WealthMark Advisory Services
Philip Scholler
President/CEO
5001 Horizons Drive
Suite 201
614-824-4352
phil@wealthmarkas.com
www.wealthmarkas.com

Cash Balance Plan

October 20, 2014

Cash Balance Plan

What is a cash balance plan?

A cash balance plan is a qualified employer-sponsored retirement plan that has become increasingly common in recent years as an alternative to (or replacement of) the traditional defined benefit pension plan. Though it is technically a form of defined benefit plan , the cash balance plan is often referred to as a "hybrid" of a traditional defined benefit pension plan and a defined contribution plan . This is because cash balance plans combine certain features of both defined benefit and defined contribution plans. Like traditional defined benefit plans, cash balance plans pay a specified benefit amount at retirement. However, like defined contribution plans, participants have individual (albeit hypothetical) accounts, allowing for easy tracking of accrued benefits.

Technical Note: *A cash balance plan is a "statutory hybrid plan" that has a "lump-sum-based benefit formula."*

How does it work?

Hypothetical accounts

Each participant in a cash balance plan has a hypothetical individual account or "cash balance" established for record-keeping purposes. With these hypothetical accounts, participants can easily view their accrued benefit at any time, unlike a traditional defined benefit pension plan. In reality, however, you, as the employer, do not contribute to individual participant accounts. Instead, you contribute to the overall plan, and all of the plan assets are held in one pension trust fund that is used to pay benefits when participants retire or terminate employment.

Comparison of benefit formulas with traditional defined benefit plan

Like all defined benefit plans, a cash balance plan "defines" (specifies) the retirement benefit that will ultimately be paid out. However, the way in which retirement benefits are calculated is not the same as with traditional defined benefit pension plans.

Under a traditional defined benefit pension plan, retirement benefits are based on a formula such as a set dollar amount for each year worked, or a specified percentage of earnings. Often, these traditional pension plans calculate an employee's retirement benefit by averaging the employee's earnings during the last few years of employment, taking a specified percentage of the average, and then multiplying it by the employee's total years of service. This typical end-of-the-career approach with a traditional defined benefit plan can increase an employee's retirement benefit by emphasizing the usually higher, last years of salary.

By contrast, with cash balance plans, the retirement benefit to be paid is the total accumulation of all contributions over the employee's working career and earnings "credited" to the employee's hypothetical account as of retirement age. A cash balance plan does not give as much weight to the last years of salary--it looks at an employee's entire salary history.

Contributions

With a cash balance plan, you, as the employer, credit each participant's hypothetical account on a regular basis (e.g., annually or monthly). The amount credited is usually a percentage of the participant's salary, but it may be a flat dollar amount in some cases. Not surprisingly, these credits are generally referred to as "contribution," "service," or "pay" credits.

Caution: *Generally, the maximum amount of compensation that a cash balance plan can take into account in determining the pay credit for a participant in 2014 is limited to $260,000 ($255,000 in 2013).*

In addition, each participant's hypothetical account is increased or decreased each period by applying a rate of interest or a rate of return, specified in the plan, to the participant's accumulated benefit as of the beginning of that period. This is called the "interest credit." A cash balance plan's interest credit can't exceed a "market rate of return."

The interest credit can be a fixed rate specified by the plan (up to 5%), or can be based on an index or mutual fund rate of return (for example, the rate of return on U.S. Treasury bills, or the rate of return of the S&P 500). IRS proposed regulations also allow the interest credit to equal the rate of return the plan actually earns on the investment of its own assets, if certain diversification requirements are satisfied (this option can help an employer avoid overfunding or underfunding the cash balance plan).

Tip: *IRS final and proposed regulations contain detailed rules regarding interest credits and the "market rate of return" requirement. The IRS proposed regulations will not be effective before 2014. However, taxpayers are allowed to rely on those regulations prior to the effective date.*

Caution: *Even though the interest credit can be based on an equity index, or on the plan's actual investment rate of return, which may result in negative earnings for a particular period, the participant's hypothetical account balance at the time benefit payments begin can never be less than the sum of all of the contribution credits to the participant's hypothetical account. This is referred to as the "preservation of capital requirement."*

The amount that you, the employer, must contribute to the plan each year is actuarially determined, based in part on "contributions" and "earnings" credited to hypothetical accounts, as well as on the actual investment performance of plan assets.

