DEFERRED COMPENSATION PLANS

BY

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PREFACE

This subject was selected because of my interest in deferred compensation plans, especially as to their federal income tax aspects.

In addition, the writer wishes to express appreciation to the many Nebraska firms for their cooperation in the completion of this study.
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INTRODUCTION

There are literally thousands of qualified deferred compensation plans in existence and, understandably, there are a number of rules which must be complied with to obtain Treasury Department approval of a qualified plan. One might think that all pension and profit-sharing plans would contain fairly common provisions at least as they relate to the same type of plan. Such is not the case because, while many of the Treasury Department rules in this area are quite specific—for example, in setting out how much may be deducted from an employer's income, most of the rules are "guideline" in nature. It seems they were designed to allow a company to "fit" a plan to its particular needs. Therefore, there are about as many different plans as there are companies who have them. The one overriding requirement that all qualified plans must adhere to is that the plans must be for the sole benefit of employees and the plan must not discriminate in favor of officers, shareholders and highly compensated or supervisory employees.
The distinction between a qualified and a non-qualified plan should be reviewed. However, except for these brief remarks nothing more will be said concerning non-qualified plans. The difference between a qualified and a non-qualified plan is in the tax treatment accorded to them. Under a qualified plan an employer is permitted to deduct currently the costs of the benefits but the employees are not taxed until the benefits are received. Under non-qualified plans the employer may or may not get a current deduction and the employee may or may not have to reflect the amount in his income currently. It is generally true that if an employer receives a deduction currently, the employee is taxed at the same time. And, conversely, if the employer does not receive a current deduction, it will generally follow that the employee is not taxed until a later date.

There are several requirements specified in the Internal Revenue Code which must be met to obtain Internal Revenue Service approval of a plan, but these will be covered in detail in later chapters. In general, pension, profit-sharing and stock bonus plans can be categorized as different types of deferred compensation plans. Looking closer, however, would require even the casual observer
to note a few basic differences in the types of plans and the reasons for adopting one in preference to another. A profit-sharing plan is particularly adaptive to provide incentive compensation, deferred compensation, retirement benefits or a combination of the three. Stock bonus plans can be used to fulfill essentially the same objectives as a profit-sharing plan. A pension plan, however, would more generally be chosen if the company's primary objective is to provide only retirement benefits. A liberal vesting rate could be provided for in a pension plan and cause it to be an attractive vehicle for providing deferred and even incentive compensation not normally thought of being applicable to such plans. The cost of maintaining a rapidly vesting pension plan could be prohibitive because the contributions cannot be based on profits and if a firm had a number of poor profit years "back-to-back," the cost of such a plan might be impossible for the company to bear.

Before reviewing the different types of qualified plans, it might be well to review a few of the reasons why any plan is adopted and why one type may be preferred to another.
CHAPTER I

ROLE OF DEFERRED COMPENSATION PLANS

Plan or No Plan

It has been said that deferred compensation plans provide the opportunity for every man to be a capitalist. No one is unaware of the two divergent views that exist in the world today which are struggling with one another in the "cold war." American industry has done much to bolster the confidence of one element of the struggle by making the average employee a real part of our individual capitalistic system. Aside from any moral considerations, American industry has attempted to reward employees in proportion to the contributions that they continually make towards not only helping a particular company prosper but, just as important, to foster well-being for the economy as a whole. To a large degree they have done this through deferred compensation arrangements.

The concept of profit sharing is not an American innovation. "A Frenchman by the name of M. Edme Gean LeClaire (1801-1872), a Parisian house painter, is generally
recognized as the 'Father of Modern Profit Sharing'."¹

Even though profit sharing was a successful tool for Mr. LeClaire, it goes without saying that the adoption of a profit-sharing plan is no panacea for all of a company's problems, and history has borne out the fact that many plans have not been successful and finally had to be abandoned.

It would seem to be academic to discuss the relative merits of having some type of deferred compensation or none at all. Most of our larger firms, at this stage in our industrial development, are not really faced with the problem of whether they wish to have a plan. Instead, they must decide as to the type and the amount of benefits they "must" afford in order to attract and keep qualified personnel. It must be remembered that "to attract and retain competent people a company must pay salaries that are competitive in the market place regardless of the quality or extent of its supplementary compensation program."² A deferred compensation program

cannot be a substitute for a sound and adequate salary administration plan.

Type of Plan

Once the current compensation of employees is reasonable and competitive, any excess compensation may better serve both the employee and the employer if it is deferred. The major deferred compensation arrangements can be classified into three groups: namely, (1) profit-sharing, (2) pension and (3) stock bonus plans. Each of the three types will be discussed later under separate chapter headings. One overriding principle applies to all of these plans and that is that they should be considered by a particular company with a view as to how to obtain the maximum benefits for the lowest cost. Certainly it is of no benefit if a plan's provisions are so onerous that in the long run the employer is forced out of business because its services or products cannot be marketed competitively because of a burdensome fringe benefit package.

