Cash Balance Corner:

Cash Balance Compliance: "Takin' Care of Business"

Welcome back to DWC's Cash Balance Corner! If you're joining us for the first time, our Cash Balance Plans 101 is an FAQ that provides an overview. This and all subsequent editions of the Corner will use that as a foundation to build from. Where applicable, we include links for easy access to resources with additional information or explanation. If you are not familiar with cash balance plans (or if you would like a quick refresher), please check out that FAQ first. So, let's get started!

Wow! We have covered a lot of ground over the last few entries, learning about how cash balance benefits are earned and funded. So far, our plan sponsor Robert Smith, Inc. has dealt with the complexities of an owner-only plan. Now, it's time to take a step back to take a look at some of the more mundane-sounding but still very important administrative-type requirements that apply to owner-only plans.

Plan Document

All qualified retirement plans are required to have a written plan document that describes how the plan will be operated. This applies to all plans, whether they cover a single participant or 100,000 participants. Participants cannot earn benefits and plan sponsors cannot make contributions (or deduct them) until this legal plan document is signed.

Starting with tax years beginning after December 31, 2020, companies have until the due date of their tax returns (including extensions) to sign a plan document to establish a new plan. However, we still recommend adopting by the end of the tax year.

In addition to adoption of the initial plan document, the IRS generally requires all plans to update their documents approximately every six years to incorporate regulatory and legislative changes. This process is known as "restating" the plan document, and the most recent cash balance restatement deadline was July 31, 2020.

Separate Trust

Qualified plan assets cannot be combined with those of the plan sponsor or any other plans. They must be held in a separate trust account in the name of the plan. If a company has multiple plans – think a 401(k) plan and a cash balance plan – each plan must have its own trust account.

There have been debates among practitioners about whether obtaining a Trust ID Number (TIN – similar to an EIN except for the plan) is mandatory. Since TINs are generally only necessary when making distributions and owner-only plans won't make any payouts for a while, it is not critical to immediately obtain a TIN. Another option that avoids the need for a TIN altogether is to contract with a paying agent to issue the distributions and handle the appropriate tax reporting.

Form 5500

All plans with non-owners (ERISA plans) must file a Form 5500 each year. Owner-only plans are only required to file beginning the year in which they have more than $250,000 in total assets as of the last day of that year. We should note that the $250,000 threshold is based on the combined asset levels of all plans sponsored by the same company. Again, assuming Robert Smith, Inc has both a 401(k) plan and a cash balance plan, we would add together the total assets of both plans as of the last day of each year to determine whether they exceed the $250,000 filing limit.

Even when a filing is required, the plan must file a streamlined version called the Form 5500 EZ. However, since the EZ cannot be filed electronically, some business owners choose to file the same 5500-SF as ERISA plans, as it can be faster and easier to submit as well as providing immediate confirmation of acceptance via the Department of Labor’s online filing portal.

PBGC Coverage

We could write an entire entry on PBGC coverage. Oh, wait, we already did! Most owner-only plans are not covered by PBGC. Some weird coverage rules come into play when the business owner hires his or her spouse in a non-community property state, but we will spare you those details.

Otherwise, it is safe to assume that all owner-only plans are exempt from paying for PBGC coverage. While this does represent a cost-savings, as we discussed in a previous installment of the Corner, that also means any company contributions to the 401(k) plan are typically limited to 6% of plan compensation.

Funding Deadlines

Owner-only cash balance plans must follow the same funding deadlines that apply to plans that have other participants. For minimum funding purposes, the contribution must be deposited no later than 8 ½ months following the end of the plan year (September 15th for calendar year plans). To be deductible, the company must deposit the contribution no later than its tax filing deadline (with extensions).

AFTAPs

There are cash balance rules written by Congress that do not make a lot of sense for owner-only plans but must be followed, nonetheless. The Adjusted Funding Target Attainment Percentage (AFTAP) notice is one such rule. It is a notice provided to the plan sponsor by the Enrolled Actuary. It is due by the end of the 9th month of the plan year.

If the plan’s funded percentage is below 80%, it cannot pay out lump sum distributions. If it drops below 60%, not only are lump sums prohibited, but all additional benefit accruals are frozen. Most owner only plans are very well funded, so the restrictions should never apply. However, if the AFTAP is not provided timely, then the plan is deemed to be only 60% funded for the rest of the year.

The actuary cannot complete the AFTAP until all contributions for the prior year are fully deposited, so typically, the only time an AFTAP is not provided timely is when a plan sponsor does not timely provide contribution verification or census data for the previous year. There is no penalty for being deemed 60%, but since the plan remains in that status for the rest of the year (even if the AFTAP is provided before the end of the year), it is best to provide the necessary information to complete the AFTAP timely.

What’s Next?

It turns out that Robert has hired an employee. That will introduce some additional requirements and complexities. The cash balance plan has a one-year waiting period before this new hire will be eligible, so that gives Robert some time to plan ahead before he has to worry about those additional requirements. In the next edition of the Corner, we will start to look at what Robert has to look forward to.