Actuaries base the amount of plan contribution on several factors, including:

- Retirement benefits promised by the plan
- Age, sex, salary, and retirement age of the participants
- Projected interest to be credited to the participants' accounts
- Projected future salary increases of the participants
- Projected rates of turnover, disability, and mortality of the participants

Caution: *Like traditional pension plans, cash balance plans must comply with Internal Revenue Code (IRC) Section 415. Section 415 limits the maximum annual benefit per participant in 2014, payable as an annuity commencing at age 62, to 100 percent of the participant's highest average compensation for a three consecutive year period or $210,000, whichever is less). A participant's hypothetical account balance cannot exceed the present value of this maximum annual benefit.*

Plan assets and investments

Plan assets are held in a pension trust that you, the employer, set up, contribute to, and use to pay benefits when participants retire or terminate employment. Participants in a cash balance plan have no say over the underlying investments selected.

Since the "earnings" credited to participants' hypothetical accounts are guaranteed and may be independent of actual investment performance, you, as the employer, bear all investment risk (but you also benefit if investments perform better than expected). The performance of plan investments will determine, in part, the contributions you need to make to fund the plan.

Plan distributions

Like any defined benefit pension plan, a cash balance plan (a) must pay benefits in the form of an annuity, unless the employee (and spouse, if married) elects a different form of benefit, and (b) generally can't pay benefits until retirement or other termination of employment. Unlike most defined benefit plans, however, cash balance plans typically offer a lump-sum payment as a distribution option.

Tip: *The Pension Protection Act of 2006 encourages "phased retirement" programs by permitting the distribution of pension benefits to employees who have attained age 62, but haven't yet separated from service or reached the plan's normal retirement age. The IRS has also issued proposed regulations that allow phased retirement payments in certain limited circumstances.*

Plan distributions--the "whipsaw" effect

Prior to passage of the Pension Protection Act of 2006 , when an employee chose to receive a lump-sum payment prior to attaining retirement age, the lump sum could in some cases actually be higher than the participant's hypothetical account balance. Under IRS rules, the amount a participant was entitled to receive was not the participant's hypothetical account balance, but rather the present value of the participant's future benefit (calculated by actuaries) at retirement age. The lump sum was calculated by using the plan's interest credit rate to project the hypothetical account balance to normal retirement age, converting that benefit to an annuity, and then using a statutorily prescribed interest rate (the discount rate) to determine the present value of the annuity. The problem would arise where the plan's interest credit rate and the discount rate were not the same.

If the plan's interest credit rate happened to equal the discount rate, the participant's lump-sum benefit would be equal to the participant's hypothetical account balance. However, if the plan's interest credit rate was greater than the discount rate, the participant's lump-sum payment would be greater than the participant's hypothetical account balance. This came to be known as the "whipsaw effect." While this was good for participants, it was generally contrary to the intent of employers establishing cash balance plans. The practice also raised age discrimination issues, since the lump sum payable to a younger worker would be

greater than the lump sum payable to an older worker with an identical hypothetical account balance. In order to avoid the whipsaw effect, employers were effectively forced to adopt the discount rate (instead of a higher market rate) as the plan's interest credit rate.

The Pension Protection Act of 2006 eliminated the whipsaw problem by allowing cash balance plans to pay a lump-sum benefit that's equal to the participant's hypothetical account balance, for distributions made after August 17, 2006.

Portability

A significant feature of cash balance plans for your employees is that, should a participant terminate employment prior to retirement age, his or her vested plan benefits are generally "portable." This means that the funds can generally be rolled over to another employer's retirement plan or to an IRA, allowing them to remain in a tax-deferred environment. Alternatively, in some cases, a terminating employee may elect to leave his or her benefits in the cash balance plan, accruing earnings credits and growing tax deferred, until retirement.

What types of employers should consider a cash balance plan?

