Cash Balance 401(k) Combination

Defined Benefit Plan Disclaimer

In General

Pension and profit-sharing plans can generally be adopted as late as a company's tax filing deadline, which occurs after the end of the tax year. All qualified plans must be written in a legal document and properly adopted prior to accepting contributions. Also, proposals are generally prepared using underlying assumptions and estimated census data; therefore, contributions should not be made until final valuations are completed.

Top Heavy Status

A plan or group of plans is considered "Top Heavy" when certain "Key" employees are entitled to more than 60% of the accumulated benefits (account balances for defined contribution plans; present values for defined benefit plans). Top Heavy plans must provide minimum allocations and benefits to "Non-Key" employees. In general, stand-alone defined contribution plans must provide a minimum allocation of 3% of compensation, defined benefit plans must provide an annual benefit increase of 2% of average compensation, and combination arrangements must provide an allocation of at least 5% of compensation.

Since Top Heavy status is based on accumulations across all of the plan sponsor's plans, there may not be enough information available to determine the Top-Heavy status of the plan's shown in this proposal. For illustration purposes they are assumed not Top Heavy, and accordingly they may not reflect the minimum contributions or benefits required by the Top-Heavy rules.

Earned Income

Owners in sole proprietorships and partnerships must have their plan compensation, or "earned income", reduced by deductions taken for retirement plan contributions. Owners in corporations will only have their W2 wages considered for earned income.

Cash Balance Defined Benefit Plans

Defined benefit plans can offer significant tax advantages for plan sponsors. A proposal may illustrate "cash balance" defined benefit plan designs. Under the law, plan sponsors of cash balance plans have a higher level of commitment than with 401(k), SEP or profit-sharing plans.

Specifically, you should understand the following:

- **Permanency requirement** - The law says that a defined benefit plan must be intended to be "permanent" when established. Therefore, a cash balance plan that is terminated shortly after its inception, or to which recurring contributions are not made, may have to provide proof to the IRS upon its termination that it was originally intended to be permanent.

- **Funding requirement** - Until being frozen or terminated, a cash balance plan will generally require a contribution each year. *Even* a frozen plan will require a contribution if the assets fall below the actuarial value of the liabilities. Failing to meet the minimum funding requirements will result in penalty taxes.

- **Highly Compensated Employees** - Highly Compensated Employees may **not** be able to take some or all of their benefits as a lump sum if the plan's funding level is below a certain percentage at the time of distribution.

- **Guaranteed Benefits** - For most cash balance plans, the Pension Benefit Guaranty Corporation (PBGC) provides government-mandated insurance coverage that guarantees a portion of the benefits promised by this plan. Unless the plan meets an exemption, it will be required to pay a premium to the PBGC each year until all participants and beneficiaries are fully paid out.

- **Distribution Limits** – IRC 415 limits the amount that may be paid out to a participant in a cash balance plan. The calculation of this amount depends on the person’s age, years of service, years of participation and historical average compensation at the time of distribution. Therefore, it is possible that a defined benefit plan may have trust assets in excess of what is allowed to be paid out at a particular point in time. This situation could result in a reversion to the plan sponsor that is subject to income taxes, as well as a 50% penalty tax. The plan’s actuary should assist in determining these limits and monitoring the plan’s funding level accordingly.

Finally, please understand the funding costs presented in any illustration are estimates intended to approximate the annual valuation performed by the plan's actuary. They are intended **only** for evaluating the **concept** of the plan. The actuarial methods and assumptions may not entirely match those that will be used by the plan's actuary, and a complete actuarial valuation will take into consideration more data elements that impact costs.

Please contact sales@hunterbenefits.com with any questions.