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## Cash Balance Plans Offer Greater Tax Savings

### *Defined Benefit Plans Increasingly Popular Due to Higher Deferred Taxable Income Amounts*

**By Dan Kravitz**

This week marks the deadline for millions of Americans to file their annual tax returns. For many people, their tax liability can decrease when they fund a retirement plan, such as a 401(k) plan. Generally, as the contributions to retirement plans increase, current taxes decrease. It is therefore advantageous to maximize contributions to such plans.

As the fastest-growing retirement plan in the United States, 401(k) plans are cash or deferred-income arrangements under which owners and eligible employees can elect to have a portion of their compensation (otherwise payable in cash) contributed to a qualified retirement plan as pre-tax reduction in salary. Employers have the discretion whether or not to make matching contributions to their employees' 401(k) accounts.

For 2007 the maximum annual 401(k) plan contribution is either \$15,500, or if the person is age 50 or older, \$20,500. For companies interested in allowing owners to defer additional taxable income, a profit-sharing plan can provide another \$29,500 per year. Unfortunately, once the \$45,000 or \$50,000 maximum annual contribution has been reached, the 401(k)/profit sharing plan is maxed out.

However, by adding a Cash Balance Plan, an employer can increase contributions substantially—up to as much as \$200,000 per year of deferred taxable income depending on age. A Cash Balance Plan is a defined benefit plan that specifies the amount of contribution to be credited to each participant and credits interest on those contributions. Each participant has an individual account which resembles the accounts in a 401(k)/profit sharing plan.

The account grows annually in two ways. First, companies contribute an amount that is determined by a formula specified in the plan document. This formula can be a percentage of pay or a flat dollar amount. Second, the account grows with an annual interest credit. The interest credit is guaranteed and is not dependent on the plan's actual investment performance. The interest credit changes each year and is usually equal to the yield on the 30-year Treasury bond, which in recent years has been around 5%. Once participants terminate employment, they are eligible to receive the vested portion of their account balance, which is determined by the plan's vesting schedule.

One advantage of the Cash Balance Plan over the traditional defined benefit plan is that each owner or shareholder knows exactly what is going into the plan on their behalf and exactly what will come out (plus interest) upon leaving the company.

After rule changes in 2001 and 2006, Cash Balance Plans have become increasingly popular in professional firms and successful companies as a way to defer taxable income and catch-up on saving for retirement.

If you have reached the limit for maximum contributions into your 401(k) plan, you may want to add a Cash Balance Plan where you and eligible employees can increase contributions as well as defer taxable income.

Dan Kravitz is the president of Kravitz, located in Encino, which has been designing and administering retirement plans, such as 401(k)s, profit sharing and Cash Balance Plans, since 1977. He can be reached at [dkravitz@lkravitz.com](mailto:dkravitz@lkravitz.com).



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