EGPS
ECONOMIC GROUP
PENSION SERVICES

# CASH BALANCE PLANS

*Frequently asked questions and answers*

## What are cash balance plans?

Cash balance plans are tax-qualified retirement plans, like 401(k) and profit sharing plans. They combine some of these plans' more user-friendly features with the much higher contribution limits available for defined benefit plans. Contributions can be defined by participant or job classification, either as a percentage of wages or a specific dollar amount.

## How much can participants contribute each year?

The maximum contribution is based on age and earnings. For example, in 2026, a 50-year-old could receive a contribution in excess of $200,000, while a 60-year-old could receive a contribution in excess of $330,000, depending on plan design and compensation. The IRS limits the maximum amount that may accumulate in a cash balance plan for any one individual. This limit is also based on age, earnings, and the number of years in the plan. With 10 or more years of participation, the maximum amount can be as much as approximately $3.8 million under the 2026 defined benefit limits.

## How can participants get money out of the plan?

Upon termination of the plan, termination of employment, or retirement, the cash balance account is paid out to participants. It may be rolled over tax-free to an IRA, just like distributions from 401(k) and profit sharing plans. Participants may then withdraw funds from the IRA as desired, and only the amount withdrawn is taxed.

## What happens if a participant dies?

Under federal law, a participant's spouse is the plan beneficiary and may roll over the account to an IRA. With spousal consent, children or others may be designated as beneficiaries.

## How and where is the money invested?

Cash balance plan funds are held in a trust created by the plan. Normally, the business owner(s) serve as the plan's trustees. Typically, the funds are pooled and managed directly by the trustees or investment manager(s) selected by the trustees. The funds may be invested in stocks, bonds, mutual funds, ETFs, cash, etc. Alternatively, plans may invest in real estate and privately traded securities, but there are some additional factors to consider before doing so. Unlike most 401(k) plans, participants do not choose their own invest-

## If participants do not choose their own investments, what do they earn in a cash balance plan?

The plan usually credits employees with a fixed interest rate each year, often around 4%, regardless of how well or poorly the plan's investments perform that year. The extent the investments do better than 4% reduces the plan's contribution cost to the company. If the plan assets underperform, the required contributions are typically raised. Effectively, the company is providing a guaranteed 4% return to the participants on their cash balance account. This is why these plans are normally combined with 401(k)/profit sharing plans.

## How much must employers contribute for participants?

Cash balance plans are most often paired with 401(k)/profit sharing plans. Typically, both plans' combined company contribution is between 7% and 10% of payroll for other employees. This can vary significantly based on the composition of the employee group.

## Can employers provide higher contributions to some employees?

Yes, cash balance plans can provide for different contribution amounts for various employees.