The adoption of a plan in many instances permits the employer to receive the benefit of a person's services during his productive years and it allows the company to
provide that employee with some measure of security once he becomes superannuated. "One of the earliest and principal purposes of employers in adopting pension plans was to promote economy and efficiency by replacing older employees with younger, more energetic and alert employees. Pensions were regarded as less costly than keeping unproductive employees on the payroll."³

Some writers in this area contend that pension plans are valued by some employers as a means of inducing longevity and identification with the employer. However, this is exactly the reason why some companies prefer not to have such plans as they desire and encourage rapid employee turnover. Many companies use both pension and profit-sharing plans as inducement for employees not to unionize, and in instances where a firm is already unionized, pressure to adopt a qualified plan may come from the union itself. While much can be said for the merits of deferred compensation plans, in practice much improvement is needed so that the "average" employee can expect to receive some type of retirement benefit from a qualified plan adopted by his employer. Part of the problem stems

from the relatively short job tenure for men in our country. As late as 1963 "average job tenure for men was 5.7 years." Accordingly, plans requiring many years before any vesting takes place or vesting only upon retirement would effectively exclude many employees from ever qualifying for much of a retirement benefit from any employer's plan. In theory, slow or no vesting, except on retirement, is supposed to provide a retention factor for covered employees, but such is not always the case. And, the absence of vesting leaves the mobile employee at a disadvantage. This is especially hard for some employees to accept, especially when one must consider that often their mobility is not of their own choosing. In our age of advanced technology and rapid obsolescence, employees working in industries that are considered "old line" and established today may find themselves in a dying industry tomorrow.

Employee turnover results from the interaction of many factors. Much of the literature on the subject may give the impression that the young, inexperienced and restless employees change jobs and that the mature, skilled and reliable employees stay put. But many impersonal factors account for large numbers of job separations. Obviously employment conditions, the state of the market, and a firm's competitive position

4 Ibid., p. 66.
affect separations and quits as well.  

Profit sharing advocates believe a carefully designed, equitable profit-sharing plan creates a direct link between employees' self-interests and corporate objectives. They claim profit sharing both demonstrates and encourages partnership and industry. True profit sharing is not a static concept—-a redistribution of existing profits, but rather a dynamic concept—-a creation of "efficiency earnings" (extra profits) in which all can share. Profit sharing is an extra reward for added cooperative activity over and above the regular line of duty.

It cannot be assumed that profit sharing will automatically solve any of a firm's problems. As a matter of fact, many times organized labor objects on the grounds that such plans depress wages, involve too much worker risk, and undermines union prestige among the workers. The effectiveness with which a company is able to administer its profit-sharing plan determines management's attitude toward such a plan. If a plan meets with success that can be measured "objectively" in terms of increased profits, better employee morale, et cetera, then the plan will be deemed to be a success. On the other hand, companies have decided that profit sharing plans actually work to the disadvantage of the

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5 Ibid., p. 69.
6 Metzger, op. cit., p. 13.
firm and in certain instances have been discontinued. For example, "the General Electric program which was operated for thirteen years was a profit percentage plan. It was abandoned because management felt too many employees participated in the profit distribution to make it an effective incentive." In the General Electric case, management felt that the union was bargaining for the same current salary as was being paid by other firms for comparable work even though the other firm did not have a profit-sharing plan. Apparently the company felt that its workers, with profit sharing as an incentive, were no more productive than the other firms' since General Electric desired to add the amount they contributed to the profit-sharing plan to the salary base for comparison purposes. General Electric also felt that "the small size of the share, especially in comparison to the extra compensation awarded company executives under a separate program, made the plan particularly subject to worker dissatisfaction."8

The presence of a profit-sharing plan may actually be a detriment to a company, especially in years when an

8Ibid., p. 144.
employee's profit sharing allocation is nominal. Couple this with a decline in value of the assets in the trust account of the employee and the effect on morale can be profound. The fact that a company may experience difficulty receiving benefits from one type of qualified plan does not mean that another type would be equally unsuccessful.

A stock bonus plan, for the most part, would have the same appeal and provide the same benefits as a profit-sharing plan and, conversely, be subject to the same limitations. In the final analysis it remains for each company to establish a "compensation package" that fits its particular needs. What may work for one company or, for that matter, what one company sets for its objective in this area usually is substantially different from another. For example, it might be foolhardy for a company that is extremely profitable, irrespective of employee participation and dedication, to adopt a profit-sharing plan. In those instances a company may simply wish to provide an adequate retirement program for long-term employees and distribute the "excess" earnings to its owners.

The growth of private plans is accelerating even
though there is considerable government effort at the present time to subject them to more restrictive legislation. The fact remains that workers like the private plans and it seems certain that they will continue to grow and expand in the future. At this time, what the government's final proposal will be in this area is merely conjecture. However, one would be safe in assuming that it is going to be vigorous in its attempt to eliminate provisions in the tax law that are deemed discriminatory in favor of special groups. Another point is that many people believe that qualified plans are not simply the business of just one firm and its employees. "An equally important theme is that the public and the government have a special interest in these plans by virtue of the loss in tax revenue resulting from the special incentives granted to them under the federal tax law."  

