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Benefits of Cash Balance Retirement Plans

Cash Balance Retirement Plans: The Pros and Cons

Cash balance retirement plans offer many benefits for both employers and employees. Whether you're a sole proprietor, business partner, or employee, you should consider utilizing a cash balance retirement plan to maximize your savings.

What is a cash balance retirement plan?

A cash balance retirement plan is a defined-benefit pension plan. Employers credit each participant's account based upon a set percentage of the employee's compensation. The employee also receives an interest charge each year.

Because they are defined-benefit plans, a participant's final benefits are not subject to investment risks. Instead, all profits and losses fall to the company as a whole.

How does a cash balance retirement plan work?

First, employers credit each participant's account with a percentage of his or her yearly salary. Most employers contribute between 5 and 8 percent of pay. This is a much higher percentage than the standard 3 percent contributions for 401(k) plans.

In addition to these credits, participants also receive an interest credit. This interest credit may either be a fixed rate (e.g. 5 percent), or it may be a variable rate (e.g. the treasury rate).

When participants retire, they may take an annuity based on their account balance. Many retirees also have the option of taking a lump sum, which they can roll into a different retirement plan, such as an IRA.

Most cash balance pension plans cost approximately $2,000 to $5,000 in setup fees, plus an additional $2,000 to $10,000 in annual administrative fees. Investment management fees range from .25 to 1 percent of assets. These plans are often more expensive to manage than some other types of retirement accounts, such as 401(k)s, but the tax benefits generally offset the expense.

What are the benefits of a cash balance retirement plan?

There are many benefits to a cash balance retirement plan, with potential tax savings being a huge part of that. Here's a quick rundown.

- High Contribution Limits
- More Retirement Savings
- Lower tax liability

Cash balance retirement plans have much higher contribution limits than a traditional 401(k) and increase with age. The current limit is over $200,000 for participants aged 60 or over. (Compare that with the current 401(k) limit, which is $57,500 for ages 60 and over.)

This allows participants to contribute a greater portion of their net income to the retirement plan, which has a couple of benefits: more money for retirement and lower tax liability now.

Who can benefit from a cash balance retirement plan?

Many taxpayers may benefit from utilizing a cash balance pension plan. However, it's not the best option for everyone.

A cash balance retirement plan is a great option in the following situations:

1. An owner or partner who wants to maximize their retirement contributions during the year. There are contribution limits for retirement plans, but cash balance retirement plans have much higher limits than others. If you would like to contribute more than $57,500 (the current 401(k) limit for ages 60 and older), a cash balance retirement plan is a good option.

2. Companies with consistent cash flow. These plans require an annual employer contribution, so your company should have enough cash flow to ensure they can meet these requirements.

3. Older participants who want to "catch up" on their retirement contributions. Because contribution limits are higher for older individuals, those over 40 will benefit more from these plans.

4. Employers who don't mind contributing 5 to 7.5% of their employees' pay to a retirement plan. These are the current averages for cash balance retirement contributions.

Most experts agree that individuals and business owners who are nearing retirement age and make more than $250,000 per year are the ideal candidates for taking advantage of a cash balance pension plan

Final Thoughts

While cash balance retirement plans have many benefits, there are a few downsides, as well.

These retirement plans may not be a good option for those currently utilizing a traditional pension plan. Traditional pension plans focus heavily on your latest working years, when salary is highest. Cash balance pension plans consider all years evenly, including your lowest salaries. This means a cash balance pension plan may result in a lower retirement benefit in the end.

These plans can also be more expensive for employers to set up and maintain. However, many employers find that the tax benefits far outweigh the costs.

So, can a cash balance plan benefit you? Well, that depends on your financial situation. To find out more information, give us a call. We can look over your unique situation and advise whether you should make the switch to a cash balance retirement plan.

About Lewis Hooper Dick, LLC

Lewis, Hooper & Dick, LLC was established in 1955 by Edward Lewis, CPA. Our professionals provide value-added and affordable accounting and advisory services to clients throughout the region. Our dedicated leadership strives to continually grow our practice by instilling our founding principles throughout our organization. The firm's professionals challenge themselves to introduce new and exciting ways to exceed our clients' personal and professional goals. Our experienced and knowledgeable staff continues to be the driving force behind our innovative techniques and ongoing success.

The firm's team of four member/owners and over 20 professionals offers comprehensive accounting, consulting, human resources, financial planning, and tax and computer services. Lewis, Hooper & Dick, LLC specializes in serving feed yards, municipalities, school districts, government entities and construction organizations. We maintain offices in Garden City and Hugoton.

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