Cash balance defined benefit plans

Consider a cash balance defined benefit (DB) plan if you're looking to increase retirement contributions for you and your employees and help reduce the taxable income for your business.

A cash balance plan is a type of DB plan that resembles a defined contribution (DC) plan and can be a powerful savings tool for business owners. When paired with a 401(k), it offers opportunities for increased tax deductions and accelerated retirement accumulations.

How a cash balance DB plan can work for you

This hypothetical illustration shows how complementing a 401(k)/profit-sharing plan with a cash balance DB plan may help you realize significant tax deductions and accelerate retirement accumulations for key employees.[1,2]

	Compensation	401(k)	Profit sharing	401(k) + profit sharing total	Cash balance	Total with cash balance
Partner 1 (age 68)	$345,000	$30,500	$46,000	$76,500	$379,215	$455,715
Partner 2 (age 58)	$65,000	$30,500	$3,900	$34,400	$90,035	$124,435
Partner total	$410,000	$61,000	$49,900	$110,900	$469,250	$580,150
4 employee total	$147,000	May vary	$11,025 (7.5% of base pay)	May vary	$2,800 ($700 each)	$13,825[3]
Total	**$557,000**	**$61,000**	**$60,925**	**$110,900**	**$472,050**	**$593,975**

By adding a cash balance DB plan, this hypothetical firm enjoys:

- Higher tax deductions — An additional current year tax deduction of $472,050 (in addition to deductions from 401(k)/profit-sharing plan).
- Accelerated accumulations — Depending on their age, partners have an opportunity to accumulate more for retirement each year than with the 401(k)/profit-sharing plan alone.
- Maximized benefits — Partners receive 97.7% of the total benefit amount with employees receiving an employer allocation and the plan must be 120% funded for full lump sum payout to Top Hat employees.

Benefits

For business owners

- Potential for increased tax deductions.
- Aids in recruitment and retention of key employees.
- Flexibility to weigh benefits toward owners and key employees.

For employees

- Higher contribution limits than DC plans, helping to "catch up" or accelerate retirement savings.
- Employer-funded benefit.
- Easy to understand with hypothetical account balances.
- Portable benefit in the event of job change or termination.
- Potential for tax-deferred growth.

Administrative requirements

Mandatory annual funding and participation requirement

- Employers control the investment options and bear the investment risk.
  (Cash balance DB plans must be opened as Trustee Directed.)
- Non-discrimination rules may impact or affect the plan design and, therefore, participation requirements.
- Business owner must commit to minimally contributing to the plan 5 – 10 years.
- Flexible plan design allows employers the ability to provide specific benefits to certain employees.
- Your financial advisor can help you select an appropriate investment strategy which is typically conservative.

Investment considerations and administrative requirements

- Cash balance DB plans generally adopt a more conservative investment strategy than DC plans and the interest crediting rate can either be fixed or market based with a targeted interest rate cap.
- Must be funded at least annually.
- Benefit calculation is typically performed annually.
- IRS Form 5500 must be filed annually.

Who is it for?

Generally, professionals and small business owners who:

- Have an income over $250,000.
- Pay significant taxes.
- Seek to make higher contributions in a shorter timeframe.
- Maximize 401(k) and profit-sharing contributions.
- Consistently profitable with substantial annual revenues.
- Commit to quarterly contributions.

How cash balance DB plans differ from DC plans

	Cash balance DB plans	**DC plans** (including 401(k), 403(b), or money purchase)
Commitment	Approximately 5-10 years (depending on the plan)	Discretionary
Investments	Employer-directed	Participant-directed
Employee benefits at retirement	Fixed	Variable
Annual funding by employers	Mandatory	Voluntary
Asset accounting	Pooled accounts	Individual accounts
Plan documents	Custom	Custom or prototype
Actuarial valuation	Required	Not applicable
Pre-tax employee contributions	Prohibited	Allowed
Benefit insurance	PBGC coverage[4]	No PBGC coverage
Fiduciary insurance	Required	Required
Compliance testing	Required, including minimum under 401(a)(26)	Required

Platform solution for small businesses[5]

- RCMA® Investment Only — Offers the investment services of Merrill to employers who want to work with a third-party administrator (TPA) or Actuary of your choice for recordkeeping, tax reporting and other administrative duties.
- Institutional Trust and Custody Services for larger plans that want a Corporate Trustee with full ERISA accounting/reporting and who want to work with a TPA or Actuary of your choice for recordkeeping and other administrative duties.

The next step is easy

To learn more about how a cash balance DB plan may help you maximize retirement contributions, contact your financial advisor or visit Workplace Benefits for Business Owners and Entrepreneurs for more information.

[1] FuturePlan by Ascensus, Retirement Plan Limits 2024. Based on IRS 2024 Contribution Limits and the hypothetical illustration shown above. Individual contribution limits may vary based on personal financial circumstances.

[2] This hypothetical illustration represents a sample plan design using various actuarial assumptions and plan provisions combined with a 401(k)/profit-sharing plan, and is intended for illustrative purposes only. This illustration also assumes that this plan would be a PBGC covered plan.

[3] Employee total does not include 401(k) contributions.

[4] Coverage may be subject to Pension Benefit Guaranty Corporation (PBGC) limits.

[5] A defined benefit solution is also available to support large institutional plans.

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