# Profit Sharing Plans

- A profit sharing plan is a plan for sharing profits with employees who have contributed to the success of the business.
- The determination as to what constitutes "profit" is at the discretion of the employer. Contributions can be made without regard to net profit.
- The plan provides an account for each participant. These accounts can be kept pooled and invested by the plan sponsor/trustee or can be participant directed.
- The plan must provide a definite formula for allocating the employer contribution among the participants. There are three different types of allocation formulas:
  - Compensation to Compensation (Prorata) – This allocation method provide for all participants to receive an equal percentage of their compensation (up to the total maximum dollar limit in effect for the year).
  - Permitted Disparity – This allocation method allows for participants with earnings in excess of the taxable wage base (the cap on compensation used for paying Social Security Taxes or FICA) to receive an allocation slightly higher than those with earnings below the taxable wage base.
  - Cross-tested (or Tiered) – This allocation method allows for contributions to be allocated amongst different allocation groups (as defined by the employer) in varying amounts as long as the allocation meets certain nondiscrimination tests. To take advantage of this method, the employer must contribute a minimum percentage of compensation (generally 5%) to participants classified as non-highly compensated employees (NHCEs). Typically, these plans are established to provide maximum contributions to the owner. Other highly compensated employees (HCEs) can be limited to a smaller percentage of compensation, depending on the plan's "top heavy" status.
- Forfeitures of non-vested accounts are reallocated to active participants' accounts and can be used to reduce employer contributions.
- Employers have more flexibility in making contributions to a profit sharing plan than any other type of plan.
- Employer contributions are limited to the lesser of 25% of compensation or $50,000. The current compensation limit is $250,000.


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## COMPARISON OF PROFIT SHARING PLAN ALLOCATIONS

| | | | | Profit Sharing Plan Allocation Methods | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Participant** | **HCE** | **Compensation** | **SEP** | **Prorata** | | **Permitted Disparity** | | **Cross-tested** | |
| Owner | Yes | $250,000 | $50,000 | $50,000 | 20% | $50,000 | 20.0% | $50,000 | 20% |
| Employee A | Yes | $115,000 | $23,000 | $23,000 | 20% | $19,611 | 17.1% | $3,450 | 3% |
| Employee B | No | $50,000 | $10,000 | $10,000 | 20% | $8,405 | 16.8% | $2,500 | 5% |
| Employee C | No | $40,000 | $8,000 | $8,000 | 20% | $6,724 | 16.8% | $2,000 | 5% |
| Employee D | No | $30,000 | $6,000 | $6,000 | 20% | $5,043 | 16.8% | $1,500 | 5% |
| | | $485,000 | $97,000 | $97,000 | | $88,783 | | $59,450 | |

| | | | | |
|---|---|---|---|---|
| **Percentage of Contribution to Owner** | **52%** | **52%** | **56%** | **84%** |
| **Contribution to Owner** | **$50,000** | **$50,000** | **$50,000** | **$450,000** |
| **Contribution to Employees** | **$47,000** | **$47,000** | **$39,783** | **$9,450** |

**Plan Features**

| | | | | |
|---|---|---|---|---|
| Vesting Schedule | No | Yes | Yes | Yes |
| Nondiscrimination Testing | No | No | No | Yes |
| Loans Permitted | No | Yes | Yes | Yes |
| Employee A excludable | No | Yes | Yes | Yes |