Almost any type of employer can adopt a cash balance plan, or convert an existing traditional defined benefit pension plan to a cash balance plan. However, a cash balance plan is generally more appropriate for relatively large employers than for smaller employers with few employees. In addition, the following factors have contributed to the creation and recent growth of cash balance plans:

- Today's employees, especially younger ones, want to see benefits that reward them early in their careers, not mainly at the end. Younger employees also like the idea that there will be a longer period of time for their benefits to compound. As compared to traditional defined benefit plans, cash balance plans generally reward younger employees more substantially earlier in their careers and spread out the benefits more evenly during the rest of their careers.
- Women and men who have more career interruptions and shorter periods of employment often prefer this type of plan if they receive a higher benefit than with a traditional defined benefit pension plan.
- Employees want more portable benefits since job changes have become the norm, rather than the exception.
- Employees and employers prefer retirement plans that are relatively easy to understand in terms of the amount of retirement benefits.

If these factors describe many of your employees, you may want to consider adopting (or converting to) a cash balance plan. On the other hand, cash balance plans should be considered very carefully where employers have a large number of older, highly compensated employees who have been with the company for a long time. As discussed later, such employees may perceive more value in a traditional pension plan than in a cash balance plan.

Also, before you decide to establish a cash balance plan or convert an existing defined benefit pension plan, you also need to consider:

- The age, sex, salary, and retirement age of the participants
- The projected future costs of the plan

A cash balance plan puts certain obligations on the employer. When you establish this type of plan, you are making an ongoing commitment for pension contributions. You, not the employees, are taking on the risk of investment performance. If the plan investments do not perform as expected, it will be your obligation to make up any shortfalls.

Tax benefits of cash balance plans

Tax considerations for employees

When you contribute to a cash balance plan on behalf of your participating employees, those employer contributions are not currently included in the employees' taxable income. The employees will not pay income tax on the money contributed to the plan as long as that money remains in the plan. Similarly, because a cash balance plan is a tax-deferred plan, investment earnings on plan funds are not currently included in employees' taxable income either. These employee tax benefits exist for most qualified retirement plans, and are a key incentive for many employees to participate in such a plan.

Of course, when a participating employee begins to receive distributions from the plan during retirement, he or she will generally be subject to federal (and possibly state) income tax on both plan contributions and related earnings. However, the rate at which a

distribution is taxed depends on the employee's federal income tax bracket for the year, and many employees may be in a lower tax bracket when they begin receiving distributions. If an employee receives a distribution from the plan prior to age 59½, he or she may be subject to a 10 percent premature distribution penalty tax (unless an exception applies), in addition to ordinary income tax.

Tax deduction for employer

Your employer contributions to the plan are generally tax deductible on your business's federal income tax return for the year in which those contributions are made. To be eligible for this employer tax benefit, your cash balance plan generally must remain a "qualified" plan.

The way in which an employer's tax deduction is calculated is generally more complex for a defined benefit plan (including a cash balance plan) than for a 401(k) or other defined contribution plan. In the case of a defined benefit plan, actuarial calculations are needed to determine benefits, liabilities, minimum funding requirements, and the maximum tax-deductible contribution under the plan, among other things. There are several possible methods that can be used to determine the employer's maximum tax-deductible contribution to the plan for any year. You should consult a tax advisor or retirement plan specialist for further guidance.

Other advantages of cash balance plans

The plan offers guaranteed pension benefits for employees

This is the key similarity between cash balance plans and traditional pension plans. Each participant ultimately receives a dollar amount guaranteed under the plan, payable upon retirement (or possibly upon termination of employment) as either a lump sum or an annuity.

As a result, participants enjoy the security of knowing that their retirement benefits are virtually guaranteed--a feature not associated with 401(k)s and other defined contribution plans, where the final payout is based largely on investment performance. The insurance provided by the Pension Benefit Guaranty Corporation (PBGC) adds further security to these arrangements (see below). You, as the employer, pay these PBGC premium insurance costs.

The plan offers unique incentives to attract and retain employees

In addition to the security of guaranteed benefits, a typical cash balance plan offers certain advantages for your participating employees. These generally include portability, or the ability of participants to roll over their vested benefits to another retirement plan or to an IRA if they leave your service. Also, the fact that participants accrue benefits evenly throughout their employment (using a fairly simple formula, in most cases) and can see their "accrued benefits" at any time eliminates much of the complexity associated with traditional pensions, making cash balance plans easier to understand. In addition, many younger employees may like the idea of being rewarded at the same rate throughout their employment, because it puts them on more of a par with older, higher-paid employees.

