Tax Advantages of Cash Balance Retirement Plans

A Powerful Tax Strategy for Small Business Owners or High Income Individuals with Self-Employment Income

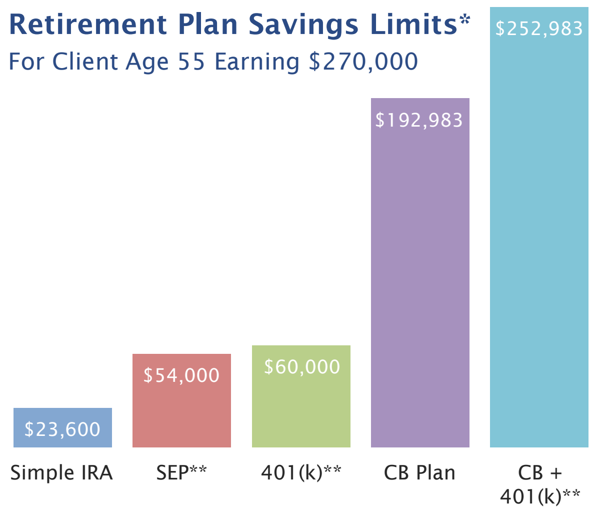
Tax deductions are becoming increasingly hard to find, especially “above the line” deductions that directly reduce ordinary income dollar for dollar. With many federal, state and local tax increases in place, Cash Balance Plans can make a bigger impact on savings than ever before.

How Does It Work?

The Cash Balance (CB) plan is an IRS-approved qualified retirement plan* that allows small business owners or individuals with self-employment income — to make large annual tax-deferred contributions. They offer business owners the ability to accumulate up to $2.7 Million in just 10 years. Cash Balance contributions are an allowable business deduction. At retirement, assets are generally rolled over into an IRA and are not taxed until they are distributed.

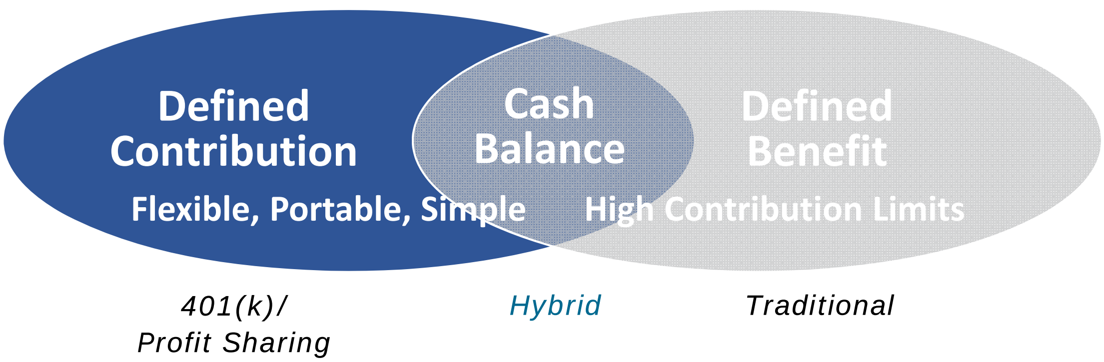
Retirement Plan Savings Limits*

For Client Age 55 Earning $270,000



* 2018 Cash Balance Plan maximum contribution limits in W-2 income; includes "catch-up" contributions of $3000 for SIMPLE IRA, $6000 for 401(k).

** Combined with a Profit Sharing Plan



While technically a Defined Benefit Plan, a CB plan is often referred to as a "hybrid" plan, because it has characteristics of both Defined Benefit and Defined Contribution plans.

How the tax deduction for the contributions to a CB plan is taken depends on the entity of the plan sponsor. The contributions for non-owners are always a company tax deduction. Owner contributions are either a company tax deduction or a personal tax deduction depending on whether or not the plan sponsor is a corporation. Thus, a significant tax deferral savings may be realized by the company and/or owners every year, and similar to other retirement plans, taxes may be paid upon withdrawal during retirement when and if the participant is in a lower tax bracket, or perhaps lives in a lower-tax state.

*https://www.irs.gov/pub/irs-tege/2013cpe_hybrid_plans.pdf

Cash Balance plan can be set up for sole proprietorships, partnerships, LLCs, nonprofits and corporations

“one of the last, best tax breaks left for closely held business owners,” - Elmer Rich III, principal of Rich and Co., Chicago

Tax Savings from a Cash Balance Plan

Cash Balance contributions reduce both taxable income and adjusted gross income (AGI), so high income earners may move into a lower tax bracket. The following taxes may be reduced or eliminated by contributing to a CB Plan:

- **Investment Tax** - An additional 3.8% tax on unearned net income is now imposed on individuals making more than $200,000 (or $250,000 for married couples). The surtax is in addition to the capital gains and dividend tax of up to 20%.
- **Top Marginal Income** - The top marginal tax rate is 39.6% for individuals earning more than $418,400 (or $470,701 for married couples).
- **Medicare Tax** - There is an additional 0.9% Medicare payroll tax on income above $200,000 for individuals (or $250,000 for married couples).
- **Phased-Out Tax Deductions** - The ability to itemize certain tax deductions has been phased out for individuals making more than $259,400 (or $311,300 for married couples).

Ideal candidates for a Cash Balance Plan may include:

- Highly profitable companies of all types and sizes, owners who desire larger tax deductions, or principals earning more than $250,000 per year.
- Family businesses -- seeking an effective tool for succession planning.
- Closely-held businesses -- several owners want a greatly enhanced retirement plan.
- Professional firms including: CPAs, engineers, architects, financial services, management consultants and others; tax deferral and asset protection are often very important to these professions, along with a highly-competitive retirement package that can help attract and retain top talent.
- Older owners who have delayed saving for retirement and need to squeeze 30 years of saving into 10.
- Owners who value asset protection, ERISA protects qualified plan assets from creditors in the event of bankruptcy or lawsuit.

Example of the Benefit

A 55-year old pediatrician expects to have an annual W-2 income of at least $270,000 from his private medical practice until he retires in ten years. He establishes a CB plan to increase his retirement savings and reduce his tax liability.

Here’s how it works for him:

Annual CB plan contribution	$192,983
Annual CB tax deduction	$192,983
Annual tax savings @40%	$77,193
Projected accumulation in 10 yrs	**$2.43 million***

*Assumes 10 year funding, 5% rate of return