StatonWalsh
Financial Clarity Through Transparency

Prepared for:

Prepared by:

Ryan Staton, MBA, CFP, AIF, CeXP, CHFC
Managing Partner
StatonWalsh
Phone: 410-777-9487
Email: rstaton@statonwalsh.com
Website: www.statonwalsh.com

December 31, 2022

Table of Contents

Cash Balance Pension Plan.. 1
Disclaimer Notice...11
Disclosure Notice... 12

Cash Balance Pension Plan

The basics: A cash balance pension plan specifies an annual contribution amount and interest rate for eligible participants. The employer contributions and the growth rate result in an amount sufficient to pay each participant – as a lump sum – the cumulative value of his or her account at retirement.

How It Works

- A cash balance plan funds the expected benefit by making an annual contribution to each participant (a pay credit) and using a specified interest rate (the interest rate credit) to "grow" the participant account. The interest rate may be fixed or variable. If a variable rate is used, the plan cannot permit any loss of principal to participants.
- Participants have *hypothetical* separate accounts within the plan, to which contributions and interest are credited as defined by the plan. The actual plan assets are pooled.
- The employer also contributes an actuarially determined amount each year to the plan to account for differences between the plan's interest crediting rate and the actual rate of return earned on plan investments. The investment risk is borne solely by the *employer*.
- Employer contributions are tax deductible.
- Contributions are not taxed currently to the employee.
- Earnings accumulate income tax deferred.
- At retirement, a participant can choose to take the benefit as a lump-sum amount or to annuitize the lump-sum amount and receive monthly payments.

- Distributions are generally taxed as ordinary income. Distributions may be eligible for 10-year income averaging,[1] or at retirement from the current employer, rolled over to a traditional or a Roth IRA, or to another employer plan if that plan will accept such a rollover. Federal law allows retirement distributions to employees who are at least age 59½ even if they have not separated from employment at the time distributions begin.[2]

Methods of Defining the Benefit

- **Contribution percentage:** Example - The contribution credit is equal to 50% of compensation.[3]
- **Defined dollar amount - step rate service weighted for prior service:** Example – The contribution credit is equal to $5,000 per year.
- **Different contributions for different participants**: Example – Participants who are in Group A receive a contribution credit equal to 100% of compensation; participants in Group B receive a contribution credit of $1,800.
- **Excess compensation only:** Example - The contribution credit for Group A is equal to 200% of compensation over $150,000. This can be used to help an employer control the annual contribution expense by controlling the wages paid to certain employees (typically the business owners).
- **Top-heavy plans:** If the present value of the accrued benefits of "key" employees[4] is

[1] Those born before 1936 may be able to elect 10-year averaging or capital gain treatment; these strategies are not available to those born after 1935.

[2] If allowed by the plan; prior to 2020, federal law required employees to be at least age 62.

[3] In 2023, $330,000 is the maximum income that may be considered. For those self-employed, compensation is limited to "net" self-employment income, i.e., gross income less the contribution and the deduction allowed for one-half of the self-employment tax. In unusual circumstances, the required contribution may exceed the allowable deduction, which can trigger an excise tax.

[4] A "key" employee is someone who, at any time during the plan year was: (1) an officer of the employer whose compensation from the employer exceeded $215,000; or (2) a more than 5% owner; or (3) a 1% owner whose compensation from the employer exceeded $150,000.

60% or more of the total value of all accrued benefits, the plan is top-heavy. In that instance, the plan must provide for a minimum level of benefits for "non-key" participants. This minimum benefit is often satisfied using a 401(k)-profit sharing plan in conjunction with the cash balance pension plan.

Additional Considerations

- **Investment of plan assets:** Investments must be diversified and prudent. Subject to plan provisions, plan assets can be invested in equity products like mutual funds, stocks, and debt-free real estate; or in debt instruments like T-Bills and CDs. Insurance products like life insurance and annuity policies may also be used.
- **Parties which are favored:** Usually favors older employees.

Maximum Benefit

Since a cash balance plan is legally a defined benefit plan, the maximum benefit under a defined benefit plan is measured in two ways:

- **Percentage:** The retirement benefit cannot exceed 100% of the average compensation for the highest three consecutive years of employment. This is reduced by 10% for each year of service less than 10.
- **Dollar amount:** The maximum annual dollar benefit is indexed at $265,000 per year (2023) for retirement at age 62. For retirement prior to age 62, this amount is actuarially reduced. The dollar amount will also be increased for retirement after age 65, subject to the percentage and dollar limitations. Lastly, if the individual has fewer than 10 years of participation at normal retirement age, the dollar amount is reduced proportionately.

In a cash balance plan, the contribution credits and the balance in the participants' hypothetical accounts are projected to retirement age and converted to an annual retirement benefit using actuarial assumptions defined in the plan. This converted benefit is measured against the maximum benefit above to ensure the plan complies with IRS limits.

