An employer seeking a larger contribution than allowed in a 401(k) plan should evaluate the benefits of a Cash Balance Plan.

What is a Cash Balance Plan?

A Cash Balance Plan is a type of defined benefit plan. It defines the employee's benefit as an account balance versus a monthly pension amount. The employer contribution is typically determined as a percentage of salary or fixed dollar amount per participant. Defined benefit plans generally allow larger contributions than defined contribution plans.

Cash Balance Plans define the employee benefit in terms of a stated account balance. In addition to a clearly defined contribution each year, participant accounts are also credited with interest based on a rate defined by the plan. The combination of these two features provides the participant with a stated balance in the plan similar to a defined contribution plan. Retired or terminated participants have the option of taking lump sum payment or lifetime annuity payments.

Investment performance is the employer's responsibility. The investments in Cash Balance Plans are managed by the employer or an investment professional selected by the employer. Since Cash Balance Plans promise to pay a specific amount upon retirement or termination, investment performance does not impact the benefit amount promised to the participant. The employer is responsible for ensuring the investments in the plan are enough to pay participants.

Cash Balance Plans can enhance the benefits of an existing 401(k) plan. Employers desiring higher contributions than allowed in a 401(k) plan can add a Cash Balance Plan in addition to the 401(k). Together, these two plans provide both maximum contributions and maximum flexibility.

Cash Balance Plans can help:

- Reduce corporate taxes
- Save more for retirement
- Attract and retain employees

Cash Balance Example

- Plan effective 1/1/2019
- HCE owner
  - 2019 compensation: $280,000
  - 2020 compensation: $285,000
  - Pay credit = 50% of compensation
- NHCE Employee
  - 2019 compensation: $40,000
  - 2020 compensation: $45,000
  - Pay credit = 6% of compensation
- Interest crediting rate: 5%

	Owner Employee	NHCE Employee
Balance 1/1/2019	$0	$0
2019 Pay Credit	$140,000	$2,400
Balance 12/31/2019 (1/1/2020)	$140,000	$2,400*
2019 Interest Credit	$7,000	$120
2020 Pay Credit	$142,500	$2,700
Balance 12/31/2020	$289,500	$5,220*

*Note that there may be additional contributions due to NHCE employees in a DC plan in order to satisfy certain testing requirements. These amounts are typically between 5 - 7% of compensation. Profit sharing contributions to NHCEs in a DC plan essentially buy HCEs the right to contribute much larger sums in a cash balance plan.

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