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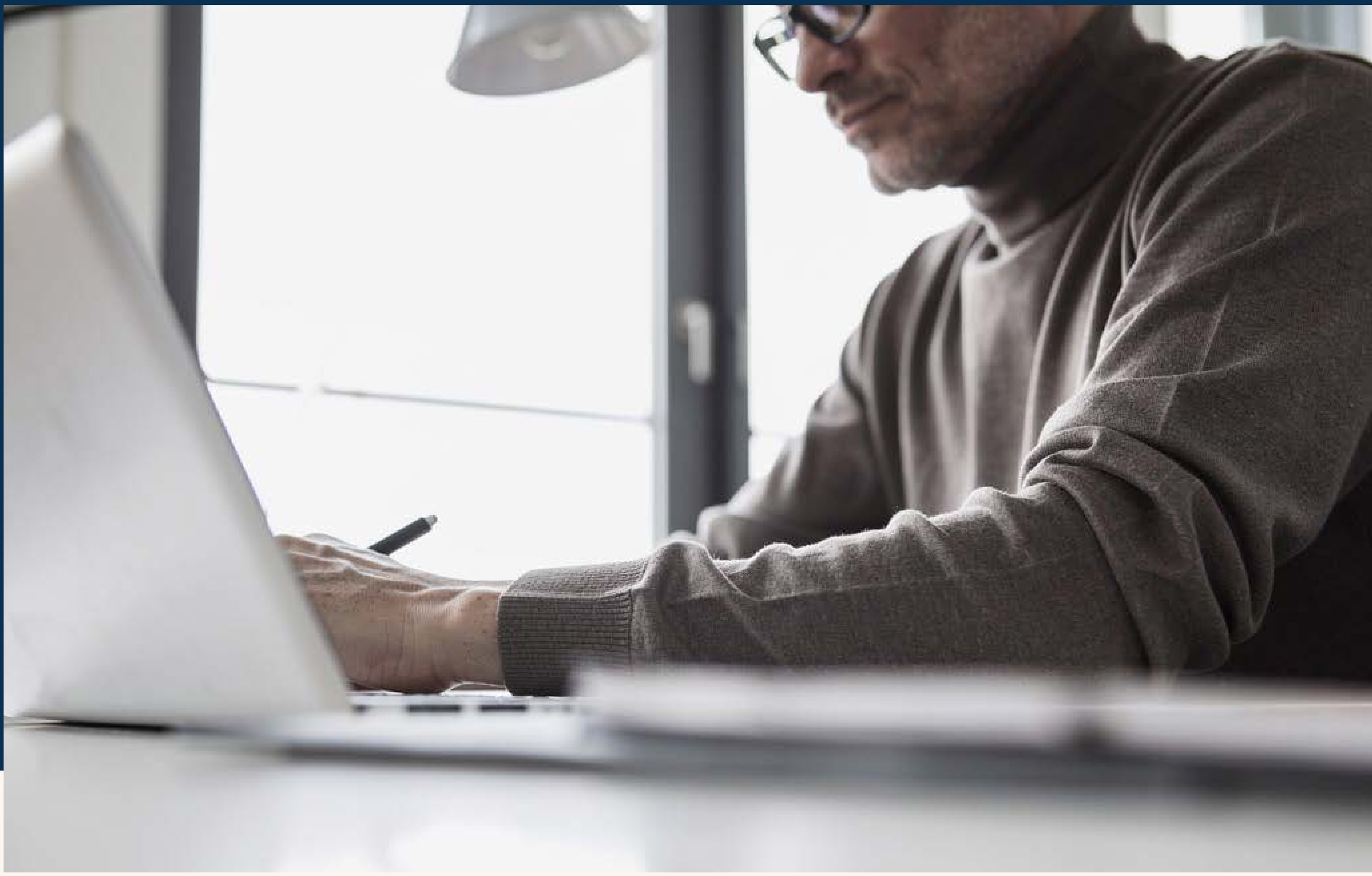

An Overview of Cash Balance Pension Plans (CBPPs)

BY BAKER WEALTH STRATEGIES

A Cash Balance Pension Plan (CBPP) is a type of qualified plan under IRS and ERISA rules. While it looks similar to a 401(k) on the surface, it is technically a defined benefit plan, which allows for much larger annual contributions and deductions. The defined benefit is stated in terms of a "cash balance" at termination versus a monthly benefit for traditional defined benefit plans.

