An Advisor's Guide to Cash Balance Plans

For Advisor Use Only

2021

TRA
The Retirement *Advantage*

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Larger Tax Deductions, More Retirement Savings

Many business owners and partners of firms are looking for larger tax deductions and accelerated retirement savings. Cash Balance plans may be the perfect solution for them.

A Cash Balance plan is a type of IRS-qualified retirement plan known as a "hybrid" plan. In a Cash Balance plan, each participant has an account that grows annually in two ways: first, an employer contribution and second, an interest credit, which is guaranteed rather than dependent on the plan's investment performance.

Cash Balance plans have much greater annual contribution limits than 401(k)s, which means participants can build substantial tax-deferred accounts. The employer contribution is determined by a formula specified in the plan document. It can be a percentage of pay or a flat dollar amount and is subject to annual maximum contribution limits.

All data represented is in this document are based on 2020 limits, tax rates and regulations.

Tax Advantages

A critical element in the benefits of Cash Balance plans is estimating the tax deferral that will occur. The top federal income tax rate is now 37%; for earners at the highest bracket, this may be the minimal level of tax savings through contributions to a Cash Balance plan. State and local taxes are other sources of potential tax reductions. State and local taxes may range from 0% to as much as 13.3% in California.

All of the following taxes may be reduced or eliminated by contributing to a Cash Balance plan:

1. **Investment Tax**
   An additional 3.8% tax on unearned net income is imposed on individual earnings over $200,000 ($250,000 for married couples). The surtax is in addition to the capital gains and dividend tax of 15% — 20% for high earners.

2. **Top Marginal Income**
   The top marginal tax rate is 37% for individuals earning over $518,900 ($622,041 for married couples). A Cash Balance contribution reducing income for a married couple below $622,041 will result in tax savings, plus a reduction in the marginal income tax rate.

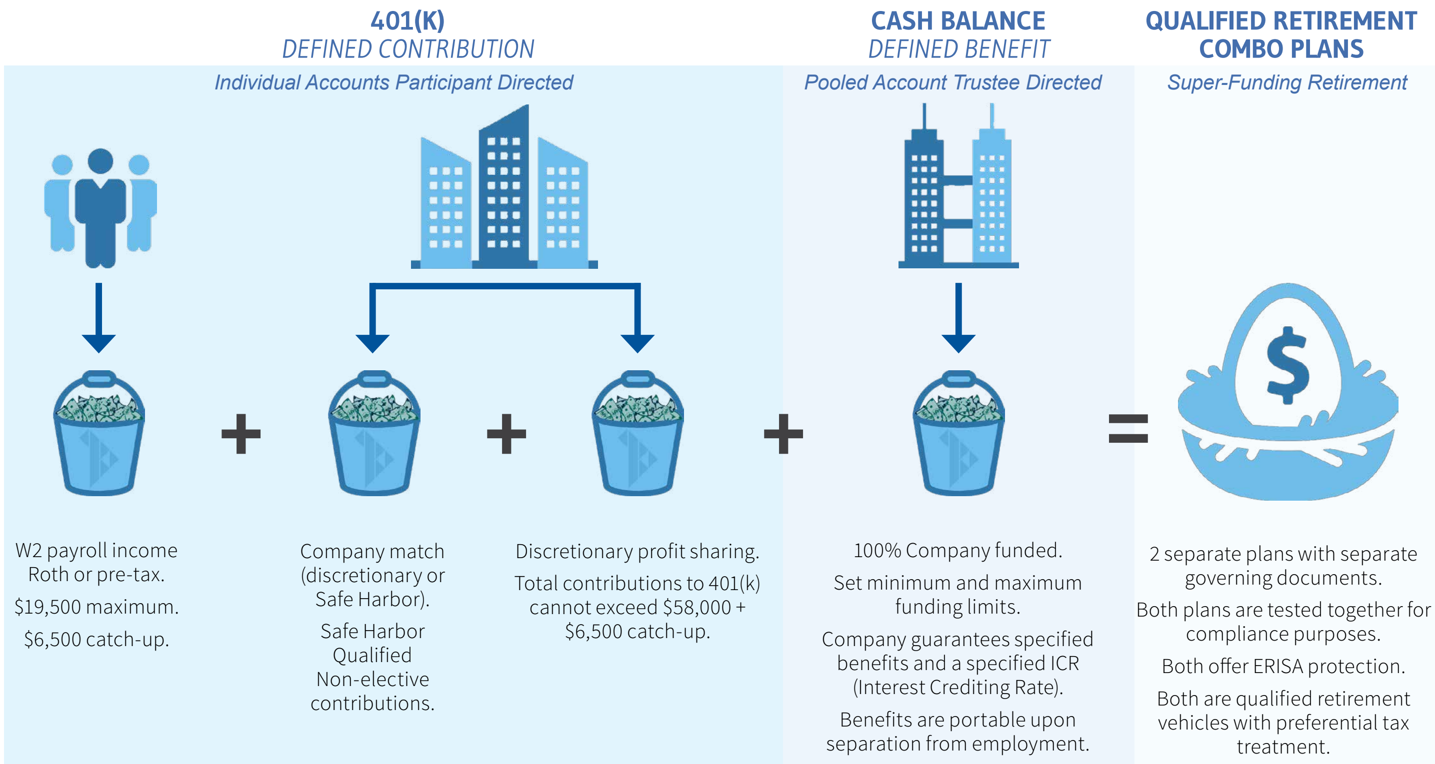
3. **Medicare Tax**
   There is an additional 0.9% Medicare payroll tax on income above $200,000 ($250,000 for married couples).

