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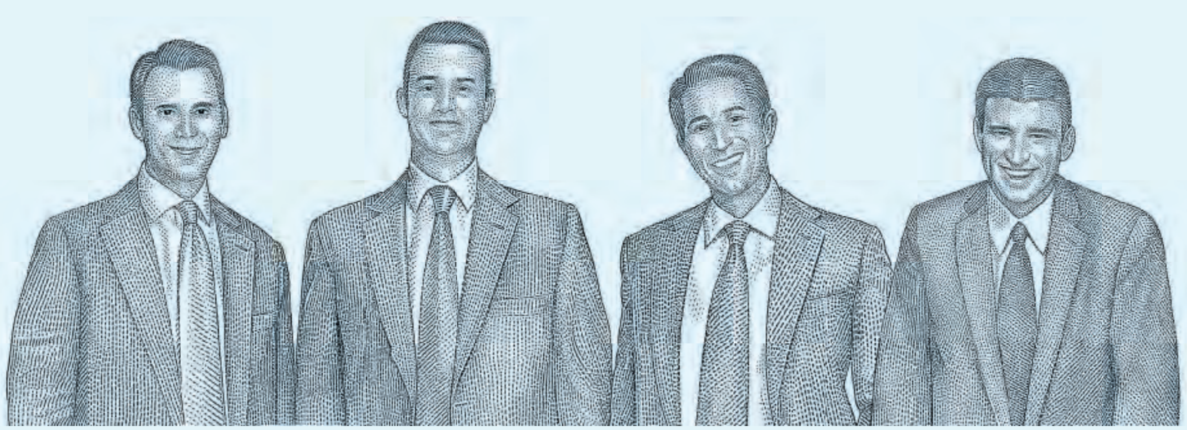
Can cash balance plans give my tax savings a tax-advantaged boost?

BY KEVIN R. LUCHETTA, CFP®, AEP®, PARTNER



Left to right: *Kevin R. Luchetta, Paul D. Tortorella, Stephen A. Schwartz, James L. DiNardo*

PIONEER FINANCIAL AT NORTHWESTERN MUTUAL – PARK AVENUE | 245 Park Avenue, Suite 1800, New York, NY 10167 | 646.459.6366

TEAM
Kevin R. Luchetta, CFP®, AEP®, Partner
Stephen A. Schwartz, CFP®, AEP®, Partner
James L. DiNardo, CLU®, ChFC®, CFP®, MSFS®, Partner
Paul D. Tortorella, Partner

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Stephen A. Schwartz, 14 years
James L. DiNardo, 14 years

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EMAIL
kevin.luchetta@nm.com
stephen.schwartz@nm.com
james.dinardo@nm.com

WEBSITE
www.pioneer.financial

ILLUSTRATION BY KEVIN SPROULS

In 2014, many of the country's high-income earners will retain less of their earnings than in previous years. With the top federal income tax bracket now standing at 39.6 percent—before state and city taxes, payroll taxes and the lost value of deductions—many high-income earners are finding themselves in a tax quandary.

As a result, many of these individuals and their financial advisors are searching for tax-favorable ways to shield their income and boost retirement contributions.

Currently, two of the most popular retirement plan options are 401(k)s and profit-sharing plans. The 2014 contribution limit for a 401(k) is $17,500 per year for an individual and for those 50 or older, $23,000 with catch-up contributions.

Profit-sharing plans increase that limit by an additional $34,500 annually. Even with a 401(k) and a profit-sharing plan in place, because both are "defined contribution" plans, the maximum amount individuals under 50 can contribute is $52,000 per year or $57,500 for those qualifying for the catch-up provision.

For many high-income earners, these limits mean that an individual can make roughly $570,000 of deductible contributions over a ten-year period. For most people, that is hardly enough to begin to set up the financial future they're dreaming of. Accordingly, many individuals are turning to "defined benefit" plans, especially cash balance plans.

Cash balance plans are gaining popularity within the retirement industry, due to plan flexibility and the ability to put away more than the maximum permitted with defined contribution plans only. By combining cash balance plans with a 401(k) and a profit-sharing plan, participants can rely on an additional annual benefit of up to $210,000 (in 2014).

Because this is an ultimate benefit limit, not a contribution limit, the amount the employer can contribute and deduct varies according to factors like age and assumed growth rate. But generally, the deductible amount is higher the closer the participant is to retirement age, and the larger the assets. Typically, business owners design a plan to take maximum tax deductions, while complying with required nondiscrimination testing.

The beauty of a cash balance plan—as opposed to many traditional defined benefit plans—is that once participants leave the company, they can take their vested balance with them. Many clients then roll their balance into an IRA or new 401(k).

Individuals participating in only 401(k)s and profit-sharing plans simply aren't taking advantage of the tax deductions currently available. While putting away about $570,000 over a 10-year period into defined contributions plans is a great start, high-income earners near retirement should consider the substantial additional contributions they can make to a cash balance plan. ●

> "By combining cash balance plans with a 401(k) and a profit-sharing plan, participants can rely on an additional annual benefit of up to $210,000."

promised benefit. What's important is that whatever contribution amount is actuarially determined, it may be 100 percent deductible in addition to the deductible contributions to the existing 401(k) and profit-sharing plans.

Beyond that, a cash balance plan is just a defined benefit pension plan providing retirement benefits to qualified participants, based on a hypothetical account balance for each individual. This makes the plan look and feel like a profit-sharing or 401(k) plan.

An employer works with a plan actuary to designate contribution amounts for each individual or segment of employees. The plan administrator invests the plan

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Kevin R. Luchetta, CFP®, AEP®
Partner

Stephen A. Schwartz, CFP®, AEP®
Partner

James L. DiNardo, CLU®, ChFC®, CFP®, MSFS®
Partner

Paul D. Tortorella
Partner

Pioneer Financial at Northwestern Mutual – Park Avenue
245 Park Avenue, Suite 1800
New York, NY 10167
Tel. 646.459.6366

kevin.luchetta@nm.com
stephen.schwartz@nm.com
james.dinardo@nm.com
www.pioneer.financial

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