



## CASE OF THE WEEK

### Profit Sharing Contribution Allocation Formulas

Our ERISA consultants on the Columbia Management Learning Center Resource Desk regularly receive calls from financial advisors on a broad array of technical topics related to IRAs and qualified retirement plans. For example, through our relationship with the Columbia Management Learning Center, we routinely guide Columbia Management's financial advisor partners through the IRS rules and regulations that govern contributions to profit sharing plans.

A recent call with a Merrill Lynch advisor in Connecticut is representative of a common scenario involving employer profit sharing contributions. The advisor asked: **In a profit sharing plan, is it possible to contribute at a greater rate for higher paid employees than for rank-and-file employees?**

#### Highlights of Recommendations

- The plan must provide a definite, predetermined formula for allocating the contributions made to the plan among its participants (Treas. Reg. §1.401-1(b)(1)(ii)).
- There are five basic types of profit sharing contribution allocation formulas: 1) flat dollar; 2) pro rata; 3) integrated (a.k.a., Social Security or permitted disparity); 4) age-weighted; and 4) new comparability.
- Integrated, age-weighted and new comparability formulas allow plan sponsors to contribute at a greater rate for select groups of employees.
- Age-weighted and new comparability plans use special nondiscrimination testing rules (i.e., "cross-testing") to meet nondiscrimination requirements.
- The Retirement Learning Center maintains a library of retirement plan documents for employers from across the country, and prepares plan "snapshot" summaries that include key plan features such as details on the plan's contribution allocation formula. Financial advisors may gain access to the plan document library by working with their Columbia Management wholesaler.
- The following table summarizes the contribution allocation formula options.

Flat Dollar	Pro Rata	Integrated
<p>The same dollar amount is given to all eligible participants.</p>	<p>Each participant's contribution is based on the same percentage of his/her compensation.</p>	<ul style="list-style-type: none"> <li>▪ A base contribution is given based on compensation up to the plan's integration level.</li> <li>▪ An additional contribution is given based on compensation above the integration level.</li> <li>▪ The integration level is generally the Social Security taxable wage base.</li> <li>▪ Contributions must fall within the IRS's permitted disparity guidelines.</li> <li>▪ Other names: Social Security, permitted disparity</li> </ul>
Age-Weighted		New Comparability
<ul style="list-style-type: none"> <li>▪ The contribution is based on a formula that considers each participant's age and compensation.</li> <li>▪ The allocation is weighted in favor of older participants.</li> <li>▪ Contributions are converted to equivalent benefits payable at normal retirement age to verify they are nondiscriminatory in nature.</li> </ul>		<ul style="list-style-type: none"> <li>▪ Participants are divided into rate groups.</li> <li>▪ Contributions between rate groups may vary provided they follow the cross-testing rules for nondiscrimination (e.g., satisfy a minimum gateway contribution).</li> <li>▪ Contributions are converted to equivalent benefits payable at normal retirement age to verify they are nondiscriminatory in nature.</li> </ul>

### Conclusion

There are five basic profit sharing allocation formulas, and the plan document must specify which one the sponsoring employer will follow. Financial advisors can use the variety of allocation options as a way to start conversations with plan sponsor prospects. For example, for employers who value simplicity, a flat dollar or pro rata formula may be the appropriate choice. For employers who want to be able to contribute at a greater rate for older employees, an age-weighted formula might be the ticket. And if an employer wishes to contribute more for higher paid employees, while still complying with IRS nondiscrimination requirements, an integrated or new comparability allocation formula may make sense. Financial advisors who can demonstrate their knowledge of the various profit sharing allocation formulas set themselves apart from the average advisor and, thereby, win more retirement plan business. As always, the Columbia Management Learning Center is ready to help.