

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. Typically, these plans are established to provide maximum contributions to the owner. Other highly compensated employees 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.
- For 2008, employer contributions are limited to the lesser of 25% of compensation or \$46,000. The 2008 compensation limit is \$230,000.

LONG BEACH OFFICE

111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802
Telephone: (562) 435-1191
FAX: (562) 495-1665
Contact Richard Green

IRVINE OFFICE

18201 Von Karman Avenue
Suite 1060
Irvine, CA 92612
Telephone: (949) 271-2600
FAX: (949) 660-5681
Contact Therese Cheevers

www.windes.com



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PROFIT SHARING PLANS

COMPARISON OF PROFIT SHARING PLAN ALLOCATIONS

Participant	HCE	Compensation	SEP	Profit Sharing Plan Allocation Methods 2008 Limits					
				Prorata		Permitted Disparity		Cross-tested	
Owner	Yes	\$230,000	\$46,000	\$46,000	20%	\$46,000	20.0%	\$46,000	20%
Employee A	Yes	\$110,000	\$22,000	\$22,000	20%	\$18,967	17.2%	\$3,300	3%
Employee B	No	\$50,000	\$10,000	\$10,000	20%	\$8,414	16.8%	\$2,500	5%
Employee C	No	\$40,000	\$8,000	\$8,000	20%	\$6,731	16.8%	\$2,000	5%
Employee D	No	\$30,000	\$6,000	\$6,000	20%	\$5,048	16.8%	\$1,500	5%
\$460,000			\$92,000	\$92,000		\$85,160		\$55,300	

Percentage of Contribution to Owner	50%	50%	54%	83%
Contribution to Owner	\$46,000	\$46,000	\$46,000	\$46,000
Contribution to Employees	\$46,000	\$46,000	\$39,160	\$9,300

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