



RETIREMENT PLANNING

Profit-Sharing Plan

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RETIREMENT PLANNING

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PLEASE NOTE

The Consolidated Appropriations Act, 2021 continues many temporary CARES Act provisions through 2021 to ease access to retirement funds, including:

- ◆ The exception to the 10% early withdrawal penalty for distributions prior to age 59½
- ◆ The elimination of the mandatory 20% withholding requirement on distributions
- ◆ The option to take out up to \$100,000 in a loan or withdrawal (if otherwise allowed under plan provisions)



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PROFIT-SHARING PLAN

SUMMARY

WHAT ARE PROFIT-SHARING ARRANGEMENTS?

Profit-sharing plans are a specific form of qualified retirement plan called a “defined contribution plan” in which the employer makes periodic contributions to the plan. Each employee’s retirement benefit depends on the amount of the employer’s contributions plus the investment performance of each employee’s account.

While the employer is obligated to make the specified contributions, the employee bears the risk of investment performance. These plans may be set up so employees can invest and manage their individual accounts.

HOW DO PROFIT-SHARING PLANS WORK?

A distinguishing feature of profit-sharing plans is that employer contributions are not required every year. However, contributions must be “recurring and substantial.” Contributions in at least three out of every five years usually satisfy this requirement.

The employer has flexibility in determining how and when to make contributions. For example, the amounts can be based on company profits in excess of a certain amount, a percentage of the company’s net income, or an annual determination by the board of directors. While contributions are deductible, they are limited to 25% of the participating employees’ total compensation.

HOW ARE CONTRIBUTIONS DETERMINED?

Employer contributions are often based on the employee’s total compensation, which can include salary, commissions, bonuses, overtime pay, etc. The maximum compensation that can be taken into account is \$290,000 in 2021. The participant’s annual contribution is limited to the lesser of 100% of the employer’s includable compensation or \$58,000 (in 2021).



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WHAT ARE THE BENEFITS?

Profit-sharing plans enjoy the usual advantages of other types of qualified retirement plans, including employer contributions that are tax deductible (within limits) and not taxed to the employee when they're made. Investment earnings also accumulate on a tax-deferred basis.

Profit-sharing plans are generally attractive to companies with relatively young owner-employees, widely fluctuating profits, and a desire to avoid being committed to annual contributions. Another attractive option is the opportunity to include a 401(k) feature that permits employees to make elective salary deferrals to the plan.

Profit-sharing plans offer a convenient, tax-advantaged way to prepare for retirement, while still allowing contribution decisions to be based on sound business practices.



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