Your business has some flexibility with contributions to hypothetical accounts

A cash balance plan is similar to a traditional pension plan in that both "define" future retirement benefits, not employer contributions. As a result, cash balance plans are not subject to the strict annual contribution limits that govern defined contribution plans. This generally means that you can contribute more to the plan than you would be able to contribute to a defined contribution plan. You also have some flexibility in terms of the formula for determining how much you credit for contributions to participants' hypothetical accounts. The amount credited is usually either a percentage of the participant's pay, or a flat dollar amount. The credits may also be age- or service-related in some cases. Some employers even credit different amounts for different components of pay, or base the credits on company performance.

The plan may be less difficult and expensive to maintain than other plans

The administrative costs of a cash balance plan may sometimes be lower than under a traditional pension plan, because it is likely that many cash balance plan participants will receive a lump-sum payout at termination or retirement. Once the participant receives a lump-sum payout, you have no additional responsibility, including no responsibility to provide a cost-of-living adjustment (COLA) for benefits to keep pace with inflation. By contrast, the majority of participants in a traditional defined benefit pension plan will receive a monthly annuity payout at retirement, requiring large numbers of checks to be cut. Also, traditional pension benefits often include a COLA, resulting in additional costs to you.

In some cases, a cash balance plan may even be less difficult and costly to maintain than a 401(k) or other defined contribution plan. Record keeping will be easier because there is no reconciliation required with trust assets, and because there are no employee contributions to be taken into account.

Caution: *Because records of individual plan accounts must be kept, record-keeping costs associated with a cash balance plan may be higher than under a traditional pension plan. Also, while a traditional pension plan generally allows you to defer payment of benefits until employees retire, a cash balance plan generally allows terminating employees to take their vested benefits with them (i.e., cash out or roll over the benefits). When benefits remain in a traditional pension plan until employees retire, you are generally able to keep the earnings on that money. For these reasons, a cash balance plan is sometimes not more cost-efficient than a traditional pension plan. The point is that overall cost efficiency depends on several factors that may vary from one situation to the next, so it is best to consult a retirement plan specialist as to whether or not a cash balance plan will save you money versus a traditional pension plan or other type of plan.*

You receive the benefit if investments perform better than expected

In other words, if you promise to credit each participant's hypothetical account with 3 percent annual interest, but the plan's underlying investments earn 8 percent each year, the 5 percent difference is yours to retain and use. If the earnings on plan assets are higher than needed or expected, the employer may take advantage of the surplus by reducing future funding contributions to the plan, or by increasing the retirement benefits to be paid to participants.

Caution: *You, as the employer, also bear the risk of any losses relating to plan investments. If those investments fail to achieve the interest rate needed, you must take steps to make up the difference.*

Creditor protection

Funds held in a cash balance plan are fully shielded from your employee's creditors under federal law in the event of the employee's bankruptcy. If your plan is covered by the Employee Retirement Income Security Act of 1974 (ERISA), plan assets are also generally fully protected under federal law from the claims of both your employees' and your creditors, even outside of bankruptcy (some exceptions apply). State law may provide additional protection.

Benefit calculation may mean less benefit funding than typical traditional pension plan

Cash balance plan retirement benefits are largely based on a straight percentage of each participant's compensation. By contrast, a traditional defined benefit pension plan's formula for calculating benefits may weigh more heavily a participant's highest-earning years prior to retirement, and total years of service. Consequently, some employers can save significantly on benefits paid under a cash balance plan.

Disadvantages of cash balance plans

Your business must make periodic payments to the plan

In general, if you establish or convert to a cash balance plan, you, as the employer, are committing to making all of the plan contributions--whether or not you have profits or the cash to do so. Contrast that with a 401(k) plan where the employees generally make the bulk or all of the contributions.

With a cash balance plan, you must fund the plan on an annual or more frequent basis. Consequently, a cash balance plan may not be the appropriate type of retirement plan for your business if you suspect that your business might not have the money to fund the plan in future years. You may be subject to substantial penalties by the IRS if you underfund the plan. Consult a tax advisor for details.

