How a Traditional Profit Sharing Plan Works

EMPLOYER

- Employer contributions are discretionary and flexible.
- Employer contributions need not be a specified percentage of compensation, nor made each year, as long as they are recurring and substantial.
- Contributions are tax deductible to the business.[1]

TRADITIONAL PROFIT SHARING PLAN

- Employer contributions are not currently taxable to employee and account growth is tax deferred.
- Investment risk remains on employee.
- The forfeited, unvested portion of former employee's accounts may be reallocated to current participants.

EMPLOYEE

- The allocation of contributions to an employee's account in 2015 may not exceed the lesser of 100% of compensation or $53,000 per year.
- The maximum compensation recognized in 2015 is $265,000.[2]
- Employee may be given right to direct investments.

EARLY WITHDRAWAL

- A 10% penalty generally applies if withdrawals are made before age 59½.
- Some exceptions to 10% penalty are available.
- Employee may borrow from plan within certain guidelines if provided for in plan documents.

RETIREMENT

- Distributions must begin by specified date.[3]
- Funds may be distributed as lump sum or periodic payments.
- Distributions are generally taxed as ordinary income and may be eligible for 10-year income averaging or rolled over into an IRA.

DEATH

- Value of account is included in owner's gross estate.
- Proceeds can pass to beneficiaries with payments made over their lifetimes.
- Income and estate taxes can severely reduce funds left to non-spousal beneficiaries.

[1] Up to 25% of covered payroll can be contributed and deducted by the employer.

[2] For those self-employed, compensation is limited to net self-employment income, e.g. gross income less the contribution and the deduction allowed for one-half of the self-employment tax.

[3] Except for 5% owners, distributions must begin by April 1 of the later of (a) the year following the year in which the participant reaches age 70½, or (b) the year following the year in which the participant retires. If the employee is a 5%-or-more owner, withdrawals must begin by April 1 of the year following the year he or she reaches age 70½.