Which Employees Must be Covered?

With some exceptions, all employees of an employer must be covered in a qualified retirement plan to meet IRS coverage requirements. Some employees may be excluded as follows:

- Employees who have not yet completed a year of service i.e., working 1,000+ hours in a 12 -month period. This 12-month period may be extended to 24 months if the plan provides 100% immediate vesting
- Employees who have not yet attained age 21
- Union employees covered by a collective bargaining agreement where retirement benefits were the subject of good faith bargaining
- Employees who are non-US resident aliens with no US source earned income.

Other employees may be excluded by provisions in the plan document. However, the plan must still pass IRS coverage requirements considering these excluded employees. Generally, this requires plans to cover at least 70% of non-highly compensated employees[1] relative to the percentage of highly compensated employees. For example, if a plan covers 80% of highly compensated employees it must cover at least 56% (80% x 70%) of non-highly compensated employees.

Contributions

The table below illustrates hypothetical first-year contributions for an employee retiring at age 62 with at least 5 years of plan participation. In all instances, the employee’s compensation is $265,000 or more. The contribution it equivalent to a projected retirement benefit of 10% of compensation per year of plan participation, which provides the IRS maximum annual benefit per year.[2]

[1] Generally, a “highly compensated employee” is any employee who was a 5% owner during the year or the preceding year, or who had compensation from the employer in excess of $150,000 (2023 value).

[2] The Pension Protection Act of 2006 permits a plan sponsor to contribute and deduct an additional amount, generally 50% of the plan’s funding target, as advance funding for future plan years.

Current Age	1st Year Contributions
30	$69,000
35	88,000
40	113,000
45	145,000
50	185,000
55	238,000
60	300,000

Annual Contributions

Year-to-year contributions will fluctuate based on the following items:

- Earnings on previous contributions.
- Gains and losses on investments (realized and unrealized).
- Participants' actual compensation.
- Death of participants before retirement.
- Disability retirements.
- Age mix of participants.
- Turnover in participants.
- Cost of annuities at retirement.
- Rate of vesting.
- Timing of contributions.
- Assumptions mandated by IRS.
- Funding limits and requirements of the Internal Revenue Code.
- Legal/actuarial requirements.

Annual funding is done on the assumption that each participant will retire. Accrued benefits in the form of contribution credits are generally earned each year. If the participant does not work until scheduled retirement, he or she may not be entitled to the entire benefit, depending on plan provisions.

Cash Balance and Traditional Defined Benefit Plans Compared

Advantages to the employer

- Cash balance plans are more easily understood by participants. The value of a current year contribution is more readily apparent than the accrual of a monthly retirement benefit payable at age 65.
- In companies with multiple owners, it is easier to set different contribution amounts based on each owner's objectives.
- In designing the plan, contributions can usually be age neutral.
- The ultimate distribution amount to be paid to a terminating or retired employee is defined by the contribution credit plus interest. Generally, there is no actuarial calculation of the benefit payment needed.
- Cash balance plan distribution amounts are not affected by current interest rates as they are in a traditional defined benefit plan.

Disadvantages to the Employer

- Cash Balance plans *must* use a shorter vesting schedule; participants are 100% vested after three years of service. Traditional defined benefit plans may use a six-year graded vesting schedule.
- If a participant elects a retirement annuity instead of a lump sum distribution, the cost of purchasing an annuity for the required benefit may exceed the value of the participant's hypothetical account, especially when prevailing market interest rates are low.

Advantages to the Employee

- The cash balance plan is more easily understood.
- Most plans provide a guaranteed rate of return. Plans that use a variable rate cannot allow a loss of principal to the participant accounts.

Disadvantages to the Employee

- Older employees may not receive as large a retirement benefit as they would under a traditional defined benefit plan.

Advantages to Employer

- Contributions are tax deductible.
- Can reward long-term employees with a substantial retirement benefit even though they are close to retirement age.
- Larger contributions for older employees may reduce corporate tax problem, e.g., excess accumulated earnings, high tax bracket current earnings, etc.
- Forfeitures of terminating employees will reduce future costs.
- It can provide employees with permanent life insurance benefits that need not expire or require costly conversion at retirement age.
- The employer directs investments.
- If former participants do not provide the plan with distribution instructions, the plan may automatically distribute accounts less than $5,000. In the case of a plan that provides for such mandatory distributions, the plan must automatically roll an eligible distribution amount that exceeds $1,000 to a Rollover IRA in the former participant's name. A plan may allow direct rollovers of less than $1,000.

