TAX ADVANTAGES OF CASH BALANCE RETIREMENT PLANS

Tax Deferred With A Cash Balance Plan

Three Key Tax Changes: How Does a Cash Balance Plan Help?

A critical element in the explanation of the benefits of Cash Balance Plans is the estimate of the tax deferral that will occur. The top federal income tax rate is now 37% and 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 is another source of potential tax reduction. State and local taxes may range from 0% to as much as 13.3% in California.

Even after the Tax Cuts and Jobs Act (TCJA), 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 earning over $200,000 (or $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 $609,350 (or $731,200 for married couples). A Cash Balance contribution reducing income for a married couple below $731,200 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 (or $250,000 for married couples).

The Tax Cut and Jobs Act (TCJA) resulted in additional complexity. A new 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 ($241,950 for a single return and $483,900 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.

Let’s consider a doctor, as follows:

W-2 Compensation	$185,000
QBI, if eligible	$300,000
QBI Deduction	$0
Taxable Income, Joint Return, over $483,900	$485,000

Let’s consider a Cash Balance contribution of $175,000 for the above example.

W-2 Compensation	$185,000
QBI, after Cash balance contribution of $175,000	$125,000
Less QBI deduction, eligible	$25,000
Taxable Income	$285,000

The doctor in this example reduced taxable income by $200,000 with a $175,000 contribution to the Cash Balance Plan. Of course, every tax situation is unique. In this example, the taxpayer would save approximately $80,000 in federal income taxes, reduce state and local income tax and possibly reduce other taxes described above.

After TCJA, Cash Balance Plans continue to provide a tax beneficial method to super save for retirement!

Learn more about how a Cash Balance Plan can help reduce taxes and accelerate retirement.

**Taxes are deferred only. This information is general in nature and is not a substitute for tax advice a particular case.*

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