CASH BALANCE PLANS

A RETIREMENT PLAN THAT PROVIDES VALUABLE TAX DEDUCTIONS & INCREASES LONG-TERM WEALTH

IMPACT ON QUALIFIED BUSINESS INCOME DEDUCTION

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SOLE-PROP EXAMPLE

(PART 1)

Laura is a sole-proprietor of an accounting firm, and is married to Justin. Together, they report annual taxable income of $460,000.

How can a cash balance plan help in creating additional tax savings under the new qualified business income (QBI) deduction?

ANALYSIS

	No Cash Balance Plan	With Cash Balance Plan
Total Taxable Income	$460,000	$460,000
Retirement Contributions	-0-	$145,000
QBI Deduction*	-0-	$31,000
Net Taxable Income	$460,000	$284,000
Net Federal Taxes	$111,000	$57,000

* Assumes sole proprietor's pass-through income is $300,000

The $145,000 retirement contribution benefits the sole-proprietor by:

(1) Lowering the taxable income below $321,400 to **take advantage of the QBI deduction** that otherwise would not have been available based on their taxable income,
(2) **Lowering federal taxes** by $54,000, and
(3) Providing **cash flow relief** ($54,000) to help fund the retirement contribution.

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THE POWER OF TAX DEFERRAL

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SOLE-PROP EXAMPLE
(PART 2)

Buidling on our sole-proprietor example, not only does Laura receive an immediate tax reduction, but by saving in a retirement plan, her long-term wealth is significantly higher.

How can a cash balance plan help in creating long-term wealth?

ANALYSIS – Assumes 7% annual investment return and 22% effective tax rate throughout 25-year time period

	No Cash Balance Plan	With Cash Balance Plan
Investable Income	$91,000*	$145,000
Value after 25 Years	$343,744	$786,978
Less Taxes	-0-	$173,135
After-Tax Wealth	$343,744	$613,843

*** Taxes are $54,000 higher without the $145,000 cash balance contribution; therefore, there is less investable income**

Investing in a retirement plan allows tax deferred build-up which provides significant value:

(1) Because Laura reduced her tax bill by $54,000, she can invest more dollars today, and
(2) Even when the future tax rate is the same as today's tax rate, more long-term wealth is accumulated because of the delay in taxation on her initial contribution and her investment returns. With the plan, she earns 7% each year until her contributions are distributed. Without the plan, she earns a net return of 5.46% since investment returns would be subject to taxation at the assumed 22% effective tax rate. In our example, without the cash balance plan her after-tax investment return is $252,744* and with the plan it is $468,843**.

* $252,744 = $343,744 less $91,000 (initial investment)
**$468,843 = $613,843 less $145,000 (initial contribution)