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Making a Profit Sharing Plan Work for Small Business Owners

By Douglas C. Radcliffe, CFP®, CLU®

Today's retirees face financial challenges unlike ever before. Longer life expectancy, inflation, turbulence in the stock market and a lack of personal savings can create the perfect retirement storm. Although no magic formula exists, there are some steps small business owners can follow to help them reach financial independence.

Combining a New Comparability profit sharing plan with a 401(k) allows individuals age 50 or older to contribute up to \$54,500 per year in pretax dollars in 2011. Small business owners in higher income tax brackets could potentially save \$18,000 or more per year in taxes. At \$54,500 per year, it doesn't take long to build a sizeable nest egg, not to mention accumulate tremendous tax savings. A few rules apply when combining the two, but the basic concept gives older, highly compensated employees — who have fewer years remaining to build up retirement funds — the option to make larger contributions.



Below is a sample Small Business census utilizing a New Comparability plan with a 401(k) plan. The hypothetical company consists of eight employees, including the owner who earns an annual salary of \$245,000 of \$490,000 in total payroll. As shown, each employee receives a company contribution equal to 4.5% of his or her annual income, and the owner 13.27% (see PS% column). "ER PS column," or Employer Profit Sharing, shows the dollar amount the company contributes to the plan. In this scenario, the 60-year-old owner receives a contribution of \$32,000 in addition to qualifying for the maximum pretax deferral of \$16,500 plus an additional "catch up" of \$5,500 allowed to those 50 years of age and older for a total benefit of \$54,500. Adding the \$9,900 in deferrals for non-highly compensated employees brings total tax deductible dollars to \$64,400, with nearly 85% of this amount going to the owner.

If the owner took the \$64,400 in personal income the taxes would be around \$24,400, so the bottom-line translates to only around \$44,000 in his or her pocket. This shows that the New Comparability plan is a great way to put money away for retirement, help your employees fund their retirement, while also saving substantial tax dollars.

Doug Radcliffe is a Senior Financial Planner and owner of Invest Central of San Antonio. Invest Central specializes in working with business owners. Security products and financial planning services offered through New England Securities, member FINRA/SIPC and a registered investment advisor. Invest Central is not affiliated with NES.

Plan features:

There is a surprising amount of flexibility in the plan's design to help meet the needs and goals of different businesses:

- A plan can accommodate different classes of employees. For example, management can be separated and given a higher level of profit sharing.
- Within limits, contributions can be based on years of employee service, thereby encouraging and rewarding longevity.
- Employers can attach a vesting schedule that requires an employee to stay with the company for a set number of years before receiving a certain portion of retirement earnings.

More options are available, and so it is wise for business owners to seek advice from a CPA, pension administration firm as well as a financial planner with small business owner experience to design the right plan for their situation.



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**Sample Small Business
NEW COMPARABILITY PLAN WITH A 401(k)
3% CONTRIBUTION SAFE HARBOR 401(k)**

* HCE Deferrals

** NHCE Deferrals AS SHOWN

	COMP	ER CONT	%of TOT
*HCE	\$245,000.00	\$54,500.00	84.63%
**NHCE	\$245,000.00	\$9,900.00	15.37%
TOT	\$490,000.00	\$64,400.00	100.00%

43,525 24,750 5,500 73,775

Name	HCE	COMP	Class	PS%	ER PS	Deferral	Catch up	Match	TOT ALLOC
60 yr old Owner	y	245,000	Owner	13.27%	32,500	16,500	5500		54,500
40 yr mgr	n	60,000	MGR	4.50%	2,700	4,200			6,900
50 yr old staff	n	40,000	Staff	4.50%	1,800	1,200			3,000
45 yr old staff	n	35,000	Staff	4.50%	1,575	1,050			2,625
40 yr old staff	n	30,000	Staff	4.50%	1,350	900			2,250
35 yr old staff	n	30,000	Staff	4.50%	1,350	900			2,250
30 yr old staff	n	25,000	Staff	4.50%	1,125				1,125
25 yr old staff	n	25,000	Staff	4.50%	1,125				1,125
* Highly Compensated Employees- owner									
** Non Highly Compensated Employees									

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