Your business may have to pay for pension insurance

A covered cash balance plan is subject to mandatory insurance coverage through the Pension Benefit Guaranty Corporation (PBGC). The PBGC is the federal agency that "insures" benefits accrued under certain defined benefit plans (including cash balance plans). If you default on or terminate the plan, the PBGC will pay benefits to the plan participants according to the provisions of the plan (up to certain ceilings). The PBGC is funded through mandatory premiums paid by employer sponsors of covered plans. If you wish to terminate your plan, the PBGC must be notified in advance and must approve any distribution of plan assets to participants.

Your business must invest plan assets and bear all the investment risk

Under a cash balance plan (as under a traditional pension plan), the responsibility of investing the plan assets for the participants rests with the employer. This is in contrast to many defined contribution plans (such as 401(k) plans), which are self-directed in that participants generally choose their own investments and have flexibility to move money around. As the employer, you may choose to not actually select the investments or manage the assets yourself. You may instead hire an administrator to handle these duties for you. However, you still bear all risks associated with plan investments. If investment returns do not keep pace with funding requirements, additional unanticipated funding contributions will have to be made.

This type of plan may not be beneficial for certain workers

Cash balance plans are often perceived as less advantageous than traditional defined benefit pension plans for older, highly compensated employees who have been with your company for many years. This is because cash balance plans generally reward each participant evenly throughout the duration of his or her employment.

By contrast, traditional defined benefit pension plans often weigh later, higher-earning years more heavily in calculating retirement benefits. Particularly in the case of a conversion from a traditional defined benefit pension to a cash balance plan, many older, longer-service employees may sometimes lose significant benefits (unless the cash balance plan has grandfather provisions or other protections, or gives older employees the choice of opting out of the conversion).

The plan is subject to various requirements

As a qualified retirement plan, a cash balance plan is not allowed to discriminate in favor of certain employees. Basically, this means that highly compensated employees may not benefit substantially more under the plan than your non-highly-compensated employees. To ensure that this is the case, your plan is generally required to undergo annual nondiscrimination testing. These testing requirements are beyond the scope of this discussion. You should consult additional resources for further guidance.

A qualified defined benefit plan (including a cash balance plan) is also subject to "top-heavy" requirements of IRC Section 416. These requirements generally prohibit high-level employees from accruing more benefits under the plan than lower-level employees. A retirement plan is considered top heavy if the present value of the accrued benefits of the key employees (generally, the company owners and officers) is more than 60 percent of the present value of the accrued benefits of all participating employees. If a plan is top heavy, a minimum retirement benefit of the lesser of 20 percent of pay or 2 percent per year of service must be provided for all non-key employees. In addition, top-heavy plans must provide for a more rapid vesting schedule than would otherwise apply.

Finally, cash balance plans must comply with the vesting, funding, disclosure, reporting, fiduciary, and other requirements that apply to qualified plans under ERISA and the IRC. Consult a tax advisor or retirement plan specialist for more information.

Tip: *ERISA doesn't apply to governmental and most church retirement plans, plans maintained solely for the benefit of non-employees (for example, company directors), plans that cover only partners (and their spouses), and plans that cover only a sole proprietor (and his or her spouse).*

How to set up a cash balance plan

Have a plan developed for your business

Due to the nature of the rules governing qualified retirement plans, you will most likely need a retirement plan specialist to develop a cash balance plan that meets legal requirements, as well as the needs of your business. You will need to do the following:

- Determine the plan features most appropriate for your business: Carefully review your business, looking at factors such as your cash flow and profits, your desired tax deduction, and facts about your employee population (including years of service, ages, salaries, and turnover rate). This will assist you in determining appropriate plan features, including investment vehicles, contribution levels, and employee eligibility requirements.
- Choose the plan trustee: The assets of the plan must be held in a trust by a trustee. The trustee has overall responsibility for managing and controlling the plan assets, preparing the trust account statements, maintaining a checking account, retaining records of contributions and distributions, filing tax reports with the IRS, and withholding appropriate taxes. The plan trustee can be you or a third party, such as a financial institution.
- Choose the plan administrator: Administering the plan involves many duties, including determining who is eligible to

participate in the plan, determining the amount of benefits and when they must be paid, and complying with reporting and disclosure requirements. The plan administrator may also be responsible for investing plan assets and/or providing investment educational services to plan participants. The employer is legally permitted to handle these responsibilities in-house, but plan sponsors often hire a third-party firm to assist with the duties of plan administration.