Since we are discussing qualified plans, it is

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important to keep in mind that because of the beneficial treatment presently accorded such plans by the federal tax law, companies do have an obligation to not only be fair and equitable with their employees but also to their government and fellow citizens alike. With this in mind, a discussion of the various qualified deferred compensation arrangements will be discussed in the subsequent chapters.
CHAPTER II

PROFIT SHARING

General

The comments in this chapter relate only to qualified profit-sharing plans. As mentioned previously, non-qualified deferred compensation plans are generally not desirable, especially from the employer's point of view, since it cannot receive a current federal income tax deduction unless, of course, the benefits are non-forfeitable and, therefore, taxed currently to the employee. In addition, the earnings of a non-qualified plan are subject to current taxation.

The phrase "qualified profit-sharing plan" has reference to a plan that meets the express requirements of Section 401 of the Internal Revenue Code. The prime benefit of such qualification means that the employer obtains an immediate federal income tax deduction for the amount contributed under the plan while the employee is not taxed until some later date. Another substantial benefit for employees is the fact that tax-free earnings
of the amounts set aside under the plan are permissible.

Some of the more important advantages of a profit-sharing plan over a pension plan with reference to both the employer and the employee are listed below.

1. Employer
   a. The employer is not required to make contributions in low profit years.
   b. Payments to the fund are, in a sense, based on ability to pay—high earnings coincide with a higher contribution and, conversely, low earnings permit a lower contribution.
   c. It encourages employees to be more creative and imaginative in trying to increase the profitability of the company.
   d. Employers are not threatened with a contingent liability as might be possible under a pension plan.

2. Employees
   a. Employees can benefit from investment growth, especially in times of inflation. (This is possible in certain types of pension plans.)
b. More distribution flexibility is available under a profit-sharing plan.

c. Employee's desire for recognition is more easily satisfied because he relates the results of his efforts to company profits.

Plan Fundamentals

The regulations state that a qualified profit-sharing plan is "a plan established and maintained by an employer to provide for the participation in his profits by his employees or their beneficiaries. The plan must provide a definite, predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment. . . . A profit-sharing plan within the meaning of Section 401 is primarily a plan of deferred compensation, but the amounts allocated to the account of a participant may be used to provide for him or his family incidental life or accident or health insurance."10

10Federal Income Tax Regulations, Section 1.401-1 (b)(1)(ii).
The Internal Revenue Service will insist that the plan be established and operated for the exclusive benefit of a company's employees and their beneficiaries. A Treasury Department Revenue Ruling provides in part that a qualified plan must be a definite written program setting forth all provisions essential for qualification. In addition the same ruling provides that in cases of a trusteed plan there must be a valid trust, complete in all respects and recognized as such under the applicable local law.\textsuperscript{11}

The establishment of a qualified plan must be communicated to the company's employees. The Internal Revenue Service requires that employees must be apprised of the establishment of a qualified plan and the salient provisions thereof. It also states that the most effective way of providing such notification is to furnish each employee with a copy of the plan.\textsuperscript{12} It is doubted that such a procedure is followed in most cases. It seems that a better approach of advising employees is


\textsuperscript{12}Ibid., Part 2(i), pp. 101-02.
to furnish them with a handout that covers the most important points in nonlegalistic terminology. If the handout procedure is followed, it is mandatory that the abbreviated material furnished to each employee make reference to the fact that a copy of the complete plan may be inspected at a designated place and time.

No employer should embark upon the establishment of any type of qualified plan unless it has been decided to steadfastly follow through with proper execution of such plan. "The term 'plan' implies a permanent as distinguished from a temporary program. Thus, although the employer may reserve the right to change or terminate the plan, and to discontinue contributions thereunder, the abandonment of the plan for any reason other than business necessity within a few years after it has taken effect will be evidence that the plan from its inception was not a bona fide program for the exclusive benefit of employees in general. . . . The permanency of the plan will be indicated by all of the surrounding facts and circumstances, including the likelihood of the employer's ability to continue contributions as provided under the plan. In the case of a profit-sharing plan, other than
a profit-sharing plan which covers employees and owner-employees, it is not necessary that the employer contribute every year or that he contribute the same amount or contribute in accordance with the same ratio every year."

The regulations state to the general effect that contributions may be used by the trustees to purchase any investments permitted by the trust agreement to the extent allowed by local law. The investments must be made for the primary purpose of benefiting employees and their beneficiaries. For example, while the trust may (and often does) invest in stock of the employer corporation, this investment may not be made for the primary purpose of aiding the employer corporation or its shareholders but rather the investment must be consistent with the exclusive benefit-of-employees requirement.

Employee Coverage

It should again be emphasized that a qualified profit-sharing plan must be for the exclusive benefit of

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13 Federal Income Tax Regulations, Section 1.401-1 (b)(2).

employees and, therefore, must be operated for the welfare of employees in general and must not be used for the exclusive benefit of shareholders, officials, or highly paid employees. The two basic requirements set forth in the Internal Revenue Code provide that there must be sufficient nondiscriminatory coverage of employees and there must be nondiscrimination in contributions or benefits. It appears that in actual practice the Service is more flexible relative to the nondiscriminatory coverage requirements than it is with the nondiscriminatory contributions or benefit requirements.

