Cash Balance Plans provide added boost for high-income earners

THE JOURNAL of SOUTH MISSISSIPPI BUSINESS

By MICHELLE MABRY

Investing in retirement has been particularly challenging for highly compensated individuals. With the strong likelihood of increased taxes on the horizon, individuals who fall into high tax brackets seek larger tax deductions. Plus, losses in retirement plan funds, as a result of the recent economic collapse, create a need for executives to quickly recover their retirement savings.

Typically, a 401(k) has been the most popular retirement plan for participants looking to save tax-deferred portions of their income. Since 1978, 401(k)s have offered tax deferred retirement savings to investors building their retirement funds. Unfortunately, a 401(k) is incapable of quickly amassing assets, posing a stumbling block for individuals looking to condense 20 years worth of savings in half the time. Depending on the participant's age, 401(k) plans currently allow contributions up to $22,000 while a profit-sharing plan allows employers, on behalf of the participant, to contribute only another $32,500.

As a result, an increasing number of firms are opting for Cash Balance Plans, which provide participants with significant tax benefits while accelerating savings. Cash Balance Plans allow for as much as $200,000 to be contributed yearly on a pre-tax basis. This amount is in addition to the $54,500 maximum available through 401(k) and profit sharing plan contributions.

Introduced in 1984 by BankAmerica Corporation, the Cash Balance Plan addressed a transformation in the company's workforce. A change in the tax law in 2001 allowed contributions to Cash Balance Plans to increase as much as 60 percent, making these plans much more attractive to successful businesses and professional firms. The Pension Protection Act of 2006 prompted a number of companies to adopt a Cash Balance Plan. Over 25 Cash Balance Plans exist in Mississippi, many in professional service businesses such as law firms and physician groups.

A Cash Balance Plan combines the features of defined benefit and defined contribution plans. As with defined contribution plans, the plan sponsor bears the investment risk and account balances can be paid out or rolled-over upon termination of employment. Similar to 401(k) plans, Cash Balance Plans are "qualified plans." That is, these plans "qualify" for tax deferral and creditor protection against bankruptcy.

A Cash Balance Plan specifies the amount of contribution to be credited to each participant. The contribution can be either a flat dollar amount or a percentage of pay. The plan credits interest on those contributions at a guaranteed rate. Each participant has an individual account, which resembles the accounts in a 401(k)/profit sharing plan. The guaranteed rate of return is notated in the plan document and is not dependent on the plan's investment performance. The rate of return changes each year and for many plans is equal to the yield on the 30-year Treasury bond, which is about 4.5 percent recently. 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.

Although Cash Balance Plans are often established for the benefit of owners and highly compensated employees, other employees also benefit. Usually, plans provide a minimum contribution of five to seven percent of pay for the firm's staff.

Cash Balance Plans provide high-income earners the opportunity to defer taxable income while increasing contributions made to their qualified retirement plan.

Michelle Mabry, president and CEO of Wealth Management Consultants in Hattiesburg, holds the CFP certification and is an Accredited Investment Fiduciary. Mabry holds FINRA Series 7, 63, and 65 securities registrations, as well as state insurance licenses. She is also a registered representative and investment adviser eepresentative of Commonwealth Financial Network. Mabry can be reached at (601) 264-0946.

michelle@wmconsultants.net
6760 Highway 98. Suite 4
Hattiesburg, MS 39402

WEALTH MANAGEMENT CONSULTANTS