Is your Business a Candidate for a Cash Balance Plan?

The recent popularity of cash balance plans has generated interest from both employers and financial advisors.

Heritage Administrative Services specializes in all types of qualified plans, specifically cash balance plans. This article seeks to define which employer demographics are most suitable for a cash balance plan.

A cash balance plan is a defined benefit plan, generally referred to as a “hybrid plan.” Cash balance plans share many of the same features as both traditional defined benefit plans and profit sharing plans. Most business entities can sponsor a cash balance plan. Whether a cash balance plan is right for a company will depend on their goals and intentions.

For many employers, the primary goal is to add a benefit that helps reward and retain key employees. That group may include both owners and partners of an entity. Once these goals have been established, Heritage can determine the required cost of employee participation. This ratio will typically be the deciding factor when choosing whether a cash balance plan should be added as an employer benefit.

As Heritage administers many cash balance plans, we can provide general characteristics of successful businesses that have added a cash balance plan as an employer benefit. Some of these characteristics include:

Company must have a consistent, profitable history: A cash balance plan requires regular, consistent contributions. An important question to start with is: does the company have a history of positive cash flow sufficient to make continual contributions? Organizations that have one great year but have flat earnings the next are not ideal candidates.

Large enough budget:
A cash balance plan is an additional employer benefit that require contributions and will incur administrative costs. Heritage recommends that an employer contribute, cumulatively, at least $100,000 so that adding the cash balance plan makes fiscal sense.

Company must be relatively small in size: If the goal is to maximize contributions to key employees or owners, the size of the company is extremely important. Our experience has shown that companies with fewer than twenty eligible employees often make the best candidates for cash balance plans.

Employer currently sponsors a 401(k)/profit sharing plan and makes an employer contribution

Cash balance plans require an employer contribution; all eligible employees will receive a benefit. When an employer sponsors a 401k/ profit sharing plan it demonstrates the employer’s willingness to make a contribution for the employees.

Additionally, profit sharing contributions that are allocated for employees can be used to offset a cash balance contribution as they are cumulatively aggregated for each employee.

As the administrator, Heritage will recognize both plans during our calculation process to ensure that all employees have equivalent benefits at retirement.

When Heritage generates a proposal for a company that contains these five characteristics, the implementation rate is very high. Frequently enough, companies that do not initially meet these requirements will often implement a cash balance plan in the following tax year after restructuring their internal operations to comply with these suggestions.

All References to IRS Codes can be found at: https://www.irs.gov/tax-professionals/tax-code-regulations-and-official-guidance

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