Advantages to Employees

- Annual employer contributions are not taxed to the participant.
- Earnings are not currently taxed.
- Participants may also have a traditional, deductible IRA (subject to certain income level limitations), a traditional, nondeductible IRA, or a Roth IRA.
- Employee is guaranteed a known contribution and interest credit.
- Participant may borrow from the plan within certain guidelines, if provided for in the plan documents.
- ERISA and federal bankruptcy law provide significant protection from creditors to participant accounts or accrued benefits in tax-exempt retirement plans.
- In most plans, the benefits are guaranteed by the Pension Benefit Guaranty Corporation.
- Depending on plan provisions, a participant who leaves an employer may have the option to leave an accrued benefit in the former employer's plan. The participant may also opt to take the accrued benefit in cash[1] or, if permitted, roll-over the funds to a new employer's plan. A participant may also choose to roll the accrued benefit into either a traditional IRA or Roth IRA.[1]

Disadvantages to Employer

- In low profit years, the employer is still obligated to make contributions.
- Even if profits are low, there is less flexibility with the level of contribution than with some other types of plans.

[1] Under federal income tax law, taking the accrued benefit in cash, or rolling the funds into a Roth IRA, are both *taxable* events in the year the funds are distributed. The funds are generally taxable to the extent they have not been previously subject to tax. Additionally, a 10% penalty for early withdrawal may apply. State or local law may vary.

- Investment risks are on the employer.
- Administration costs are usually higher because an actuary must certify as to the reasonableness of the contribution and deduction (unless it is a fully insured plan).
- If there are rank and file employees, and the plan terminates, there may be insufficient assets to pay all accrued benefits. The shortfall must be made up by either the business contributing, or by the assets being reallocated from owner-participants to non-highly compensated participants.
- When a plan terminates, it may find that there are surplus assets which may not be distributed to participants. Any such surplus returned to the employer is subject to a 50% (20% in some instances) excise tax. In some cases, the employer may choose to transfer surplus assets to a Qualified Replacement Plan, such as a 401(k) Profit Sharing Plan, to avoid this excise tax.
- In most plans, the benefits are guaranteed by the Pension Benefit Guaranty Corporation; the employer must pay an annual premium to the PBGC for this guarantee.
- If a small defined benefit plan terminates with insufficient assets, the rank-and-file participants receive the full value of their benefits, while the business owners receive the remaining balance. If there are insufficient assets, the Pension Benefit Guaranty Corporation (PBGC) will guarantee some benefits.
- If the employer must prepare audited financial statements (for lenders, bonding, etc.), any unfunded plan liabilities must be reflected on its balance sheet.

Disadvantages to Employees

- Older participants may receive a larger benefit with a traditional defined benefit plan.

Coronavirus Aid, Relief, and Economic Security (CARES) Act

The CARES Act contained a number of temporary provisions applicable to IRAs and qualified retirement plans, including:

- **Coronavirus-related distribution (CRD):** One section of the CARES Act provided for a "Coronavirus-related distribution," or CRD. A CRD – optional (not mandatory) for a qualified retirement plan sponsor – was a distribution made from January 1, 2020, through December 30, 2020, from an IRA or qualified retirement plan. A CRD could not exceed $100,000 in aggregate per individual, was exempt from the usual 20% mandatory federal income tax withholding, and must have been made to an individual (or spouse or dependent) who was diagnosed with SARS-CoV-2 or COVID-19, or who experienced an adverse financial consequence as a result of the COVID-19 pandemic. A CRD was exempt from any 10% early withdrawal penalty that may have applied and, unless the individual chose otherwise, the CRD could be included in taxable income ratably over a three-year period. A CRD may be re-paid, without regard to the normal contribution limits, over a three-year period.

Important Notice

This report is intended to serve as a basis for further discussion with your other professional advisors. Although great effort has been taken to provide accurate numbers and explanations, the information in this report should not be relied upon for preparing tax returns or making investment decisions.

Assumed rates of return are not in any way to be taken as guaranteed projections of actual returns from any recommended investment opportunity. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney.

Disclosure Notice

This is for informational purposes only. Although the information has been gathered from sources believed to be reliable, please note that individual situations can vary. Therefore, the information should be relied upon only when coordinated with individual professional advice. StatonWalsh and Founder's Financial Securities do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

Ryan Staton is an Investment Advisor of, and securities offered through, Founders Financial Securities, LLC Member FINRA/SIPC and Registered Investment Advisor

Check the background of this firm on http://brokercheck.finra.org/

If a numerical analysis is shown, the results are neither guarantees nor projections, and actual results may differ significantly. Any assumptions as to interest rates, rates of return, inflation, or other values are hypothetical and for illustrative purposes only. Rates of return shown are not indicative of any particular investment, and will vary over time. Any reference to past performance is not indicative of future results and should not be taken as a guaranteed projection of actual returns from any recommended investment.

Record of Reports

12/31/2022 12:50 AM Coordinated Universal Time

Cash Balance Pension Plan 1
Disclaimer Notice 11
Disclosure Notice 12

Client Name: ____________________

Presentation Date: ____________________