

Profit Sharing Plans...An Overview

Description:

Profit sharing plans are not required to have a "definitely determinable benefit" or contribution. As a result, contributions to a profit sharing plan can vary from year to year, at the discretion of the employer. While the employer is not required to make contributions to the plan each year, there must be recurring and substantial contributions in order for the plan to retain its qualified retirement plan status. While the amount of the annual contribution to a profit sharing plan can vary from year to year, once a contribution is made to the plan, it must be allocated to the accounts of plan participants in a uniform, non-discriminatory manner, where it is invested on their behalf. When a plan participant retires, the amount of his or her retirement benefit is then based on the value of the participant's account at retirement.

Profit Sharing Plan Contributions:

The profit sharing plan document specifies how contributions to the plan will be determined. There is considerable flexibility available in this regard. For example, annual contributions can be based on a specified percentage of net profits, or can be equal to the amount by which profits exceed a specified dollar amount, or can be equal to an amount determined by the board of directors each year.

Advantages:

Contributions are based on business profitability or left to the discretion of the board of directors.

The employee assumes the risk of investment performance.

Employees who have an opportunity to share in company profits may be better motivated employees.

Disadvantages:

Since profit sharing plans tend to favor younger employees, who have a longer time period in which their retirement accounts can grow, it may not be possible with a profit sharing plan to provide a substantial retirement benefit to older owneremployees or key employees who have fewer years until retirement.