The Internal Revenue Code provides a mathematical test of coverage to determine if the plan qualifies. The law requires that the plan actually cover:

(1) 70% or more of all employees or

(2) 80% or more of all eligible employees if 70% of all employees are eligible.

The following employees may be excluded under either (1) or (2) above:

(1) Employees who have not been employed more than a minimum period prescribed by the

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plan—not exceeding five years.

(2) Employees whose customary employment is for not more than 20 hours in any one week.

(3) Employees whose customary employment is for not more than five months in a calendar year.

Operation of Plan

In most profit-sharing plans a definite formula is provided for determining the amount of profits to be contributed yearly. However, such a provision is not required by the Internal Revenue laws. Generally the yearly employer's contribution is limited to 15% of the compensation of the employees who participate in the plan. While there is no maximum limit that may be contributed to the plan, only 15% of the participants' compensation will be allowed as an income tax deduction to the employer. Any excess contributions can be carried forward for possible future deductions. In most cases it is desirable to have the plan provide for a definite formula for determining the profits to be contributed to the plan. The absence of a definite formula requires that the accrual-basis employer take action prior to the year end to insure deductibility of its contribution.
Although the employer's contribution does not have to be determined according to a definite formula, it should be noted that "all contributions to a profit-sharing plan must be allocated among participants, and must be allocated in accordance with a definite formula contained within the plan." The formula for allocating the employer's contribution may give weight to years of service, total compensation or a combination of both of these plus other factors. In any case, the contributions cannot be such that the plan will discriminate in favor of officers, shareholders, supervisors or other highly compensated employees.

The Internal Revenue Code does not require vesting other than a participant's account balance must fully vest at normal or stated retirement age or at any earlier termination of the plan. Since, in most businesses, it is common for the "prohibited" group of employees to work longer for the company, this group does, in practice, often times share in more forfeitures. Therefore, if vesting is delayed to a significant degree, an element of discrimination often "creeps" into a plan.

As a result, some Internal Revenue Service offices require at least partial vesting prior to normal retirement age. Many plans provide for 10% vesting per year for each year of participation in the plan plus complete vesting upon death prior to retirement and in cases of total and permanent disability.

According to the federal income regulations, the only requirement with respect to forfeitures is that they not be allocated among participants in a discriminatory manner. At this time the Internal Revenue Service would prefer to have forfeitures used to reduce future employer contributions but whatever provision is made for forfeitures, they must not result in prohibited discrimination. Many plans in existence provide for allocating forfeitures in proportion to the employee account balances but this is presently in disfavor with the Service since the prohibited group will have built up proportionately larger account balances and thus benefit most from the forfeitures.

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As previously discussed, a plan must provide a definite, predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan. Some of the common methods of distributing the plan proceeds are:

1. Lump sum payments
2. Variable periodic payments
3. Fixed periodic payments

Tax Consequences

The importance of a qualified deferred compensation arrangement such as a profit-sharing plan is highlighted by the tax benefits to both the employee and the employer. First, as to the employees, if the plan is a qualified one, the employee is not required to include the employer's contribution to the plan in his current income. An exception to nontaxability exists when part of the employer's contribution is used to buy life insurance and to the extent that it represents the cost of the pure insurance element of the payment, it is considered income. ¹⁹

¹⁹Federal Income Tax Regulations, Section 1.72-16 (b).
With the exception of a lump-sum payment of the employee's account (which is entitled to capital gain treatment\(^\text{20}\)), any amount distributed or made available to the employee during the year is taxed at ordinary income under the annuity rules of Internal Revenue Code Section 72. In such case the employee's own contribution is considered to be his cost of the annuity and a proportionate share of each payment is considered return of this cost, and the balance is considered ordinary income.

Generally under a lump-sum settlement non-cash distributions are includible in income to the extent of their fair market value. However, in instances where securities of an employer corporation are distributed, deferral of tax is permitted until disposition of the security occurs. Deferral is allowed to the extent of any appreciation in the value of such security while it was held by the trust.\(^\text{21}\)

The advantages of a qualified plan do not inure to the benefit of the employees only. The significance

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\(^{20}\)Ibid., Section 1.402(a)-1(a)(6)(i).