Submit the plan to the IRS for approval

Once a plan has been developed, it should be submitted to the IRS for approval if it is not a prototype plan previously approved by the IRS. As there are a number of formal requirements that must be met (for example, you must provide a formal notice to employees), a retirement plan specialist should assist you with this task. Submission of the plan to the IRS is not a legal requirement, but it is highly recommended. The IRS will carefully review the plan and make sure that it meets all of the applicable legal requirements. If the plan meets all requirements, the IRS will issue a favorable "determination letter." Otherwise, the IRS will issue an adverse determination letter indicating the deficiencies in the plan that must be corrected.

Adopt the plan during the year for which it is to become effective

You must officially adopt your plan during the fiscal year for which it is to become effective. A corporation generally adopts a cash balance plan or other retirement plan by a formal action of the corporation's board of directors. An unincorporated business should adopt a written resolution in a form similar to a corporate resolution.

Provide copies of the summary plan description to all eligible employees

ERISA requires you to provide a copy of the summary plan description (SPD) to all eligible employees within 120 days after your plan is adopted. A SPD is a booklet that describes the plan's provisions and the participants' benefits, rights, and obligations in simple language. On an ongoing basis you must provide new participants with a copy of the SPD within 90 days after they become participants. You must also provide employees (and in some cases former employees and beneficiaries) with summaries of material modifications to the plan. In most cases you can provide these documents electronically (for example, through e-mail or via your company's intranet site).

File the appropriate annual report with the IRS

Each employer that maintains a qualified retirement plan is generally required to file an annual report with the IRS. The annual report is commonly referred to as the Form 5500 series return/report. You must file the appropriate Form 5500 series return/report for your plan for each plan year in which the plan has assets. Consult a tax or retirement plan specialist for more information.

Converting a traditional pension plan to a cash balance plan

In general

Much of the controversy surrounding cash balance plans in the past had to do with companies converting traditional pension plans to cash balance plans. Such conversions have appealed to some companies as a way to cut costs and attract younger workers. Unfortunately, converting a traditional pension plan to a cash balance plan tends to have a negative impact on older, long-term workers. Why? Under a traditional pension plan, retirement benefits are often calculated according to a formula that heavily weights total years of service and highest-earning years (usually those years immediately preceding retirement). These factors tend to favor older, longer-term employees. Cash balance plans, on the other hand, tend to credit contributions and earnings on a much more level basis. Most controversial, however, was a conversion technique known as the "wear-away" period utilized by some companies when converting traditional pensions to cash balance plans.

"Wear-away" periods

When a pension plan is amended, the anti-cutback rule requires that each participant's accrued benefit at the time of the amendment must be protected. One of the ways some companies have dealt with the anti-cutback rule when converting traditional defined benefit plans to cash balance plans has been by the use of wear-away periods. Under a typical wear-away formula, a participant is entitled to the greater of his or her accrued benefit under the original plan formula (the benefit protected by law), or the accrued benefit under the new cash balance formula, calculated by applying the new formula to all of the participant's years of service.

An employee's protected accrued benefit under the traditional defined benefit formula is often greater than the accrued benefit under the new cash benefit formula. Because of this, the practical effect of a wear-away period is that even though the employer

may regularly credit the hypothetical cash balance accounts of these participants, they effectively receive no additional benefits until their hypothetical account credits catch up to the present value of the protected benefits they were entitled to under the discontinued traditional pension plan. This often meant that years could pass before these participants received any true additional benefits under the cash balance plan. For older participants close to retirement, this has had the effect of freezing their retirement benefits during their highest-earning years (typically the years that would result in the highest benefit increase under the traditional pension plan). It was not clear if these provisions violated federal age discrimination laws, which prohibit plans from ceasing or reducing a participant's benefit accruals because of the attainment of any age.

Conversions after the Pension Protection Act of 2006

The Pension Protection Act of 2006 effectively prohibited the use of "wear-away" formulas described above. For conversions after June 29, 2005, a plan must provide that the accrued benefit of any individual who was a participant immediately before the conversion is at least equal to the sum of:

- The participant's accrued benefit for years of service before the effective date of the conversion, determined under the terms of the plan as in effect before the conversion, plus
- The participant's accrued benefit for years of service after the effective date of the conversion, determined under the terms of the plan as in effect after the terms of the conversion

Questions & Answers

Which employees do you have to include in your cash balance plan?

