Increase Tax Deductions and Boost Retirement Savings with a Cash Balance Plan

By David B. Mandell, JD, MBA, Jason M. O'Dell, MS, CWM and Carole C. Foos, CPA

A Cash Balance Plan is a Qualified Retirement Plan (QRP) that can provide physicians with a way to increase tax deductions and simultaneously boost retirement savings. This type of QRP is often overlooked but is, in fact, a powerful tax planning tool that many medical practices have yet to consider.

Cash Balance Plans: "Modern Retirement Plans"

We refer to cash balance plans (CBPs) as "modern retirement plans" because their use has grown rapidly in closely held businesses, including medical practices, during recent years. CBPs are a solution for high income practice owners looking for tools that can provide them with significant short-term tax deductions, along with strong long-term economics.

With the new tax code specifically excluding physicians, attorneys, consultants, CPAs and others from some of its most powerful tax benefits, we would not be surprised to see more of these types of businesses looking to implement CBPs in the coming decade. A CBP is truly one of the few remaining substantial tax tools for 2019 and beyond.

Also, for those whose income puts them above the new tax code's qualified business income (QBI) threshold limits, CBPs can be a tool to reduce taxable income enough to qualify for the QBI deduction, creating one deduction that leads to a second deduction.

Cash Balance Plan Basics

In a CBP, a participating employee will have access to a certain sum upon reaching retirement. Let's use $100,000 as an example. In order to get to $100,000 at retirement, the plan assumes a combination of employer contributions and compound interest over time. When the employee retires, he or she can take the $100,000 either as a lump sum, or as an annuity that pays a portion of the $100,000 in periodic payments.

Each participant's account balance grows annually in two ways:

Benefit Credit

The benefit credit is a percentage of pay or flat dollar amount that is specified in the plan document. The credit is often class-based, so that higher dollar or percentage amounts accrue to owners/partners; lower dollar or percentage amounts to staff. This, as one would expect, makes the CBP ideally suited for businesses and medical practices.

Interest Credit

The interest credit is a guaranteed rate of return specified in the plan document that is typically tied to federal long-term interest rates or set at a fixed rate around 4 percent. The interest credit is not dependent on the plan's actual investment performance, but the plan's investment portfolio should be structured to attempt to perform in line with the anticipated crediting rate.

How Cash Balance Plans are Similar to and Different from Traditional Defined Benefit Plans

CBPs are like traditional defined benefit plans in terms of the funding and reporting requirements. Minimum funding standards apply; there is a minimum annual employer contribution that is reported on the CBP's tax form 5500. An actuary is required to calculate this contribution amount using a reasonable actuarial funding method and actuarial assumptions specified by the IRS. The employer can decide to contribute an amount between the minimum funding requirement and the maximum permitted deduction but should attempt to fund to the actuary's recommended contribution level in order to meet the plan's current benefit liability.

On the other hand, CBPs are different from traditional defined benefit plans that promise a specified monthly benefit amount at retirement (i.e., 3 percent of pay per year of employment, payable at the retirement age of 67). CBPs define benefits in the form of an account balance, rather than a periodic amount. This can be helpful because employees always understand what they are entitled to under the CBP, since it is a specific amount. Owners and employees both know what is going into the plan on their behalf, and what will come out when they leave.

Cash Balance Plans Work Well with 401(k)s

CBPs are not mutually exclusive to 401(k)s. In fact, a medical practice can typically utilize both types of plans simultaneously. Because many medical practices already have 401(k) plans in place, physician owners often consider "layering in" a CBP on top of their existing 401(k).

Main Benefits of CBPs

There are four compelling reasons why medical practices are interested in CBPs:

1. **Significantly increased deductions for plan contributions**

In 2019, 401(k)s are subject to maximum deductible contribution limits of $19,000, with profit-sharing plan limits at $56,000. (The catch-up contribution for those over age 50 is an additional $6,000 annually.) These limits will increase slightly each year. Properly structured CBPs, on the other hand, can allow business owners to make tax deductible contributions of $200,000 or more, potentially saving them $80,000 to more than $100,000 in income taxes annually.

2. **Additional Costs are Much Less than Additional Tax Savings**

CBPs usually involve higher annual administration costs and higher employer contribution amounts for employees than 401(k)s and/or profit-sharing plans. Nonetheless, the tax savings typically dwarf these additional expenses, making the CBP extremely attractive.

3. **Possible Second Level of Tax Deduction**

For those whose income puts them above the new tax code's qualified business income (QBI) threshold limits, CBPs can be a tool to reduce taxable income enough to qualify for the QBI deduction, creating one deduction that leads to a second deduction.

4. **Greater Access to Top (+5) Asset Protection Level**

As an exempt asset under federal law and most state laws, ERISA-qualified QRPs are protected at the highest (+5) level. Unless a CBP is put in place for only one owner, with no other employees, this ERISA protection will usually also apply to the CBP. With larger contribution levels allowed in the CBP, this means more wealth can be protected in the CBP than in most other QRPs.

How a Cash Balance Plan Can Create Two Deductions for the Price of One

Earlier we mentioned that, for those whose income puts them above the new tax code's qualified business income (QBI) threshold limits, CBPs can be tools to reduce taxable income enough to qualify for the QBI deduction even if taxpayer's business is a specified service trade or business. In this way, the CBP can create one deduction that leads to a 2nd deduction. Let's look at an example:

	Before Cash Balance Plan	After Cash Balance Plan*
QBI	$585,822	$300,000
199A Deduction	$0	$60,000
Total Taxable Income	$585,822	$240,000
Federal Income Taxes	$177,118	$60,086
Difference in Federal Income Taxes**	-	$117,032

***CBP contribution in year 1 of $285,822**

****Adding a cash balance plan reduces federal tax by 66%**

Conclusion

Cash Balance Plans are powerful planning tools that provide larger contributions than the QRPs most medical practices use today. CBPs can be attractive to practice owners who are looking for greater tax deductions, asset protection, and superior retirement savings. The authors welcome your questions.

David B. Mandell, JD, MBA, is an attorney, consultant and author of more than a dozen books for doctors, including ***Wealth Management Made Simple*** and ***For Doctors Only: A Guide to Working Less and Building More***, He is a partner in the wealth management firm OJM Group www.ojmgroup.com, where Jason M. O'Dell, MS, CWM and **Carole C. Foos, CPA** are also partners, authors and consultants. They can be reached at 877-656-4362 or mandell@ojmgroup.com.

Disclosure:

OJM Group, LLC. ("OJM") is an SEC registered investment adviser with its principal place of business in the State of Ohio. SEC registration does not constitute an endorsement of OJM by the SEC nor does it indicate that OJM has attained a particular level of skill or ability. OJM and its representatives are in compliance with the current notice filing and registration requirements imposed upon registered investment advisers by those states in which OJM maintains clients. OJM may only transact business in those states in which it is registered or qualifies for an exemption or exclusion from registration requirements. For information pertaining to the registration status of OJM, please contact OJM or refer to the Investment Adviser Public Disclosure web site www.adviserinfo.sec.gov.

For additional information about OJM, including fees and services, send for our disclosure brochure as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest or send money.

This article contains general information that is not suitable for everyone. The information contained herein should not be construed as personalized legal or tax advice. There is no guarantee that the views and opinions expressed in this article will be appropriate for your particular circumstances. Tax law changes frequently, accordingly information presented herein is subject to change without notice. You should seek professional tax and legal advice before implementing any strategy discussed herein.