Considerations in Making an End-of-Year Decision to

Implement a Cash Balance Plan

For close to twenty years December has been the time business owners make a decision on whether to implement an add-on Cash Balance Plan or, in some cases, a combination of Profit Sharing and Cash Balance Plans. Many of these cases are ones that we have analyzed earlier in the year and the sponsor has now decided to go ahead, and some are plans that were almost installed in the prior year but the sponsor was not quite ready. Still others are plans that the sponsor decided to put in at the last minute after doing year-end tax planning. Last year we implemented six new cases on December 31 alone!

For many business owners, with holiday events and family time, it is hard to focus on making a quality decision at this time of year. Hence, this short article helps to clarify the decision-making process. This process can be grouped into three areas:

1. Timing – Ability to execute the plan by end of year and to contribute by the earlier of the tax return due date (with any extension) and September 15, 2016.
2. Benefits versus Costs – Comparison of the contribution for the owner(s) and favored individuals along with the related tax deduction on the one hand, and on the other hand the after-tax cost of the “rank-and-file” contribution, PBGC-1 premiums (if any), actuarial fees, and owner and staff time. Where a 401(k)/Profit Sharing Plan is in place this calculation can be done to convey the additional benefits and costs.
3. Stability and Downside Flexibility – Stability of future cash flow and the participant census, and the ability to plan well to handle business cycles.

Let’s look at these three items in more detail:

1. Timing – While a business owner may not yet have an in-depth understanding of what they are getting into, they along with their advisors should:
    a. Have a good overall sense of the Plan and have all their important questions answered.
    b. Know that they can make the contribution when due for the first year and also be on track to make the contribution for the second year on a timely basis. As mentioned below, there are strategies for providing downside flexibility for future “bumps in the road,” but we generally recommend that the business be able to make at least the recommended contribution in the first two years.

2. To assess whether the installation of a Cash Balance Plan has benefits that far outweigh costs:
   a. Determine that there will be sufficient cash flow after the owners take funds out of the company to meet personal needs and reinvest necessary funds in the business.
   b. Determine any extra employee costs needed to make the numbers work in a Cash Balance Plan design. For example, the owner may determine that he wants his long service employees to have enough put into the plans to provide for an adequate retirement. Let's say the cost to provide adequate benefits is $20,000 a year, while the total non-owner cost with a Cash Balance Plan is $30,000. Hence, the additional cost is $10,000.
   c. Add to this cost any other costs such as professional fees, PBGC premiums, if applicable, and the value of extra time spent by the owner and any staff.
   d. When all these numbers are adjusted for taxes an initial benefit/cost comparison can be made.
   e. This quick analysis does not represent all the considerations in making a decision but it is a good start. Many times our firm discourages installation of a plan if it does not make sense for the business owner based on the information we have been given. An unwise installation is problematic for us as well as the sponsor.
3. Over the past thirty years we have worked on Defined Benefit Plans (and almost twenty years on Cash Balance Plans) to help them go through various business cycles. When companies experience the usual business cycles and can give us a heads-up on significant changes to cash flow and/or their employee census, we can almost always help them go through funding variations without having to borrow funds or reduce reinvestments in the business.

NEXT STEPS – The 1-2-3 of Getting Started

1 – Ten Minute Analysis – On hundreds of cases we have helped business owners quickly see if putting in a Cash Balance Plan is feasible and we almost always do this in much less than ten minutes. If it won't work, you do not have to waste any more time. If the numbers look good, such as "$150,000 deduction with $140,000 going to the owner," then there is incentive to go to Step Two.

2 – Creating a spreadsheet analysis of who will get what. To do this we need some employee census data: date of birth (or age), date of hire (or service), pay, hours if less than 1000 (estimates are OK), and information on ownership and family relationships, information on any plans already in place, and any information on any controlled groups or affiliated service

groups. The spreadsheet aids in further discussions with the owner and any advisors. Note, we do not bill for any proposals or related discussions.

3 – Once a general go-ahead is given we do thorough due diligence and collect any missing data. Documents are then produced for signature before the end of the year.

As you can see from the above, the steps in determining the viability of implementing a new Cash Balance Plan are not difficult and require minimal effort on the business owner's part. Thanks for reading and feel free to contact us should you have any questions.

Copyright 12/08/2015, John S Agatston Actuarial Services, 412-967-6240, www.cashbalancecombo.com