CASH BALANCE PLANS ARE TYPICALLY RECOMMENDED WHEN A BUSINESS:

- Is highly profitable and consistently generates excess cash flow
- Wants to reduce current-year tax liability in a meaningful way
- Has an owner who wants to accelerate retirement savings, often beyond what a 401k allows
- Is comfortable putting away $100K+ into retirement each year

CONTRIBUTIONS TO THE PLAN ARE:

- Made 100% by the employer
- Designed so that the majority of total contributions benefit the business owner
- Fully tax-deductible to the business
- Tax deferred while inside the plan
- Scalable through contributions that can be adjusted to reflect business realities each year, even if that means freezing the plan to not make any contributions that year
- Flexible in timing, as plans can be established and funded up until tax filing (including extensions)

Contribution amounts are based on age and wages per participant. For the business owner, only compensation subject to payroll taxes is considered.

ENTITY TAXATION	ELIGIBLE COMPENSATION
S Corporation	W-2 wages paid to the owner
C Corporation	W-2 wages paid to the owner
Sole Proprietor	Net schedule C earnings (after SE tax)
Partnership	K1 if subject to SE tax or guaranteed payments

ACCOUNT STRUCTURES

- **401(k) Plan:** Can be used in combination with CBPP but not required
- **401(k) Match:** If present, will reduce the funding requirement for employees through the CBPP
- **Profit Share:** A defined contribution account where most of an employee's funds are held
- **Pension Account:** An investment account with mostly owners' funds

Investments inside the plan are professionally managed to support the plan's obligations. These investments can be held in similar investments as you would find in an IRA and adjusted according to a business owners' risk tolerance.

One of the advantages of a well-designed CBPP is including an exit strategy for funds by using life insurance. The insurance tax code can be used to gain permanent tax savings instead of just deferring taxes. A portion of plan contributions is used to fund a strategically structured life insurance policy inside the plan using pre-tax dollars.

- Using insurance increases the amount of contribution and deduction on the front end.
- After 5 years, the policy is purchased out of the plan at a discounted fair market value.
- This is structured as a sale, not a taxable distribution.
- Once outside the plan, the policy's cash value can grow tax-free and be accessed as tax-free retirement income.
- The death benefit can be accessed early if LTC expenses arise. Any remaining death benefit passes to beneficiaries as tax-free income.

This approach allows assets to move from a tax-deferred environment into a tax-free bucket, while maintaining compliance with pension plan rules. While optional to include, the use of insurance is the most powerful tax savings portion of the plan.

Plans are typically designed for 10-year funding but can be adjusted based on business needs. Even after it's designed, the plan can always end early, and funds can be rolled to an IRA (not a taxable event).

Fees associated with the plan come in two parts. First, the actuary charges a setup fee as well as an annual maintenance fee; this covers all tracking of employee allocations, annual testing, and compliance reports filed each year. Baker Wealth Strategies charges an asset management fee that covers servicing the plan as well as managing the assets.

IMPLEMENTATION STEPS:

- Meet with the business owner to discuss the overall goals of the plan.
- Collect business census (payroll data) and basic business information.
- Baker Wealth Strategies works with actuaries to design an initial plan.
- Hold a follow-up meeting with the business owner to finalize plan design and answer questions.
- Plan documents are sent and signed through Docusign.
- Investment accounts are opened and funded.
- Annual servicing is offered with actuarial certification, compliance filings, and funding decisions.

CASE STUDY

CLIENT: Jim, age 65, a doctor living in California with $881,000 of self-employment income.

GOAL: Reduce current tax liability while accelerating retirement savings.

PLAN DESIGN AND FUNDING INCLUDED:

- **$471,336** in total pension contributions (deductible, actuarially determined, with optional pre-funding)
- **$168,000** life insurance premium allocation through the CBPP (as part of the exit-strategy design)

OUTCOMES:

- **Immediate Tax Savings (Year 1):** $200,702
- **8-Year Estimated Tax Savings:** $2,007,018
- **Tax-Free Life Insurance Income:** $1,655,239 (assuming 6% avg return)
- **Total Projected Benefit:** Over $3.6M in tax savings plus future income

If your clients are facing a large tax bill and want to explore whether a Cash Balance Plan is appropriate, Baker Wealth Strategies can start immediately and coordinate with you to produce a clear proposal and implementation timeline.

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