



The Appeal of Seriously Top Heavy Retirement Plans

- ▶ The “cash balance” plan is a pension plan that business owners can use to reward both themselves and their key employees with outsized retirement plan contributions.

By J. Leland “Lee” Davis

Today's business owners and professionals are plagued by any number of challenges. Yet many still manage to create and run highly profitable businesses.

Emerging Strategies

An emerging strategy called the “cash balance” plan is a pension plan that business owners can use to reward both themselves and their key employees with outsized retirement plan contributions. Business owners also can generate large tax deductions in the process.

Comparatively, today's 401(k) plans have many nuances – from “safe harbor” provisions to the “new comparability” or cross-tested method. These nuances actually can help business owners tailor plans that are unique to their needs. One method allows owners and other highly compensated workers to participate fully in the plan, while the other allows larger contributions to be handed out to a specific class of employee, often highly compensated executives and key people.

Cutting-Edge Concepts

However, many advisors aren't aware of the symphony that can be created with the combination of the 401(k) and a specialized pension plan. Among the cutting-edge concepts in this regard is the combination of the new comparability (cross-tested) 401(k) plan with the cash balance pension plan.

To illustrate the advantage of combining these two plans, consider the example of a hypothetical medical practice with six producing physician owners. Structured as an S corporation for tax purposes, this could also be any business with big earners. The following illustration shows the impressive

Sample Corporation
Plan Year-December 31, 2014
Retirement Plan Cost Summary

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Notice the large amount the company may put in for owners and key people.

H C E	Date of Birth	Date of Hire	Date of Termination	Hours	Total Comp.	Plan Comp.	Profit Sharing	Match	Cash Balance	Total Employer	401(k)	Total
PRIN	Y	1/25/1971	7/7/2010	1001	\$ 826,362	\$ 260,000	\$ 30,125	\$ 4,375	\$ 105,000	\$ 139,500	\$ 17,500	\$ 157,000
PRIN	Y	4/2/1956	7/1/1986	1001	787,098	260,000	28,750	5,750	225,000	259,500	23,000	282,500
PRIN	Y	7/15/1969	8/1/2005	1001	711,849	260,000	30,125	4,375	110,000	144,500	17,500	162,000
PRIN	Y	1/13/1970	1/1/2010	1001	482,414	260,000	30,125	4,375	110,000	144,500	17,500	162,000
PRIN	Y	7/28/1968	8/1/2000	1001	393,121	260,000	30,125	4,375	120,000	154,500	17,500	172,000
PRIN	Y	1/28/1934	1/1/1967	1001	165,053	165,053	28,750	5,750		34,500	23,000	57,500
		9/5/1952	9/21/1987	1001	56,330	56,330	3,802	704	1,000	5,507	2,817	8,324
		10/4/1962	11/28/1987	1001	44,583	44,583	3,009		1,000	4,009		4,009
		7/21/1964	2/2/1995	1001	58,607	58,607	3,956	733	1,000	5,688	2,930	8,618
		6/7/1957	5/4/1998	1001	41,392	41,392	2,794	1,302	1,000	5,096	5,207	10,303
		7/26/1942	8/28/2000	1001	26,942	26,942	1,819	808	1,000	3,627	3,233	6,860
		11/18/1957	9/28/2000	1001	39,910	39,910	2,694	650	1,000	4,344	2,600	6,944

result of integrating a cash balance plan with a new comparability 401(k) plan, and the remarkable efficiency of the resulting scenario for the owners.

First, the new comparability profit sharing plan formula generates a \$277,047 employer contribution, with \$178,000 going to the physician owners themselves – about 64 percent of the total. Taken by itself, this is somewhat better than if those owners took out the same amount of money as income and paid taxes on it. The other advantage to implementing this type of plan is that the owners save income taxes in the range of \$110,000 annually.

Then comes the magic of adding the cash balance pension plan to the equation. The large pension contribution of \$705,728 generates more than \$280,000 of tax savings annually in a combined 40 percent income tax bracket. Most important, more than \$670,000 goes directly to the retirement account of the principals – that's more than 90 percent!

Combination Advantages

» Using both plans in concert, each high-earning owner is able to put away an annual total ranging from a low of \$157,000 to a high of \$282,000. Keep in mind that future pension contributions may decrease with age, of course. That is far more than the \$51,000 limit for 401(k) profit sharing plans alone.

» This combination is also a wonderful

way to generate a huge retirement bankroll for the owners. Placing large amounts into tax-deferred plans like these allows owners essentially to control when the income taxes are paid by controlling when they take their distributions in retirement.

Key Points to Remember

Of course, the medical practice must put away at least some amount for the other employees too under this arrangement – \$1,000 and under for each in the cash balance plan, and the 401(k) plan also needs a bit more for each employee. Here are some key factors to be aware of: Administrative guidelines must be followed; ongoing reporting is necessary; these expenses are considerations; and pension plans require continuing contributions and generally aren't as flexible as profit-sharing plans.

Executed properly, a combination plan strategy reduces the tax bite and boosts tax-deferred savings immensely. Savvy advisors and their clients owe it to themselves to investigate these strategies. Implementing them properly can create a virtual gold mine for retirement. [in](#)

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