You generally must include all employees who are at least 21 years old and have at least one year of service. Two years of service may be required for participation as long as the employee will be 100 percent vested immediately upon entering the plan. If desired, you can impose less (but not more) restrictive requirements.

Tip: *For eligibility purposes, a year of service is a 12-month period during which the employee has at least 1,000 hours of service.*

In addition, your cash balance plan is subject to federal restrictions regarding how many employees must participate in the plan. Specifically, on each day of the plan year, a cash balance plan must benefit no fewer than the lesser of (1) 50 of your employees, or (2) 40 percent or more of all of your employees, and at least 2 employees must benefit (unless there is only 1 employee in the company).

When must plan participation begin?

An employee who meets the plan's minimum age and service requirements must be allowed to participate no later than the earlier of:

- The first day of the plan year beginning after the date the employee met the age and service requirements, or
- The date six months after these conditions are met

Example(s): *Jack, age 48, was hired by Little Co. on December 1, 2012. Little Co. has a cash balance plan, and the plan year begins on January 1 of each year. Jack will have one year of service as of December 1, 2013. He must be allowed to participate in the plan by January 1, 2014.*

What is a highly compensated employee?

For 2014, a highly compensated employee is an individual who:

- Was a 5 percent owner of the employer during 2013 or 2014, or
- Had compensation in 2013 in excess of $115,000 and, at the election of the employer, was in the top 20 percent of employees in terms of compensation for that year. (This $115,000 limit is subject to cost-of-living adjustments each year.)

For purposes of defining a highly compensated employee, compensation includes all taxable personal services income (such as wages, salaries, fees, commissions, bonuses, and tips), as well as elective or salary-reduction contributions to 401(k) plans and cafeteria plans.

When do employees have full ownership of the funds in their accounts?

The process by which employees acquire full ownership of their plan benefits is called "vesting." Employer contributions must be 100 percent vested after three years of service.

Tip: *A plan can have a faster, but not slower, vesting schedule than the law requires.*

What happens to an employee's account if the employee terminates employment before he or she is 100 percent vested?

If a participant in your cash balance plan separates from service before being 100 percent vested in the plan, the employee will forfeit the amount that is not vested. The amount forfeited can then be used to reduce future employer contributions under the plan, or can be reallocated among the remaining participants' accounts. The IRS generally requires forfeiture allocation in proportion to participants' compensation rather than in proportion to their existing account balances.

Do you need to receive a favorable determination letter from the IRS in order for your plan to be qualified?

No, a plan does not need to receive a favorable IRS determination letter in order to be qualified. If the plan provisions meet IRS and ERISA requirements, the plan is considered qualified and is entitled to the accompanying tax benefits. However, without a determination letter, the issue of plan qualification for a given year does not arise until the IRS audits your tax returns for that year. By that time, it may be too late for you to amend your plan to correct any disqualifying provisions. A determination letter helps to avoid this problem because auditing agents generally will not raise the issue of plan qualification if you have a favorable determination letter (or if a preapproved prototype plan is used).

What happens if the IRS determines that your plan no longer meets the qualified plan requirements?

The IRS has established programs for plan sponsors to correct defects. These programs are designed to allow correction with sanctions that are less severe than outright disqualification. Your tax professional will be able to assist you in following these programs should the need arise. However, if you are unable to correct the defects in your plan as required, the plan may be disqualified. Loss of a plan's qualified status results in the following consequences:

- Employees could be taxed on employer contributions when they are made, rather than when benefits are paid
- Your deduction for employer contributions may be limited
- The plan trust would have to pay taxes on its earnings
- Distributions from the plan become ineligible for special tax treatment (see above), and cannot be rolled over tax free

IMPORTANT DISCLOSURES

Broadridge Investor Communication Solutions, Inc. does not provide investment, tax, or legal advice. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable—we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.

Securities and investment advisory services offered through Girard Securities, Inc., member FINRA, SIPC. WealthMark Advisory Services is not affiliated with Girard Securities, Inc.

WealthMark Advisory Services
Philip Scholler
President/CEO
5001 Horizons Drive
Suite 201
614-824-4352
phil@wealthmarkas.com
www.wealthmarkas.com