

# NEW LAW PAVES THE WAY FOR SUBSTANTIAL TAX DEFERRED RETIREMENT SAVINGS

The Pension Protection Act (PPA) officially blessed cash balance plans as legitimate tax-qualified retirement savings vehicles, creating tremendous opportunities for self-employed individuals and small business owners to accumulate retirement savings while dramatically reducing taxable income.

## Cash Balance Plans

Cash balance plans are qualified retirement programs designed to look and function more like popular defined contribution (DC) profit sharing plans. However, because they are defined benefit (DB) in nature, cash balance plans enjoy potential for substantially higher tax deductions when compared with their defined contribution counterparts.

Notional cash balance accounts are created for each plan participant. These hypothetical accounts increase each year with contributions and interest fully funded by the employer.

Employee benefits can be stated as a percentage of participant compensation or fixed dollar amounts, and benefit levels can vary among employee groups or even by individual employee. When offered in combination with a defined contribution plan, business owners may be able to leverage profit sharing contributions into higher cash balance allocations for themselves.

Interest is credited to participant balances annually based on a guaranteed rate of return defined in the plan document, independent of the plan's actual asset allocation and investment performance.

### Cash Balance Plan Advantages

- ◆ Significantly higher tax deductions than defined contribution plans
- ◆ Ability to pre-fund benefits
- ◆ Easy to understand and communicate
- ◆ Flexible plan design options for any type of business
- ◆ Combines easily with existing 401(k) and profit sharing plans to maximize benefits
- ◆ Retirement benefits can roll over to IRAs, extending tax benefits

## Comparison of Maximum Contribution Levels for 2008

Current Age	401(k)/PS Plan	Cash Balance	DB/DC Combo
40	\$ 46,000	\$ 49,500	\$ 78,800
45	46,000	76,200	105,500
50	51,000	127,400	161,700
55	51,000	179,200	213,600
60	51,000	208,700	243,000

## Investment Opportunities

Participant accounts—both annual contribution and interest credits — are funded exclusively by the employer who effectively guarantees some (conservative) rate of return. Plan sponsors fund these obligations in a single trust under their control and discretion; employees do not self-direct accounts the way many 401(k) plans allow.

The plan sponsor may select from any number of investment options, including mutual funds, individual stocks and bonds, ETFs, and almost any other marketable security. The plan may also purchase individual life insurance policies with face values of up to \$1.5 million per participant.

## Other Funding Considerations

Because the employer is providing a guaranteed rate of return, required annual contributions to the plan will increase or decrease in large part based on the difference between actual investment return and each year's interest crediting rate.

Cash balance plans hold another key advantage over DC plans—they may be pre-funded. Annual contributions are generally stated as a range, allowing sponsors to utilize even higher deductions while decreasing future funding requirements.

## Plan Design Example One

A 48 year-old physician in private practice has earned \$110,000 (after self-employment taxes) for several years and intends to retire at age 60. She wants to maximize tax-deductible retirement savings, but her profit sharing plan only permits an annual contribution of \$46,000.

Deductions of as much as \$85,000 would be available in a cash balance plan. When combined with a 401(k) plan, total annual deductible contributions increase to more than \$105,000 – virtually eliminating taxable income! If investments return 6% annually, retirement savings would total almost \$2 million by age 60.

## BDS Actuarial Services

55 Linden Street  
Worcester, MA 01609  
Phone: (508) 755-8883  
Fax: (508) 890-2302

Website: [www.bdsconsultinggroup.com](http://www.bdsconsultinggroup.com)



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## Plan Design Example Two

An LLP with two principals and four employees currently sponsors a profit sharing plan with annual contributions equal to 10% of pay. The owners would like to increase deductible retirement contributions while maximizing their personal retirement savings.

Name	Age	Pay	Contrib
Owner1	52	\$230,000	\$23,000
Owner2	50	230,000	23,000
Ee1	42	65,000	6,500
Ee2	35	45,000	4,500
Ee3	26	30,000	3,000
Ee4	20	20,000	2,000
Total		\$620,000	\$62,000
Owner %		74.2%	74.2%

Establishing a 5% safe harbor profit sharing plan would eliminate potential top-heavy benefit issues and employee deferral discrimination testing, allowing the owners to adopt a non-matching 401(k) and defer as much as \$20,500 in 2008 each regardless of employee deferrals.

The owners may also adopt a cash balance plan that leverages their profit sharing contributions to maximize their own retirement savings. A conservative plan design would allow each owner additional annual contributions of \$46,000 with no employee cost.

Name	410(k)/PS	CB	Total
Owner1	\$32,000	\$46,000	\$78,000
Owner2	32,000	46,000	78,000
Ee1	3,250	0	3,250
Ee2	2,250	0	2,250
Ee3	1,500	0	1,500
Ee4	1,000	0	1,000
Total	\$72,000	\$92,000	\$164,000
Owner %	88.9%	100.0%	95.1%

Increasing profit sharing deferrals to 7.5% for non-owners would allow the principals to increase their annual cash balance contributions to as much as \$125,000 each. Alternatively, the cash balance plan could be designed to allow different contribution levels for each owner.