Another concept from a tax perspective is the Qualified Business Income (QBI) deduction. Taxpayers who qualify for this deduction receive a 20% deduction of the QBI on their tax return. When capital is the source of income production for a business, the business qualifies for a QBI deduction. Many businesses (doctors, attorneys, consultants, actuaries, CPAs) do not qualify for the QBI deduction unless their income is below certain levels ($213,300 for a single return and $426,600 for a married couple filing a joint return). For these business owners, a Cash Balance contribution to reduce income could result in eligibility for the QBI deduction.

Top Cash Balance Plan Client & Employee Benefits

- **Higher level of tax-deferred contributions** than other employer-sponsored retirement plans.
- **Accelerated retirement savings** – catch up on contributions, fast!
- **Opportunity for greater returns on retirement savings** when combined with a 401(k) plan along with protection against market volatility.
- **Lower costs** for sponsors than traditional Defined Benefit plans.
- **Effortless for employees**, since employers make the contributions on their behalf and professional investors handle investment selection.
- **Fully portable for employees**, since they can roll funds over into an IRA if they terminate employment.

Cash Balance Plans At A Glance



2021 Maximum Contribution Limits

401(k), Profit Sharing & Cash Balance Plans

Age	401(k) Only	401(k) with Profit Sharing	Cash Balance**	Total
60 – 65	$26,000	$64,500	$260,000	$324,500
55 – 59	$26,000	$64,500	$205,000	$269,500
50 – 54	$26,000	$64,500	$155,000	$219,500
45 – 49	$19,500	$58,000	$125,000	$183,000
40 – 44	$19,500	$58,000	$90,000	$148,000
35 – 39	$19,500	$58,000	$70,000	$128,000
30 – 34	$19,500	$58,000	$50,000	$108,000

**Information above is based on a Normal Retirement Age of 62, or current age if older, 5.5% interest and applicable mortality after Normal Retirement Age, 5% interest preretirement and no mortality and maximum compensation for 2021 of $290,000*

*** Depends on actual age*

Marketing Strategies

Consider clients and prospects in these situations as possible candidates for Cash Balance plans:

- **Small to medium-size businesses and professional practices** that have predictable cash flow and profitability and are looking for ways to reduce taxable income, including financial advisors.
- **Age 40+ business owners** who have not saved meaningfully for retirement and need to accumulate significant retirement savings over a short period of time.
- **Older business owners nearing retirement**, who are looking for a succession planning tool. With a Cash Balance plan, younger owners can leverage large employer tax-deferred contributions for the older owners, which builds up a significant benefit that can be used to offset the cost of the final buyout.
- **Businesses recruiting young professionals** who would value an employer-funded retirement benefit that will accumulate steadily over time.
- **Individuals who are earning significant income** from serving on boards of directors or consulting and who want to save this income and reduce their taxes.
- **Independent contractors or owner-only businesses** with steady income who want to accelerate retirement income savings.