\(^{21}\)Ibid., Section 1.402(a)-1(b).
of a qualified profit-sharing plan to an employer means that an immediate tax deduction can be obtained for its contributions to the plan even though the employee can defer reporting such amount until they are distributed or made available to him at a later date. The employer must make sure that it not only complies with the laws regarding qualified deferred compensation plans, but it also must not violate the "reasonable allowance for compensation for services actually rendered" in order to obtain a current deduction. Contributions are, therefore, deductible under a qualified plan "only to the extent that they are ordinary and necessary expenses during the taxable year in carrying on the trade or business or for the production of income and are compensation for personal services actually rendered."\(^2\)

The primary limitation other than the ordinary and necessary expense rule relates to the 15% of compensation otherwise paid or accrued during the taxable year by the employer to the employees. Generally the deductions are allowable only for the year in which the contributions are actually made by the employer even though

\(^{22}\) Ibid., Section 1.404(a)-1(b).
it may make its tax return on the accrual method of accounting. The laws do permit an accrual-basis tax-payer to claim a deduction for any payment made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

As a rule the earnings of a trust forming a part of a qualified profit-sharing plan are exempt from taxation. This feature, of course, is one of the reasons why a qualified plan has considerable merit in a company's overall deferred compensation program. Tax-free earnings, therefore, are a cause for a much more rapid increase in corpus in which the employees will benefit than would be the case if earnings of the trust were taxed currently. For that matter, there would not be any benefit in having a qualified plan if the trust's income were considered taxable. The reason is that a taxable trust is taxed at the higher individual rates, whereas most employees would be entitled to the lower joint return rates provided under the law.

23 Internal Revenue Code, 1954, Section 404(a)(6).
CHAPTER III

PENSIONS

General

Similar to a profit-sharing plan, a qualified pension plan permits the employer to obtain an immediate income tax deduction with a corresponding deferral of income tax on the funds so contributed as far as the employee is concerned. A pension plan within the meaning of Section 401(a) of the Internal Revenue Code is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. The amount of retirement benefits and the company contributions to the plan are not dependent upon profits. The regulations hold that benefits are not definitely determinable if funds arising from forfeiture on termination of service, or other reasons, may be used to provide increased

benefits for the remaining participants.

The retirement benefits most often are measured by, and based on, such factors as years of service and compensation received by the participants.

Some of the more important advantages of a pension plan over a profit-sharing plan with reference to both the employer and employee are listed below:

1. Employer
   a. Since vesting provisions usually are more stringent under pension plans, the "retention power" is greater.
   b. Because of the stringent vesting requirements, the pension plan may have a more favorable "experience" and thus be less costly to an employer.
   c. Past service can be recognized and this helps to improve employee relations, especially with the older employees.

2. Employees
   a. Since past service can be recognized, older employees are usually well satisfied with a pension plan.
b. A definite retirement program is established with stated benefits payable upon retirement that many employees prefer over the contingent amounts payable under a profit sharing-arrangement.

c. No danger of retiring at a "slump" in the market and thus losing substantial benefits.

Some of the common types of pension plans are group annuity, individual annuity, convertible life insurance, trusteeed and deposit administration. In any case it must be remembered that the primary purpose for establishing a pension plan is to provide for adequate retirement benefits. If the benefits are too low, many of the advantages sought such as retention of employees, improved employee relations, et cetera, will be lost.

Plan Fundamentals

A plan will, for the purposes of Section 401(a), be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of many purchase pension plans, such contributions are
fixed without being geared to profits. A money purchase plan was not mentioned in the preceding section, but it should be noted that companies which may have limited funds available for expenditures for a pension plan sometimes adopt "money purchase" plans. Under this type of a plan both the employer and the employee make contributions which are fixed as a percentage of the employee's salary and usually an annuity is purchased with the funds available. The important thing in this regard is to remember that the amount contributed cannot be based on profits.

Disability and incidental death payments through insurance or otherwise are permissible under a pension plan. However, a plan will not qualify if provisions are made for payments of benefits not customarily included in pension plans such as layoff benefits or benefits for sickness, accident or similar outlays.

As is true of other qualified plans, the term "plan" implies a permanent as distinguished from a temporary program. The employer has the right to change or terminate the plan, but the discarding of the plan for

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25 Ibid., Section 1.401-1(b)(1)(i).
reasons other than business necessity within a few years will probably cause the Internal Revenue Service to hold that the plan was not instituted for the exclusive benefit of employees in general. Especially will this be true if, for example, a pension plan is abandoned soon after pensions have been fully funded for persons in favor of whom discrimination is prohibited under Section 401(a). 26

Again, as in the case of a qualified profit-sharing plan, a pension plan must be communicated to the employees. In brief, each employee must be advised of the more important provisions of the plan, and he is to be notified of the place and time where the complete plan may be inspected.

Contributions to a pension plan are based on the cost of the benefits under the plan except for money purchase plans in which case contributions are fixed.

Employee Coverage

A pension plan is equally as restrictive as a qualified profit-sharing plan in the matter of discrimination. The contributions and benefits under the plan

26 Ibid., Section 1.401-1(b)(2).
must not discriminate in favor of employees who are officers, shareholders, supervisors or other highly compensated employees. The Internal Revenue Service is concerned not only that the plan was nondiscriminatory at the time of its inception but, also, that discrimination does not creep into the plan through actual operation. While there are objective tests as to the number of employees that must be covered, the existence of discrimination is somewhat difficult to prove and can be the subject of controversy between the company and the government. Generally speaking, there is considerable latitude in determining who is to be permitted to come under the provision of the plan; but, in any case, the employer must always be alert to the fact that the Internal Revenue Service will look especially close for discriminatory treatment in favor of officers, shareholders, et cetera. However, a plan will not be considered discriminatory merely because it excludes employees whose sole compensation is subject to social security taxes or because it is limited to salaried or clerical employees.

