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the
MANDMARBLESTONE*Group llc*
retirement plans redefined

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Cash Balance Plans

Frequently Asked Questions

Introduction

This piece is intended to provide owners of small to medium size businesses with answers to frequently asked questions about cash balance plans.

Focus

The focus of the questions and answers is "owner-centric" retirement plans, those plans that provide the major part of the contributions to business owners, their family members and favored employees, while providing lower contribution amounts to all other employees.

Frequently Asked Questions

Question 1: What is a cash balance plan?

Answer 1: A cash balance plan is a type of qualified retirement plan that guarantees participants a retirement benefit.

<u>Question 2</u>: Who makes the contributions to a cash balance plan?

<u>Answer 2</u>: The company that establishes the plan makes the contributions to the cash balance plan, not the plan participants.

<u>Question 3</u>: How is the contribution amount determined?

<u>Answer 3</u>: The contribution formula is determined by an actuary when the plan is established, so that the contributions being made to the different categories of participants meet the objectives of the owners. The contributions must meet requirement of IRS regulations, so that the plan is not considered to be discriminatory in favor of owners, family members and highly compensated employees. Thus, at the outset, the owners must determine how much the company is to contribute for each category of employees. Most often, company owners and family members are in the favored group, and receive larger contributions than all other employees, who receive lower contributions.

<u>Question 4</u>: Are the annual contribution amounts predictable, so that a company budget for the contribution?

<u>Answer 4</u>: When the plan is designed, the company establishes an annual interest rate to be credited to the account balance of each plan participant. Since the interest rate is guaranteed, the company's contribution is adjusted to account for differences between the guaranteed interest rate and the interest rate actually earned by the plan's investments. So as long as the earnings rate is close to the guaranteed rate established in the plan, then the annual contributions will fall within a reasonable range of the predicted contribution amount set by the plan contribution formula.

<u>Question 5</u>: Are the annual contributions mandatory?

<u>Answer 5</u>: Yes, annual contributions to a cash balance plan are mandatory.

Question 6: What are the annual contribution limits for each participant?

Answer 6: The law does not set a contribution limit for each participant, as is the case in a 401(k) plan. Rather, the sum of the annual contributions and guaranteed interest rate for each participant at their retirement date may not exceed the lump sum that is the actuarial equivalent of the maximum annual retirement benefit. For 2009, the maximum annual retirement benefit for a plan participant is $185,000 per year. This equates to a lump sum of approximately $1,850,000. This results in larger contributions being permitted for employees who are closer to retirement, since there is less time to accumulate the required lump sum.

Question 7: How do company contributions to a cash balance plan differ from a 401(k) plan in the amount of the contribution to each participant?

Answer 7: The company contributions to a 401(k) plan are limited to a percentage of salary, while company contributions to a cash balance plan are limited by the projected lump sum needed at a participant's retirement to provide the maximum annual retirement benefit. This often results in substantially larger tax-deductible contributions being available for company owners in a cash balance plan.

> **Contribution Examples**: Here are some examples of an individual's annual 401(k) Profit Sharing plan contributions as compared to such individual's contribution to a combination cash balance plan and a 401(k) profit sharing plan. It is assumed that the individual earns at least $245,000 per year.

401(k) Profit Sharing Plan

Age	401(k) Deferral	Profit Sharing	Total
40	$16,500.00	$32,500.00	$49,000.00
45	$16,500.00	$32,500.00	$49,000.00
50	$22,000.00	$32,500.00	$54,500.00
55	$22,000.00	$32,500.00	$54,500.00
60	$22,000.00	$32,500.00	$54,500.00
65	$22,000.00	$32,500.00	$54,500.00

Combination 401(k) Profit Sharing Plan and Cash Balance Plan

Age	401(k) Deferral	Profit Sharing	Cash Balance	Total
40	$16,500.00	$32,500.00	$69,000.00	$118,000.00
45	$16,500.00	$32,500.00	$88,000.00	$137,000.00
50	$22,000.00	$32,500.00	$113,000.00	$167,500.00
55	$22,000.00	$32,500.00	$145,000.00	$199,500.00
60	$22,000.00	$32,500.00	$186,000.00	$240,500.00
65	$22,000.00	$32,500.00	$192,000.00	$246,500.00

Question 8: Do plan participants have an account balance?

Answer 8: Every employee has a "hypothetical account balance," which, in fact, is the amount that a participant would be entitled to receive if they were to terminate employment.

Question 9: How does a participant's account balance grow?

Answer 9: A participant's account balance grows each year by the company's contribution credit to each participant and the guaranteed interest rate credit established as part of the plan design.

Question 10: Do plan participants have control over the investment of their accounts?

Answer 10: No. The plan assets are invested as a single account.

Question 11: What determines if a company is a good candidate to establish a cash balance plan?

<u>Answer 11</u>: A company is a good candidate for a cash balance plan if a 401(k) profit sharing plan, by itself, does not provide a large enough contribution to owners. For 2009, the annual contribution limit for employee salary deferrals and company contributions is $49,000 ($54,500 if a participant is at least age 50). Since a company's cash balance contribution is mandatory, a good cash balance candidate should have predictable revenue. Cash balance plans are used most frequently in professional practices and closely-held businesses.

<u>Question 12</u>: If a company establishes a cash balance plan with the objective of maximizing contributions to the owners, how much will the company have to contribute for non-owners?

<u>Answer 12</u>: While the contribution amount for non-owners is determined by IRS regulations, in general, a company should count on contributing between 3% and 8% of compensation of non-owners.

<u>Question 13</u>: If a company has a 401(k) plan, may the company also establish a cash balance plan?

<u>Answer 13</u>: Yes, a company may have both a 401(k) plan and a cash balance plan. While this combination of plans is complex, and requires the highest level of professional advice, it most often provides the largest aggregate contributions for owners.

<u>Question 14</u>: May the benefits of plan participants be subject to a vesting schedule, so that if a plan participant terminates employment they do not take all of their hypothetical account balance.

<u>Answer 14</u>: Yes, the benefits of plan participants may be subject to a vesting schedule, so that if a participant leaves the company before three years of employment, they forfeit their account, and the forfeiture may reduce the company's contribution in the year of forfeiture.