In addition, clients may want to know that assets in Cash Balance plans are protected from creditors in bankruptcies or lawsuits.

Complimentary Client Illustration & Consultation: Contact Us Today

Have a Cash Balance plan client in mind? For a complimentary illustration and consultation, contact your TRA Regional Sales Consultant (RSC) directly, call 888.872.2364 or email sales@tra401k.com.

Marketing Strategies

Five Ideal Candidates for Cash Balance Plans

1. Principals seeking a tax deduction of more than $50,000 or making more than $250,000 per year.
2. Highly profitable companies of all types and sizes; look for those businesses, such as technology, healthcare, and those providing essential services.
3. Successful family and closely held businesses.
4. CPA and law firms, medical groups, engineers, and professional firms.
5. Older owners who need to consolidate 20 years' worth of saving for retirement into 10 years.

Fast Track Catch-Up Contributions to Reach Retirement Goals

Many high-income business owners may have spent most of their careers building their companies — and may not have saved enough for retirement. Adding a Cash Balance plan to a 401(k) profit sharing plan can help them catch up quickly. For example, as this table shows, a 52-year old accumulates nearly $3.7 million in retirement savings over a 10-year period when Cash Balance plan contributions are added to 401(k) plan and profit sharing contributions.

Year	Age	Cash Balance Contributions	401(k) Contributions	Profit Sharing Contributions	5% Annual Rate of Return	Year End Value
2020	52	$171,896	$26,000	$17,100	-	$214,996
2021	53	$180,490	$26,000	$17,100	$10,750	$449,336
2022	54	$189,515	$26,000	$17,100	$22,467	$704,418
2023	55	$198,991	$26,000	$17,100	$35,221	$981,729
2024	56	$208,940	$26,000	$17,100	$49,086	$1,282,856
2025	57	$219,387	$26,000	$17,100	$64,143	$1,609,486
2026	58	$230,357	$26,000	$17,100	$80,474	$1,963,417
2027	59	$241,875	$26,000	$17,100	$98,171	$2,346,563
2028	60	$253,968	$26,000	$17,100	$117,328	$2,760,959
2029	61	$266,667	$26,000	$17,100	$138,048	$3,208,774
2030	62	$280,000	$26,000	$17,100	$160,439	$3,692,313

Actual returns may be lower or higher than the 5% annual rate of return shown. The table also applies the 2020 IRS limits on qualified plans in future years.

FAQs

How does the annual interest credit work?

The annual interest credit is guaranteed and is not dependent on the plan's investment performance. The interest credit is usually tied to the 30-year Treasury Rate (as defined annually by the IRS), which has ranged from 3% to 4% in recent years. Thanks to recent law changes, there are now many other interest crediting rate options, including the actual rate of return on plan assets.

How are plan investments handled?

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 be used to reduce future employer contributions. This will not affect the amount that is credited to the participants' accounts. Conversely, if the plan's investment earnings are less than the guaranteed rate, then future employer contributions will be increased. This make-up is typically spread out over seven years. A wide range of investment vehicles can be used by plan sponsors to achieve the interest crediting rate.

Can Cash Balance plans be offered in addition to 401(k) Profit Sharing plans or other plans?

Yes, employers can offer a combination of qualified retirement plans in order to produce a larger contribution. In fact, in most cases, a 401(k) Profit Sharing plan in conjunction with a Cash Balance plan is necessary to produce the desired owner and employee contributions.

What are the distribution options upon retirement or if leaving the employer?

When participants terminate employment, they are eligible to receive the vested portion of their account balances.

Any vested account in a Cash Balance plan can be paid as a lump-sum distribution or annuity. A lump-sum distribution can be rolled over to an IRA or another qualified retirement plan.

Can Cash Balance contributions change?

Yes, but with 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 works 1,000 hours during a plan year. In addition, a plan can also be frozen or terminated.

Must everyone participate equally in the Cash Balance plan?

No. Each participant can have a different contribution amount.

What about tax deductions and allocation of plan contributions for partnerships?

Tax deductions for contributions made on behalf of non-partner employees are taken on a partnership's tax return. Tax deductions for contributions made on behalf of partners are taken on their personal or corporate tax returns. (However, 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.

