TRISTAR PENSION CONSULTING

2017 Cash Balance Guide

Cash Balance Retirement Plans

The information provided herein is for quick reference only. All ERISA, IRS and DOL rules and requirements are complex and require additional data not included here.

What is a cash balance plan?

A cash balance plan is a type of employer-sponsored defined benefit (DB) retirement plan. Unlike traditional defined benefit plans that provide for a monthly benefit at retirement, which can be confusing and hard to grasp, cash balance plans provide the **promised benefit in the form of an "account" balance**. The participant statement provided to the participant resembles a 401(k)/profit sharing plan statement. This makes the cash balance benefit much easier to understand and is, thus, more appreciated by employees.

How does a cash balance plan work?

In general terms, the cash balance plan document will define groups of participants and their "**pay credit**". This pay credit might be defined as a percentage of compensation or a dollar amount (or some combination of both). For example, the pay credit may be the lesser of 50% of compensation or $125,000 for the principals and the lesser of 3% of compensation or $1,000 for the rank and file employees.

In addition to the pay credits, the hypothetical accounts are credited with guaranteed interest at the **interest crediting rate** defined in the plan document. Typical rates include Treasury Rates or a fixed rate (or some combination of both). For example, the interest crediting rate may be the lesser of a fixed rate or an index.

How is the interest crediting rate set?

By law, the interest crediting rate must not exceed a "market rate". Setting the interest rate is part of the initial plan design; once set, the interest crediting rate definition normally does not change.

Contact Us:

TriStar Pension Consulting | tristarpension.com

9150 N. May Avenue, Suite A | Oklahoma City, OK 73120 | (405) 848-401k

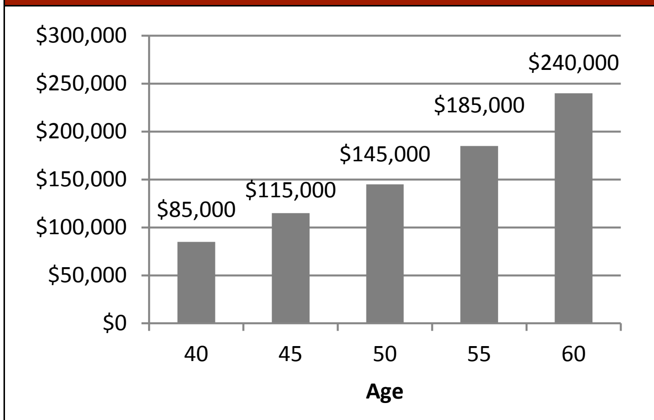
How does a cash balance plan complement the 401(k)/ profit sharing plan?

The 401(k)/profit sharing plan, also known as the defined contribution (DC) plan, is an important part of the cash balance design. The profit sharing allocations to NHCEs[2] in the DC plan essentially buy the HCEs[1] the right to **contribute much larger sums of money** into the cash balance plan. Plan sponsors adding a cash balance plan should be informed that their profit sharing contributions are not necessarily discretionary any longer.

What are the tax deduction rules?

The deductible limit to combined plans (DB and DC) is the greater of 25% of compensation or the minimum required funding amount for the DB plan. Post 2005, the 25% limit does not apply if the employer contributions to the DC plan do not exceed 6% of aggregate compensation. When DC contributions exceed 6%, only those over 6% are considered in the 25% limit. Effectively, this translates to a **31% limit**. Larger limits apply if the plan is subject to coverage by the PBGC[3].

Approximate annual contribution limits by age



Contribution deposit deadlines

For tax deduction purposes: By the due date or extended due date of the employer's tax return.	
Minimum funding requirements: Cash balance plans must make required minimum funding contributions within 8½ months following the plan year end.	

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Implementation deadline

No later than the last day of the tax year (typically 12/31).

What happens when someone terminates?

Distributions from cash balance plans are subject to most of the same rules as traditional DB plans. The participant must be offered annuity payment options in addition to the lump sum option.

An important distinction is that cash balance plans are not subject to the same interest rate rules for determining the amount of the lump sum as traditional DB plans. This ultimately makes the **cash balance distributions more easily determined and projected**. Distribution restrictions may apply depending on the plan's funding levels at the time of termination.

Does cash balance plan administration require an actuary?

Yes. Just as an enrolled actuary is required to administer a traditional defined benefit plan, they are required to administer a cash balance plan. The enrolled actuary is responsible for filing the Schedule SB, an informational filing that includes the actuary's certification that the plan's funded status complies with the IRS' regulations. The Schedule SB summarizes the valuation results from the plan year and reports funded percentages as well as minimum contribution requirements and amounts deposited.

Why choose a cash balance plan over a traditional DB plan?

- Age-neutral contributions for non-owners
- Avoid lump sum swings due to interest rate shifts
- Professional groups are more able to equalize benefits
- More meaningful and understandable benefit to employee

Cash balance plan example

- Plan effective 1/1/16
- Single participant – doctor/owner
- 2016 compensation: $265,000
- 2017 compensation: $270,000
- Pay credit = 50% of compensation
  - $132,500 for 2016; $135,000 for 2017
- Interest crediting rate: 5%

	Dollars ($)
Balance 1/1/16	--
2016 Pay Credit	132,500
Balance 12/31/16 (1/1/17)	132,500
2017 Interest Credit (5% of $132,500)	6,625
2017 Pay Credit	135,000
Balance 12/31/17	**$274,125**

Key Terms

[1]**HCE (Highly compensated employee)**

A highly compensated employee is an individual who:

- Owns more than 5% of the interest in the business at any time during the year or the preceding year, irrespective of compensation; or
- For the preceding year, received compensation from the employer of more than $120,000, and if the document provides, was in the top 20% of employees based on compensation.

[2]**NHCE (Non-highly compensated employee)**

A non-highly compensated employee is an individual who:

- Has equal to or less than 5% company ownership; and
- Earned less than $120,000 in the preceding year.

[3]**PBGC (Pension Benefit Guaranty Corporation)**

- Mandatory insurance coverage for defined benefit plans
- The following plans are exempt from PBGC coverage:
  - Owner-only plans, and
  - Plans for professional service employers with less than 26 active participants (doctors, lawyers, CPAs, etc.).
- Flat Rate Premium: $69 per-participant for single employer plans
- Variable Rate Premium: $34 per $1,000 of unfunded vested benefits