Operation of Plan

Since contributions under a pension plan are not
a determinant of profits, there is no specific employer's limitation on the contributions under the plan as there is in profit-sharing arrangements. There is a requirement that the benefits under a pension plan be "definitely determinable" and the regulations state that "benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants."\(^{27}\) As a matter of fact, the requirement that the benefits be definitely determinable normally precludes a fixed contribution. However, in some instances the Internal Revenue Service will permit fixed contributions where the contributions are based on an actuarial computation.

An employer does have contribution limitations that cannot be exceeded in any one year under a qualified pension plan. The law allows as a deduction the greater of the following during the taxable year:\(^{28}\)

1. Five percent of the compensation paid or accrued to all employees under the trust,

\(^{27}\)Ibid., Section 1.401-1(b)(1)(i).

\(^{28}\)Internal Revenue Code, 1954, Section 404a(1).
assuming this is reasonably necessary to fund the plan, plus an amount to fund past and current service credits on a level basis over the remaining future service of the participants, or

2. An amount equal to the normal cost of the plan plus ten percent of the cost of funding past service credits until completely funded.

The Internal Revenue Code does not require vesting of a participant's balance other than it must fully vest at normal or stated retirement or at any earlier termination of the plan. This same requirement is equally applicable to profit-sharing plans. The Internal Revenue Service prefers some sort of graduated vesting prior to retirement age, and a few pension plans have such a provision. The employer, of course, has good reason to limit vesting rights because it does serve to substantially reduce company contributions. Since forfeitures of employee account balances under a pension plan must be used to reduce future contributions, there is a greater tendency to eliminate vesting provisions. Under a profit-sharing arrangement, however, forfeitures
can be allocated to the remaining participants and most profit-sharing plans do provide for graduated vesting of the account balances. The reason for more instances of vesting relating to profit-sharing plans is based on the fact that contributions are based on a percentage of profits. As a result there is little incentive to restrict contributions to the plan since presumably the percentage-of-profit figure originally set is one that the company feels is realistic and the forfeitures represent "frosting on the cake" to long-term employees.

It is obvious that the absence of vesting in a pension plan can be very inequitable to comparable employees, one of which dies a short period before retirement age and the other a short period after. In the case of the person who dies before retirement age, neither he nor his beneficiaries would receive anything under the plan; whereas the one who died a short period after retirement age would receive his entire benefits. The company, in adopting a pension plan and setting the vesting rules, should attempt to be as equitable as possible to all employees, keeping in mind that so doing could substantially increase the cost of the pension plan to the company. In any case it would appear that
the company has a continuing obligation to inform employees of the provisions of the plan and at least attempt to impress upon them the company's objectives in providing the plan, and the part the plan is designed to fulfill in providing employee benefits.

In summary, a qualified pension plan must provide definitely determinable retirement benefits. In addition it may provide disability and incidental death benefits. A few of the common methods of distributing the benefits under the plan are:

1. Lump sum payments
2. Joint and survivor pensions
3. Monthly life benefits

Tax Consequences

The same general tax benefits that are available under qualified profit-sharing plans are equally applicable to qualified pension plans. Under a qualified plan the employer is allowed to deduct from current income amounts contributed to the plan, subject to the statutory limits, and the employee is not taxed on the amounts contributed in the year the payments are made but rather is taxed at the time of distribution. The
exception to the nontaxability provisions of employer contributions to the employee does not cover the term cost of life insurance under the plan. "The cost of the life insurance protection under such contract shall be included in the gross income of the participant for the taxable year or years in which such contributions or earnings are so applied." There is a further overriding test which must be met regarding contributions to the plan and that is the amounts, when considered with the employee's current salary, must be reasonable in nature to be deductible.

A lump sum distribution under a qualified pension plan, under certain circumstances, entitles the employee to long-term capital gain treatment. If the total distributions payable with respect to any employee are paid to or includible in the gross income of the distributee within one taxable year of the distributee on account of the employee's death or separation from the service, or death after such separation from service, the amount of such distribution, to the extent it exceeds the net amount

29 Federal Income Tax Regulations, Section 1.72-16 (b)(2).
contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months. If amounts are received other than as a lump sum distribution, the income is taxed as ordinary income under the annuity rules of Internal Revenue Code Section 72. This simply means that the employee's own contribution is considered to be the cost of his annuity and a proportionate amount of each payment is considered return of cost and the balance is taxed as ordinary income. If an annuity or insurance contract has a cash surrender value, such value will not be considered income to the employee unless and until the contract is surrendered. A transferable annuity contract issued after 1962 is taxable, however, unless made nontransferable within 60 days after its distribution.

The same rules that apply to a profit-sharing plan are applicable to pension plan contributions in that the employer must actually make the payments to the plan prior to the time prescribed by law for filing the

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return including extensions thereof.
A qualified stock bonus plan is governed essentially by the rules pertaining to profit-sharing plans. The regulations refer to a stock bonus plan as a "plan established and maintained by an employer to provide benefits similar to those of the profit-sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company. For the purpose of allocating and distributing the stock of the employer which is to be shared among his employees or their beneficiaries, such a plan is subject to the same requirements as a profit-sharing plan." 32

Nothing more will be said about this type of plan because the rules and regulations pertaining to profit-sharing plans are equally applicable to stock bonus plans.