Is the plan subject to IRS nondiscrimination testing?

Yes, like any other qualified plan, a Cash Balance plan is subject to nondiscrimination testing. Employers can anticipate contributions in the range of 5% to 7.5% of pay for staff if the owners or partners receive the maximum Cash Balance contribution. The exact percentage required for employees depends on the number of employees included in the plan and the results of nondiscrimination testing.

How does the cost to set up and maintain a Cash Balance plan compare with the cost of a 401(k) Profit Sharing plan?

Although it may appear that Cash Balance plans are more expensive to set up and maintain than 401(k) Profit Sharing plans, Cash Balance plans are typically more cost-effective. Cash Balance plans ultimately help employers and participants save more with significantly higher tax-deferred contribution limits and major tax deductions.

Roles & Responsibilities

Here's a ready reference guide for the set up and ongoing administration of Cash Balance plans.

	Plan Sponsor (Employer)	TRA	Plan Advisor	Plan Provider
Plan Set-up and Implementation				
Plan design	✓	✓	✓	
Investment selection	✓		✓	
Provide items requested during implementation phase such as complete employee census information as well as conversion documents, *if applicable*	✓			
Execute plan documents and contracts	✓			
Determine employee eligibility	✓			
Plan Document Services				
Provide all document related services to ensure the plan remains in compliance, including Summary Plan Description and Summary of Material Modifications		✓		
Plan Administration and Government Reporting				
Manage overall plan operations to ensure the plan is operating according to the terms of the plan document	✓			
Provide census information for annual compliance testing and reporting	✓			
Prepare annual actuarial report, including required Adjusted Funding Target Attainment Percentage (AFTAP) certification		✓		
Calculate maximum deductible or maximum permitted contribution, *if applicable*		✓		
Prepare signature ready Form 5500 series and other government forms, as needed, for submission by plan sponsor		✓		
Prepare required participant Annual Funding Notice or Summary Annual Report, *if applicable*		✓		
Prepare PBGC Comprehensive Premium Filing, *if applicable*		✓		
Review and electronically sign the IRS Form 5500 and PBGC filing, *if applicable*	✓			
Prepare quarterly plan sponsor financial statements				✓
Prepare employee benefits statements for active participants and, if applicable, terminated participants		✓		
Prepare Plan Sponsor election, *if applicable*		✓		
Perform non-discrimination testing, including combined non-discrimination testing, *if applicable*		✓		
Provide ongoing consulting related to the operation and design of the plan		✓		
Distribution Services				
Calculate accrued benefits and vesting of accrued benefits		✓		
Provide retirement benefit estimates and election paperwork to plan sponsor		✓		
Provide retirement benefit estimates and election paperwork to participants	✓			
Review and authorize distribution requests	✓			
Issue distribution checks				✓
Withhold and remit taxes to IRS; prepare Form 1099R				✓
Calculate and request payments due to a Qualified Domestic Relations Order		✓		

Your Trusted Partner

TRA is your trusted partner in the retirement plan business — especially when it comes to Cash Balance plans.

Here are the steps to take to make the most of this year's selling season:

- **Remember** that Cash Balance plans must be implemented by the client's tax due date for 2020 and contributions must be made by the tax filing due date for 2020 or September 15, 2021, whichever comes first.
- **Review** the resources on the TRA website (https://tra401k.com/cash-balance-plans) for Cash Balance plans.
- **Refine** your current client list and target who would benefit most from accelerating their retirement savings while achieving larger tax deductions.
- **Reach out** to your Regional Sales Consultant at TRA (https://tra401k.com/resource/why-tpa-for-plan-advisors/) for a complimentary Cash Balance plan consultation and illustration.

Don't Let the Opportunity Slip Away

Don't miss out on this year's Cash Balance plan selling season!

- New Cash Balance plans must be set up by your client's tax due date for 2020.
- Cash Balance plan contributions must be made by your client's tax filing due date for 2020 or September 15, 2021 – whichever comes first.

Not all courses of action may be financially advantageous for all retirement plans, their sponsors, and their participants. You and your clients should meet with the professionals at TRA to discuss the details of any actions to take and then review them with their legal or tax advisors before moving ahead.

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