

THE BENEFIT BULLETIN

FAST FACTS ABOUT RETIREMENT PLANS

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CASH BALANCE PLANS THE NEW RETIREMENT KID ON THE BLOCK

Qualified retirement plans are an extremely important planning tool for businesses. These types of plans typically come in two varieties: 1) defined contribution plans and 2) defined benefit plans.

Defined contribution plans. These types of plans may encompass salary deferrals based on an employee's own contributions, (i.e. 401(k) plans) as well as employer contributions (i.e. employer matching contributions on deferrals, employer profit sharing contributions, or both) contributed on behalf of an employee. Defined contribution plans are widespread. However, they do pose limitations for people who want to defer larger amounts of money. Defined contribution plans have a total annual limit, per participant, including salary deferrals and employer money, of \$46,000 for the year 2008. If eligible for catch-up contributions, the limit is \$51,000. For those employers who would like to defer a greater amount of money, a type of plan has recently gained attention, due to the Pension Protection Act of 2006, called the Cash Balance Defined Benefit Retirement Plan.

Traditional defined benefit Plans. These types of plans have somewhat fallen out of favor in the last few years. However, with the enactment of the Pension Protection Act of 2006, the "cash balance" defined benefit has overcome some previous hurdles and become popular. The cash balance plan is known as a "hybrid" plan. Before the Pension Protection Act of 2006, cash balance plans were generally available, but were not widely understood or utilized.

The draw to cash balance plans is primarily based upon the amount of potential deferral of taxable income. It is not uncommon for individuals making in excess of \$230,000 per year to be able to deduct as much as \$200,000 a year in a cash balance plan. Coupled with a defined contribution plan, these numbers can possibly even approach \$250,000.

What is a cash balance plan? As mentioned above, there are two general types of qualified retirement plans: 1) Defined Benefit Plans and 2) Defined Contribution Plans. In general, defined benefit plans provide a specific benefit at retirement for each eligible employee, based upon a formula, while defined contribution plans may set out the amount of contributions to be made by the employer toward an employee's retirement account. In a defined contribution plan, the actual amount of retirement benefits provided to an employee depends on the amount of the employee and/or employer contributions, as well as the gains or losses of the account.

A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance rather than the amount of monthly benefit to be received at a set age based upon a formula. Generally, a cash balance plan defines benefits payable to the participants as either a percentage of pay or a flat dollar amount, or a combination of both. It is also possible to differentiate between different classes of employees in the cash balance plan. Some employees can have a higher contribution amount or percentage than others, if required tests are satisfied. Because of the way benefits are calculated, there is a "hypothetical account balance" that is generated for each participant. At the end of each year, the participant can see this hypothetical account balance.

How much can be saved? The table below shows the potential amount that could be deferred in an arrangement consisting of *both* a cash balance and a 401(k) plan, at maximum funding levels. The design of a 401(k) with profit sharing contributions, together with a cash balance plan, can provide for a larger overall contribution.

Age	401(k) only	401(k) with Profit Sharing	Cash Balance	Total
65	\$20,500	\$51,000	\$185,000	\$236,000
64	\$20,500	\$51,000	\$190,000	\$241,000
63	\$20,500	\$51,000	\$193,000	\$244,000
62	\$20,500	\$51,000	\$197,000	\$248,000
61	\$20,500	\$51,000	\$187,000	\$238,000
60	\$20,500	\$51,000	\$177,000	\$228,000
59	\$20,500	\$51,000	\$168,000	\$219,000
58	\$20,500	\$51,000	\$158,000	\$209,000

59	\$20,500	\$51,000	\$168,000	\$219,000
58	\$20,500	\$51,000	\$158,000	\$209,000
57	\$20,500	\$51,000	\$150,000	\$201,000
56	\$20,500	\$51,000	\$142,000	\$193,000
55	\$20,500	\$51,000	\$135,000	\$186,000
54	\$20,500	\$51,000	\$128,000	\$179,000
53	\$20,500	\$51,000	\$121,000	\$172,000
52	\$20,500	\$51,000	\$115,000	\$166,000
51	\$20,500	\$51,000	\$108,000	\$159,000
50	\$20,500	\$51,000	\$103,000	\$154,000
49	\$15,500	\$46,000	\$98,000	\$144,000
48	\$15,500	\$46,000	\$93,000	\$139,000
47	\$15,500	\$46,000	\$88,000	\$134,000
46	\$15,500	\$46,000	\$84,000	\$130,000
45	\$15,500	\$46,000	\$80,000	\$126,000
44	\$15,500	\$46,000	\$75,000	\$121,000
43	\$15,500	\$46,000	\$72,000	\$118,000
42	\$15,500	\$46,000	\$68,000	\$114,000
41	\$15,500	\$46,000	\$64,000	\$110,000
40	\$15,500	\$46,000	\$61,000	\$107,000
39	\$15,500	\$46,000	\$58,000	\$104,000
38	\$15,500	\$46,000	\$55,000	\$101,000
37	\$15,500	\$46,000	\$52,000	\$98,000
36	\$15,500	\$46,000	\$49,000	\$95,000
35	\$15,500	\$46,000	\$47,000	\$93,000
34	\$15,500	\$46,000	\$44,000	\$90,000

Why is a cash balance more beneficial than a traditional defined benefit plan? A cash balance plan is generally better received by plan sponsors and participants alike. Under a traditional defined benefit plan, the benefits payable are determined by a fixed calculateable formula at normal retirement age. Because of the complex formula, employees, especially younger ones, have a difficult time equating the benefit amount being contributed annually on their behalf by their employer. However, in a cash balance plan, the formula is based on a percentage of pay or a flat dollar amount and the participant can actually see an “account balance”. This is much easier to understand in the workforce than a traditional defined benefit plan.

Cash balance plans are generally more portable than defined benefit plans. Cash balance plans, while still a defined benefit plan, also have advantages of flexibility and cost. The design for cash balance plans allows flexibility not generally afforded to defined benefit plans. As such, the funding requirement on behalf of the employer is much more readily determined.

Are you a candidate for a cash balance plan? Generally speaking, cash balance plans are attractive for high income earners and professional service providers. This would include medical groups, closely held businesses, architects, CPAs, law firms and others similarly situated. More specifically, the following characteristics are important:

- a. Owners who would like to contribute more than \$46,000 (or \$51,000 if applicable) per year into a retirement account;
- b. Companies that are relatively stable in their business plan model and have certain expected profits;
- c. Owners who are older than 40 years of age;
- d. Companies that are already making a substantial contribution to a qualified retirement plan for participants.

The Benefit Bulletin is a publication of:
Pension Plan Administration, LLC
200 Louisiana, Little Rock, Arkansas 72201
Phone: 501-320-2430 Fax: 501-320-2440
Website: www.pensionplanadmin.com

Website: www.pensionplanadmin.com

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