Some of the salient features of a stock bonus

32 Ibid., Section 1.401-1(b)(1)(iii).
plan can be summarized as follows:

1. Employer contributions are not necessarily dependent upon company profits.

2. Distributions under the plan must be made in stock of the employer company.

3. Contributions to the plan can be made in employer stock thus providing means for preserving cash.

4. This type of a plan provides an effective vehicle for taking advantage of the benefits of Section 402; that is, upon distribution, the employee is not immediately taxed on the appreciated value of the employer company stock while it was held by the trust.
CHAPTER V

SURVEY OF FIRMS

In an effort to determine the extent firms in Nebraska made use of qualified deferred compensation arrangements, it was decided that 70 firms would be furnished a questionnaire which was designed to elicit certain basic information concerning their plans. An attempt was made to pick firms representing most of the major industries throughout the state. Also an effort was made to select only corporations since that entity is the only type which would be able to establish the three qualified deferred compensation plans under study.

Of the seventy questionnaires that were sent out, thirty-eight of the firms were kind enough to complete and return them. This fifty-four percent affirmative response to the questionnaire was considered excellent because it would require a review of the plan to supply the answers due to the nature of the data requested. A few of the firms that did not have any type of qualified
plan did indicate that their firm had a cash bonus arrangement. This indicates that those firms recognize the benefit of sharing the profits, but probably chose not to go into a qualified plan for reasons of administration.

Of the thirty-eight firms answering the questionnaire, fourteen indicated that they did not have any type of qualified plan. However, as previously mentioned, a few of these firms did have some type of a bonus arrangement. Table 1 reveals that most of the firms not maintaining any type of qualified plan were relatively small in size. In terms of numbers, the majority had less than fifty employees. It should be mentioned that as some of these firms grow, it is entirely possible that they will establish some type of qualified plan. This can be verified by referring to Table 2 and noting that many of the firms that now have qualified plans were in existence several years before such arrangements were adopted.

Of the twenty-four companies answering the questionnaire that maintained some type of qualified plan, nine chose the profit sharing route. Included with profit sharing for this purpose was a thrift plan which is not,
### Table 1

**DATA SUPPLIED BY FIRMS NOT MAINTAINING ANY TYPE OF QUALIFIED DEFERRED COMPENSATION PLAN**

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Number of Employees</th>
<th>Year Business Started</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust Company</td>
<td>5</td>
<td>1952</td>
</tr>
<tr>
<td>Tabulating Card Manufacturer</td>
<td>38</td>
<td>1958</td>
</tr>
<tr>
<td>Manufacturer</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Advertising Agency</td>
<td>15</td>
<td>1932</td>
</tr>
<tr>
<td>Outdoor Advertising</td>
<td>25</td>
<td>1963</td>
</tr>
<tr>
<td>Construction Equipment</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Foundry</td>
<td>40</td>
<td>1883</td>
</tr>
<tr>
<td>Real Estate</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Television Broadcasting</td>
<td>45</td>
<td>1954</td>
</tr>
<tr>
<td>Construction</td>
<td>12</td>
<td>1963</td>
</tr>
<tr>
<td>Metal Processing</td>
<td>70</td>
<td>*</td>
</tr>
<tr>
<td>Printing</td>
<td>18</td>
<td>1948</td>
</tr>
<tr>
<td>Truck Body Manufacturer</td>
<td>85</td>
<td>1946</td>
</tr>
<tr>
<td>Radio Station</td>
<td>8</td>
<td>1965</td>
</tr>
</tbody>
</table>