## Can employers exclude some employees from the plan?

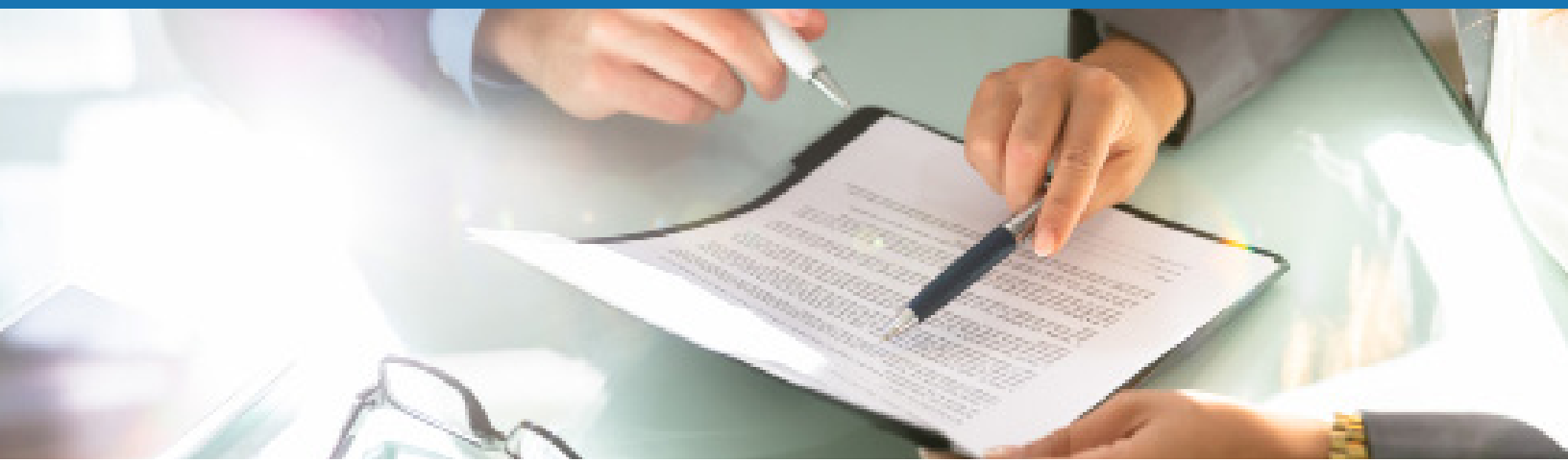
Yes, it is possible to exclude some employees. The plan must pass coverage, participation and nondiscrimination tests, but a wide range of flexibility is available for passing these tests.

## How are annual contributions determined?

Each year, a pension plan actuary calculates a contribution range. The company can contribute and deduct any amount that falls within that range from its taxable income. This range varies from a minimum funding amount to a maximum deductible contribution amount. These amounts are based on rules and assumptions prescribed by the tax code, the IRS, and the plan's actuary. Additional factors that affect funding are:

- Value of the plan assets
- Ages and salaries of participants
- Plan-defined interest crediting rate

The maximum contribution is the annual limit that is deductible to the company. The contributions must be deposited no later than the due date of the business tax return (including extensions) to take a deduction for the contribution. The company may also contribute to the plan throughout the year. It is also possible for the employer to "overfund" the plan in certain years, up to 150% of the value of the earned benefits. This allows a company to take a much larger tax deduction in a "good" year and build up a fund within the plan that can be used to reduce the required contribution in a future year.



## What happens when an employee leaves?

When an employee terminates employment, a distribution of their vested account balance generally becomes available, normally in the year following the year they leave. Under the law, they may choose to receive their account balance paid as an annuity for life, but this option is seldom utilized.

## How do accounts become vested in a cash balance plan?

The plan can require 3 years of employment to be fully vested. If a participant terminates without a vested benefit, the account is forfeited, reducing the amount necessary to fund future contributions.

## What if an employer can't afford to contribute in a certain year?

The plan can be amended to freeze or lower the allocations for a given year if the amendment is adopted before any employee works 1,000 hours (about 5-1/2 months into the year for full-time employees). 15-day advance notice to participants is required before the amendment can be in effect (45 days for plans with 100 or more participants). If the amendment is not made in time for the current year, it can apply to the next year. The minimum required contribution will still have to be made no later than 8-1/2 months after the end of the plan year.

## How does a cash balance plan work with my existing profit sharing 401(k) plan?

Cash balance plans work best when paired with a profit sharing 401(k) plan. Due to the requirements that apply for nondiscrimination, coverage, and participation, the large benefits for owners in a cash balance plan are usually provided through minimum profit sharing contributions for non-owners in the 401(k) plan. This is done so that both plans can be tested together. By doing this, the cash balance plan can also be designed to cover a minimum number of employees required to meet IRS participation requirements. This combination provides much more favorable results to business owners than a standalone cash balance plan. It also provides several other advantages:

- Minimizes the cash balance plan with the company-guaranteed 4% interest credit
- Puts more money in the 401(k)/profit sharing plan, where it can be subject up to a longer vesting schedule (up to 6 years)
- Allows employees to self-direct the profit sharing contribution (most 401(k) plans allow for this)