Profit Sharing Case Study

How a business owner can reduce her 401(k) profit sharing costs by $51k per year

Reduction in the owner's annual expense for the profit sharing program

$51,000

At a Glance

Situation

- 62-year-old dentist
- Owns a practice with five employees
- Practice has a Safe Harbor 401(k) with Pro-Rata profit sharing
- Owner wants to reduce profit sharing costs while still contributing $50,000

Possible Benefits

- Reduce owner's annual expense for the profit sharing program by $51,000
- Still allows maximum annual contribution and maximum tax advantages to owner

Challenge

Consider a 62-year-old dentist who has developed a thriving practice over the last 25 years. Along with her five employees, she takes tremendous pride in giving her patients brilliant, radiant smiles.

She has a 401(k) plan with a pro-rata profit sharing component. The challenge is that the pro-rata profit sharing formula is very expensive for her because it requires a significant employer contribution to the employees in order for her to maximize her own contribution. In fact the pro-rata formula requires that she give the employees the same percentage that she gives herself in the plan. This means that in order for her to contribute $50,000 annually to the plan, she must give an employer contribution of ~$68,000 per year to her employees. In some years this is cost-prohibitive, which keeps her from maximizing her own benefits.

She is looking for a more cost-effective approach to profit sharing—one that allows her to maximize for herself, without breaking the bank.

Objective

The practice offers a 401(k) plan with a pro-rata profit sharing component. The structure of the profit sharing program requires significant annual employer contributions to the employees in order for the owner to maximize her benefits.

While she enjoys the benefits of her profit sharing plan, her objectives in the near-term are to:

1. Reduce the annual cost of the profit sharing contributions
2. Continue to maximize her annual retirement contributions

Solution

The practice consults with Fisher Retirement Solutions™ regarding ways to optimize its retirement program.

Fisher\SMB helps the practice evaluate options, like changing their profit sharing formula from pro-rata to new comparability. Making this modification to the existing plan can reduce the annual cost to the practice significantly.

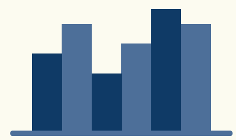
Utilizing a new comparability formula, the total employer cost toward employee contributions decreases from $68,000 to $17,000. The dentist is able to continue contributing $50,000 to her own plan, while reducing her overall costs by $51,000 annually.

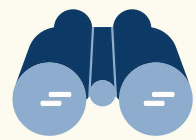
Savings are tax-deferred until withdrawn in retirement. Profit sharing isn't a good fit for every business.

Consult with a professional to help determine if the benefits of profit sharing outweigh the costs for your specific business.

$51K
Reduction in annual profit sharing expenses

$306K
Decrease in profit sharing expenses over 6 years





Results

- **Reduced Profit Sharing Costs**
  The dentist reduces the annual profit sharing cost from $68,000 to $17,000
- **Maintain Maximum Allowable Retirement Plan Contribution**
  She is able to contribute $50,000 into her personal retirement account.

What Is Profit Sharing

Profit sharing is a type of retirement plan contribution that comes from the company. Contributions are flexible from year to year and are a tax-reducing business expense. Earnings grow tax-deferred.

2 Main Types:

	Pro-Rata	New Comparability
How It Works	The most common type of profit sharing. All plan participants get the same contribution level, including the owner.	Can be the most cost-effective for owners. Cross-testing allows owners to potentially receive a substantially higher contribution than rank-and-file employees.

Pro-Rata vs. New Comparability

Employee	Age	Annual Compensation	Pro-Rata	New Comparability	B/W
Owner	**62**	**$250,000**	**$50,000**	**$50,000**	**-**
Employee 1	45	$100,000	$20,000	$5,000	**-$15,000**
Employee 2	45	$75,000	$15,000	$3,750	**-$11,250**
Employee 3	40	$75,000	$15,000	$3,750	**-$11,250**
Employee 4	35	$50,000	$10,000	$2,500	**-$7,500**
Employee 5	25	$40,000	$ 8,000	$2,000	**-$6,000**
TOTAL EMPLOYER CONTRIBUTION			**$118,000**	**$67,000**	**-$51,000**
% to Employer			**42%**	**75%**	**+33%**
% to Employees			**58%**	**25%**	**-33%**

This is based on a hypothetical illustration. Results will vary by company.

Are You a Fit for a New Comparability Profit Sharing Plan?

	Better Fit	Poorer Fit
What is the owner:employee ratio?	< 1:25	> 1:25
Owner Age vs. Employee Age	Owner Is Older	Employees Are Older
Business is willing to give ~5% to non-owner employees	Yes	No
Owner's W2 income is higher than non-owner employees	Yes	No

Profit Sharing Benefits & Risks

Benefits

- Allows for maximum cost-effective employer contributions into the plan—up to $70,000 per year ($77,500 if age 50 or older).
- Contributions to the plan are flexible, and are a tax-reducing business expense.
- A vesting schedule of up to 6 years can be added to profit sharing contributions.

Risks

- In order for the owner to receive the maximum benefits, there may be a required employer contribution to eligible employees.

Helpful Resources

Safe Harbor Case Study

Learn how to maximize your personal annual retirement contribution with a Safe Harbor 401(k).

Tax Savings Guide

Learn how to unlock the IRS tax benefits available to you by downloading our free Tax Savings Guide.

Cash Balance Guide

Download this guide to learn how to leverage a Cash Balance Plan for huge tax savings.

Give us fifteen minutes and we'll consult on an actionable plan to optimize your retirement program for tax savings. Some oners may be able to reduce their profit sharing expenses by more than $50,000 per year.

Contact Us

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