



What is a Profit Sharing Plan?

A Profit Sharing Plan is a defined contribution plan under which the employer has the flexibility to contribute between 0% and 25% of eligible participant’s compensation. This contribution may be allocated based on salary, age, service or a combination of these factors. Profit sharing plans typically require more administration and paperwork than a Simplified Employee Pension or an IRA and may include yearly IRS filings. However, unlike those arrangements, participants may be forced to remain employed for several years before they own 100% of their account balance. At the time of retirement, the ultimate benefit is based on the participant’s account balance. Below is a description of the different types of contribution allocations under this type of plan as well as some sample illustrations.

Pro Rata: Each participant’s contribution is based on the same percentage of his/her compensation.

Integrated: A base contribution is given based on compensation up to the plan’s integration level. An additional contribution is given based on compensation above the integration level. The integration level is general the Social Security taxable wage base. This favors higher paid employees by providing the additional share of the contribution to be based on compensation that would otherwise accrue minimal social security benefits or none at all. This type of allocation should be used to provide larger proportionate contributions to higher paid employees that are the same age or younger than other employees.

New Comparability: Also called Cross-Tested, a New Comparability allocation tends to skew the contributions to the older, more highly paid employees. Participants are divided into different classifications. Contributions between classification groups may vary provided they follow the general testing rules for nondiscrimination (e.g., all participants must receive a minimum gateway contribution.) This type of plan involves complicated calculations and may require actuarial consulting, but it still less expensive and more flexible than a defined benefit plan. Employee demographics play a key roll in this type of plan, and any changes may affect the allocations greatly.

Name	Age	Annual Salary	Pro Rata	% of Pay	Integrated	% of Pay	New Comparability	% of Pay
Owner	57	\$330,000	\$66,000	20%	\$ 66,000	20%	\$ 66,000	20%
Ann	48	\$105,000	\$ 21,000	20%	\$ 17,920	17%	\$ 5,250	5%
Bea	32	\$ 65,000	\$ 13,000	20%	\$ 11,094	17%	\$ 3,250	5%
Cid	25	\$ 30,000	\$ 6,000	20%	\$ 5,120	17%	\$ 1,500	5%
Don	21	\$ 20,000	\$ 4,000	20%	\$ 3,413	17%	\$ 1,000	5%
Total		\$550,000	\$110,000		\$103,547		\$ 77,000	
% to Owner			60.00%		63.74%		85.71%	