

# Cash Balance Plan Overview & FAQ

## What is a cash balance plan?

A cash balance plan is a tax-qualified retirement plan that combines features of a defined contribution plan (like a 401(k)) with features of a more traditional defined benefit pension plan. Cash balance plans provide guaranteed benefits for employees and are maintained on an individual account basis. The plan may also be designed to better control the cost of the employee benefits, and it can also use an innovative allocation method to provide comparable benefits to the owners when compared to the average benefit awarded to the non-owner employees.

## Can an employer sponsor a cash balance plan if it has an existing 401(k) plan?

A cash balance plan can be adopted as a standalone plan, but it also can be adopted by an employer that already sponsors a 401(k)/profit-sharing plan. If an employer currently does not have any retirement plans in its benefits package, it can adopt the two plans simultaneously. In many cases, the pairing of a cash balance plan with a 401(k)/profit-sharing plan can create the opportunity for significant tax-deferred savings.

## Why are these plans popular?

With the combination of a cash balance plan and 401(k)/profit sharing plan these plans' ability to offer combinations with significant contribution and benefit flexibility is popular among business owners. The combination allows for greater design flexibility which permit differing benefits between a select group of participants while also helping to control the overall plan cost.

## How much life insurance can I put in a cash balance plan?

The amount of life insurance that can be acquired is limited in all defined benefit plans. Generally, death benefits will be considered incidental if less than 50% of the employer's contribution is used to purchase whole life insurance. If a client uses universal life insurance, the death benefits will be considered incidental if less than 25% of the employer's contribution are used.

## When does the life insurance need to be removed?

The life insurance held by the plan is used to fund the pre-retirement survivor benefit. Thus, upon retirement or separation from service, it needs to be removed from the plan. Generally, the policy may be: 1) Surrendered for its cash value, 2) Distributed to the participant, 3) Purchased by the participant, or 4) Exchanged for a policy outside the plan. (Please refer to Form No. 0014975, "Beyond Retirement or Separation from Service").

## What are the tax advantages of a cash balance plan?

Cash balance plan have the potential to offer tax benefits for business owners beyond those available in a 401(k)/profit-sharing plan.

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There are various income, gift and estate tax consequences of utilizing life insurance within a qualified plan. A decision to include life insurance within a qualified plan should be made after considering the tax results and your client's non-tax needs for insurance. We recommend that your client discuss their situation with their tax and legal counsel before purchasing an insurance product within a qualified plan. Certain limits apply as to how much life insurance can be purchased inside a qualified retirement plan. Also, action must be taken to remove the life insurance policy from the qualified retirement plan upon termination of employment. The plan administrator can assist with these details.

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Cash balance contributions are deductible dollar for dollar for the business. Earnings on plan contributions grow tax-deferred. When distributed, either as a lump sum or annuity payments, benefits are taxed as ordinary income.

## What is the time commitment for cash balance plans?

Qualified plans need to follow the IRS rules regarding permanency. Generally, the company would need to commit to funding the plan for no fewer than five years, unless there is a legitimate business reason for freezing or terminating the plan (such as sale of the business or bankruptcy). Failure to do so could open the company up to IRS penalties and the disqualification of the plan.

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