit Sharing	Cash Balance	Total Contribution	Tax Savings*
Owners								
Owner	47	62	\$210,000	\$23,000	\$100	\$135,000	\$158,100	\$63,240
Sub Total			\$210,000	\$23,000	\$100	\$135,000	\$158,100	\$63,240
Employees								
6 Employees			\$289,000	\$0	\$20,375	\$14,300	\$34,675	\$13,870
Total			\$499,000	\$23,000	\$20,475	\$149,300	\$192,775	\$77,110

Percent of Contribution to Owner	82%
Projected Cash Balance Account Value : Owner	\$2,708,210
Projected Annual Benefit from Cash Balance Plan : Owner	\$176,532

Assume 40% tax rates.

Examples are based on specific assumptions and used for illustration only.

Case Study : Law Firm

Cash Balance Illustration Prepared For : Law Firm

Annual Contribution Schedule

Name	Age	Retirement Age	Annual Salary	401(k)	Profit Sharing	Cash Balance	Total Contribution	Tax Savings*
Owners								
Owner 1	43	62	\$275,000	\$23,000	\$100	\$130,000	\$153,100	\$61,240
Owner 2	74	78	\$345,000	\$30,500	\$100	\$460,000	\$490,600	\$196,240
Sub Total			\$620,000	\$53,500	\$200	\$590,000	\$643,700	\$257,480
Employees								
3 Employees			\$208,000	\$0	\$17,000	\$9,251	\$26,251	\$10,500
Total			\$828,000	\$53,500	\$17,200	\$599,251	\$669,951	\$267,980

Percent of Contribution to Owners	96%
Projected Cash Balance Account Value : Owner 1	\$3,493,148
Projected Cash Balance Annual Benefit : Owner 1	\$226,615

Projected Cash Balance Account Value : Owner 2	\$2,442,202
Projected Cash Balance Annual Benefit : Owner 2	\$291,362

Assume 40% tax rates.

Examples are based on specific assumptions and used for illustration only.

Key Dates

Cash Balance Plans

- **Establishment Deadline:** These plans should be established by December 31 of the plan year. However, businesses have until their tax filing deadline, including any extensions, to set up the plan for that year.
- **Contribution Deadline:** While contributions are not immediately required, they must be made by the business's tax filing deadline, including any extensions. This deadline is typically no later than 8½ months after the end of the fiscal year.

Safe Harbor 401(k) and Profit Sharing Plans

- **Setup Deadline:** To maximize contributions, Safe Harbor 401(k) and Profit Sharing plans must be established before October 1 of the plan year.
- **Contribution Deadlines:**
 - **Corporations:** Must make their contributions within two weeks following the end of their fiscal year.
 - **Other Entities (e.g., partnerships, sole proprietorships):** Have until their tax filing deadline, including extensions, to make contributions. This deadline is also no later than 8½ months after the end of the fiscal year.

“Choosing the right retirement plan for your small business can be a \$2 million decision. If you are highly compensated and your financial goals include saving as much as you can for retirement, the cash balance/401(k) plan combo might be the solution for you.”

— Forbes, February 2020

Summary

Maximized Tax Savings with Controlled Costs: Integrating a Cash Balance plan with a Safe Harbor 401(k) allows business owners to optimize tax savings while managing the costs of employee retirement benefits efficiently.

Superior Savings Potential: Business owners who have surpassed the limits of SEP-IRA or SIMPLE plans and seek greater savings opportunities can significantly benefit from this combination. Contributions can be three to four times higher than what other plans typically allow, offering a substantial boost in retirement savings.

Customizable Contributions for Partners: Partners in a business can tailor their pay credits according to their age, compensation, and cash flow requirements, providing a flexible approach to retirement planning.

Estate and Succession Planning for Family Businesses: Family-owned businesses can leverage high contributions for senior members to support estate and succession planning strategies, ensuring smooth transitions and financial security for future generations.

Flexible Employee Benefit Allocation: During plan design, owners can create different “classes” and set varying contribution levels for distinct employee groups. This flexibility allows for tailored benefit allocations that align with business goals and workforce needs.

Commitment to Annual Funding: Business owners typically commit to funding these plans for at least three to five years. However, the plan can be terminated if the owner retires or sells the company. Depending on the timing and assets in the Cash Balance plan, owners might need to contribute to one or both plans in the year of termination.

Diverse Investment Options: Plan assets can be invested in a wide range of securities, including equities, mutual funds, bonds, and annuities. As long as these investments have a determinable fair market value, they are eligible for inclusion in the plan.

Tax-Deferred Growth: Investments grow on a tax-deferred basis, accelerating wealth accumulation. Upon retirement or plan termination, assets can be rolled into an IRA, where they continue to grow tax-deferred until withdrawals begin.

Annual Compliance Testing: All plans undergo annual compliance testing to ensure they meet IRS regulations. Business owners must update their information annually or as soon as significant changes occur in their business situation. Plans can be amended as necessary to remain compliant.

Tax-Deductible Contributions and Fees: Contributions and plan administration fees are considered deductible business expenses, often saving owners tens of thousands of dollars in taxes each year.

Creditor Protection: As IRS-qualified retirement plans, assets within Cash Balance plans are protected from creditors in cases of bankruptcy or lawsuits, providing an additional layer of financial security.

Bottom Line

For small business owners, professionals, and partners earning over \$330,000 annually, managing tax liability becomes crucial. This challenge drives many to seek ways to maximize tax-deferred retirement savings and leverage dollar-for-dollar tax deductions on contributions to owner/employee retirement accounts. A combination of Cash Balance and 401(k) plans offers a powerful strategy to optimize these tax benefits and retirement contributions fully in line with IRS regulations. Through these plans, business owners can potentially defer taxes on more than \$3,500,000 over the next decade, while also effectively managing the cost of employee benefits.

Oakwood Summit specializes in designing, administering, and providing actuarial services for Cash Balance and Defined Benefit Retirement Programs. Our core mission is to help high-income clients retain more of their earnings each year by offering top-tier, tax-advantaged retirement plans sanctioned by the IRS. For detailed information, visit www.oakwoodsummit.com.

Please note, this information serves as a quick reference. The rules and regulations of ERISA, IRS, and DOL are complex and require more comprehensive details than provided here. For specific advice regarding your retirement plan, contact Oakwood Summit. Additionally, consult your tax advisor to determine if a Cash Balance plan is suitable for your needs

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All strategies referenced, including those involving advanced retirement planning or defined benefit structures, are subject to eligibility requirements, regulatory guidelines, and individual financial considerations. Outcomes will vary based on factors including income, age, business structure, contribution levels, and market performance.

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Implementation of any strategy should be done in coordination with qualified professionals, including your CPA, tax advisor, attorney, and financial advisor. We do not provide legal or tax advice unless explicitly engaged to do so under a separate written agreement.

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