

BUSINESS OWNERS • TAX STRATEGY

# The Cash Balance Plan

How Some Business Owners Contribute Far Beyond the 401(k) Limit, Pre-Tax

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## Key Takeaways

- A cash balance plan is a type of defined benefit plan, a hybrid between an old-school pension and a 401(k), that can allow much larger pre-tax contributions for the right business owner.
- Contribution limits rise with age and income. An owner in their 50s can potentially contribute well into six figures annually, on top of a 401(k).
- The business, not the participant, bears the investment risk relative to a guaranteed crediting rate, which adds predictability but also obligation.
- The tradeoffs are real: required annual contributions, employee coverage costs, actuarial administration, and a multi-year commitment.

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## Why This Matters

There is a retirement account that can let some business owners contribute well beyond the familiar 401(k) limits and deduct every dollar. It is not a loophole. It is a cash balance plan, and most high-income business owners have never heard of it. This paper explains what it is, who it fits, and the honest drawbacks. It is educational and not individualized tax advice; whether it makes sense depends on facts specific to your business.

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## A Bit of History

For most of the 20th century, large American companies promised employees a defined benefit pension: work here for decades, and we will guarantee a monthly check for life. The company funded it, managed it, and bore the risk. In the 1980s, companies began freezing those plans and 401(k)s took over, shifting the risk and the funding onto employees. But if you own a business, you can build your own version of that old pension, funded with pre-tax dollars. That is essentially what a cash balance plan is.

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## How It Works

A cash balance plan is a defined benefit plan, a hybrid of a pension and a 401(k). Each year the business contributes to the plan, the money goes into a trust and is invested in a standard mix of assets, and the

account grows at a guaranteed crediting rate, often tied to a fixed percentage or something like the 30-year Treasury rate.

Unlike a 401(k), the participant does not bear the investment risk relative to that crediting rate. The plan promises a guaranteed rate; if the investments outperform, the surplus stays in the plan, and if they underperform, the business makes up the difference. For the participant, that means seeing a real dollar balance growing at a guaranteed rate rather than a market balance that can drop sharply in a bad year. Contributions are deductible to the business, and at retirement the balance can be taken as a lump sum or a monthly income stream.

## Why the Numbers Can Be Large

Contribution limits are tied to age and income: the older you are, the more you can contribute, because there are fewer years to fund the promised benefit. An owner in their 50s can potentially contribute a substantial six-figure amount per year, on top of 401(k) contributions. As a simple illustration, a \$250,000 contribution for someone in a high federal bracket could reduce current federal taxes by a meaningful amount, with those dollars then compounding tax-deferred inside the plan. The exact figures depend entirely on age, income, and plan design, and must be calculated by an actuary.

## Why It Works for the Right Person

- The deduction is immediate, reducing taxable income in the year the contribution is made.
- It is an accelerator for late starters. If you spent your 30s and 40s building a business rather than maxing out retirement accounts, a cash balance plan can compress years of saving into a shorter window.
- The guaranteed crediting rate adds predictability, which matters most in the years just before retirement when a large drawdown is hardest to recover from.
- Plan assets generally carry strong creditor protection in most states, adding a layer of asset protection.
- It can be stacked with a 401(k) profit-sharing plan, pushing total annual retirement contributions substantially higher for owners in their 50s.

## The Honest Tradeoffs

The cons are real and worth understanding before committing. Cash balance plans require annual contributions; this is not a contribute-when-convenient arrangement, so volatile income is the biggest practical risk. Because the business bears investment risk relative to the crediting rate, a poor market year can require additional contributions to make up the gap. If you have employees, the IRS requires covering eligible ones, and depending on headcount and compensation that cost can be meaningful. Administration costs more than a 401(k) because an actuary must calculate contributions each year. And

it is not a short-term tool; these plans work best run for at least five to ten years, and setting one up only to shut it down after two can create problems and costs.

## Who This Fits

The profile that makes the most sense is a business owner or self-employed professional, generally 45 or older, with consistent high income, a relatively small number of employees, and a genuine tax problem to solve. Physicians, attorneys, consultants, and real estate professionals with steady fee income are common candidates. If you are in your 30s, still growing revenue, or carrying a large employee base, the calculus changes; it may still work, but it needs to be modeled against your specific situation.

*The point isn't that everyone needs a cash balance plan. It's that if you're writing large checks to the IRS every April and no one has ever raised this with you, it's worth a conversation.*

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## References and Sources

The following sources support the figures, rules, and statements described in this paper. They are provided for verification and for compliance review.

Internal Revenue Service. "Cash Balance Plans." IRS.gov. <https://www.irs.gov/retirement-plans/cash-balance-plans>

Internal Revenue Service. "Choosing a Retirement Plan: Defined Benefit Plan." <https://www.irs.gov/retirement-plans/choosing-a-retirement-plan-defined-benefit-plan>

U.S. Department of Labor, Employee Benefits Security Administration. "Types of Retirement Plans." <https://www.dol.gov/general/topic/retirement/typesofplans>

Internal Revenue Code §415 (limitations on benefits and contributions) and §401(a).

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