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How To Set Up A Cash Balance Pension Plan

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The cash balance pension plan has been growing in popularity with the self-employed and small business owners who are looking to minimize their taxes. This valuable [retirement plan](#) also works well for those with large incomes who have procrastinated when it comes to investing for retirement.

Why You Should Start A Cash Balance Plan

A [cash balance pension plan](#) is a qualified retirement plan, which is fully funded by the employer. Depending on your income and how far you are from retirement, a cash balance plan allows for contributions as large as \$3 million in 2021. More common are business owners making contributions in the range of \$150,000 to \$350,000, per year. This is usually in addition to a profit-sharing 401(k) plan, which only allows a maximum contribution of \$58,000 (employee + employer for 2021). In case you were wondering, you get a tax deduction for each dollar you contribute to a cash balance pension plan.

How It Works - Starting a Cash Balance Plan

When we are talking about tax savings, the cash balance plan will look a lot like your defined contribution plan, think 401(k). In reality, a cash balance pension plan is actually a defined benefit plan. The employer will be making contributions over time to help fund a "[defined pension benefit](#)." In the plan design, the return on assets in the participants' accounts are guaranteed.

If your investment choices perform better than the guaranteed benchmark return, your contribution the following year will be smaller. Conversely, if the plan's investments do not meet or exceed the guaranteed return, the employer has to make up the difference. The good news here is that shortfall allows for a larger contribution and more tax savings in the future. Also, the business owner has seven years to make up the shortfall. This also gives the investment time to help make up some, or all, of the shortfalls.

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How To Set Up The Cash Balance Plan

The process of setting up a cash balance pension plan is much more complicated than just opening an IRA or investment account. You will need

to work with your [fiduciary financial planner](#), CPA, and likely other professionals to make sure the plan is optimized for your specific needs and funding goals.



Your trusted financial advisor will first collect an employee census that outlines the demographics of your employees (if you have them), such as employee wages and salaries. With this demographic information, the pension planner calculates how much can go into the plan for executives and owners and how much will have to go in for the employees each year to pass IRS testing. There are strict rules to ensure that the plan's benefits don't discriminate in favor of officers, shareholders, or any employees.

Step two for setting up a cash balance plan is putting together a legal document laying out all the plan's details, including the contributions for the participants and the annual interest crediting. This cash balance plan setup document must be signed no later than the end of the fiscal year for which the company wants to take the deduction.

While the **cash balance plan must be set up during the fiscal year**, you have substantially more time to fund the plan. Contributions to your cash balance plan must be funded by the due date of your tax return, including extensions. That means you have until September 15, 2022, to fund the cash balance plan to get the tax deduction for 2021, assuming you've filed for a tax extension.

The tax benefits are enormous, with a cash balance plan. But there are drawbacks; you can expect to spend a good amount of money to have the plan set up and administered each year. The good news is these costs are also tax-deductible business expenses.

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How To Run Your Cash Balance Pension Plan

There are a few other things to keep in mind when running a cash balance plan for your business. This is not just a set it and forget it plan. It will take a little bit of work each year. Luckily, most of this heavy lifting can be done by your financial planner and the pension team.

Not all employees will need to be in the plan. However, once an employee works 1,000 hours during a plan year, you are required to allow them into the plan. So, plan on a midyear checkup to review any hiring or firing you may have done and how this will affect contributions to the plan. If, for some reason, you end up with a surge in new employees, and contributing to all of them is unfeasible, you can potentially freeze the plan. Even just temporarily.

If you end with a highly profitable year, you can increase the planned contributions to the plan. You would have until 2.5 months after year's end

to amend an up and running plan.

Accumulated funds in the pension can be paid either as a lump sum or as an annuity income payment. Pension funds can also be rolled over to an IRA when an employee leaves or the plan is shut down. This is assuming the plan allows for lump-sum withdrawal pre-retirement.

Setting up a cash balance plan is a big commitment. However, the tax savings can be worth more than the hassle. Work with your fiduciary financial planner to see if a cash balance plan is right for your small business. If that person is unable to help with this analysis, it may be time to find an advisor who can.

Cash balance plans are not right for everyone. They are [typically combined with a profit-sharing 401\(k\)](#) plan that is already being maxed out.

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