*Unknown
<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Type of Plan</th>
<th>Number of Employees</th>
<th>Number of Employees in Plan</th>
<th>Year Business Started</th>
<th>Year Plan Started</th>
<th>Integrated with Social Security</th>
<th>Normal Retirement Age</th>
<th>Early Retirement Age</th>
<th>Basis of Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dairy &amp; Snack Foods</td>
<td>Profit Sharing</td>
<td>604</td>
<td>90</td>
<td>1884</td>
<td>1956</td>
<td>No</td>
<td>65</td>
<td>60</td>
<td>Executive, administrative &amp; professional</td>
</tr>
<tr>
<td></td>
<td>Pension</td>
<td></td>
<td></td>
<td></td>
<td>1956</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>All other full time employees</td>
</tr>
<tr>
<td>Industrial Distributor</td>
<td>Profit Sharing</td>
<td>140</td>
<td>80</td>
<td>1879</td>
<td>1956</td>
<td>No</td>
<td>65</td>
<td>None</td>
<td>Age 23 &amp; 3 yrs service</td>
</tr>
<tr>
<td>Smelter &amp; Refiner</td>
<td>Profit Sharing</td>
<td>60</td>
<td>60</td>
<td>1907</td>
<td>1952</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>15 mo continuous service</td>
</tr>
<tr>
<td>Banking</td>
<td>Profit Sharing</td>
<td>368</td>
<td>133</td>
<td>1896</td>
<td>1957</td>
<td>No</td>
<td>65</td>
<td>62</td>
<td>Age 28 &amp; 2 yrs service</td>
</tr>
<tr>
<td></td>
<td>Pension</td>
<td></td>
<td></td>
<td></td>
<td>1949</td>
<td>No</td>
<td>65</td>
<td>62</td>
<td>Age 25</td>
</tr>
<tr>
<td>Construction Machinery Dealer</td>
<td>Profit Sharing</td>
<td>70</td>
<td>60</td>
<td>1938</td>
<td>1957</td>
<td>No</td>
<td>65</td>
<td>60</td>
<td>1 yr service</td>
</tr>
<tr>
<td>Flour &amp; Feed Manufacturer</td>
<td>Profit Sharing</td>
<td>1800</td>
<td>300</td>
<td>1929</td>
<td>1957</td>
<td>Yes</td>
<td>65</td>
<td>60</td>
<td>Full time employee with 4 yrs service</td>
</tr>
<tr>
<td>Professional Services</td>
<td>Profit Sharing</td>
<td>430</td>
<td>200</td>
<td>1918</td>
<td>1951</td>
<td>No</td>
<td>62</td>
<td>None</td>
<td>Based on service; length not provided</td>
</tr>
<tr>
<td>Department Store</td>
<td>Profit Sharing</td>
<td>3000</td>
<td>1200</td>
<td>1890</td>
<td>1966</td>
<td>No</td>
<td>65</td>
<td>62</td>
<td>Regular employee with 4 yrs service</td>
</tr>
<tr>
<td>Insurance</td>
<td>Thrift Plan</td>
<td>655</td>
<td>602</td>
<td>1887</td>
<td>1967</td>
<td>No</td>
<td>65</td>
<td>62</td>
<td>Age 30 or 5 yrs service</td>
</tr>
<tr>
<td>Sheet Metal Fabricator</td>
<td>Pension</td>
<td>700</td>
<td>Unknown</td>
<td>1934</td>
<td>Unknown</td>
<td>Yes</td>
<td>65</td>
<td>None</td>
<td>10 yrs service</td>
</tr>
<tr>
<td>Heavy Equipment Dealer</td>
<td>Pension Plan</td>
<td>125</td>
<td>58</td>
<td>1945</td>
<td>1956</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>Age 30 &amp; 5 yrs service</td>
</tr>
<tr>
<td>Insurance-Life/Health/Accident</td>
<td>Pension Plan</td>
<td>3591</td>
<td>1214</td>
<td>1909</td>
<td>1944</td>
<td>No</td>
<td>65</td>
<td>60</td>
<td>Age 30 &amp; 5 yrs service</td>
</tr>
<tr>
<td>Type of Business</td>
<td>Type of Plan</td>
<td>Number of Employees</td>
<td>Number of Employees in Plan</td>
<td>Year Business Started</td>
<td>Year Plan Started</td>
<td>Integrated with Social Security</td>
<td>Normal Retirement Age</td>
<td>Early Retirement Age</td>
<td>Basis of Eligibility</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>--------------</td>
<td>---------------------</td>
<td>-----------------------------</td>
<td>-----------------------</td>
<td>-------------------</td>
<td>-------------------------------</td>
<td>----------------------</td>
<td>---------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>Meat Slaughtering &amp; Processing</td>
<td>Pension Plan</td>
<td>1600</td>
<td>Unknown</td>
<td>1885</td>
<td>1916</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>15 yrs service</td>
</tr>
<tr>
<td>Utility</td>
<td>Pension Plan</td>
<td>949</td>
<td>894</td>
<td>1912</td>
<td>1944</td>
<td>Yes</td>
<td>65</td>
<td>55</td>
<td>1 yr service</td>
</tr>
<tr>
<td>Feed Dehydration</td>
<td>Pension Plan</td>
<td>40</td>
<td>14</td>
<td>1945</td>
<td>1958</td>
<td>No</td>
<td>65</td>
<td>None</td>
<td>5 yrs service</td>
</tr>
<tr>
<td>Transportation</td>
<td>Pension Plan</td>
<td>32000</td>
<td>2650</td>
<td>1868</td>
<td>Unknown</td>
<td>No</td>
<td>65</td>
<td>None</td>
<td>Non-union officer in supervisory position</td>
</tr>
<tr>
<td>Utility</td>
<td>Pension Plan</td>
<td>1256</td>
<td>1200</td>
<td>1946</td>
<td>1946</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>1 yr service; not eligible if hired after age 55</td>
</tr>
<tr>
<td>Insurance-Life/Health/Accident</td>
<td>Pension Plan</td>
<td>202</td>
<td>89</td>
<td>1901</td>
<td>1928</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>Age 30 &amp; 1 yr service</td>
</tr>
<tr>
<td>Manufacturing -- Hourly Plan</td>
<td>Pension Plan</td>
<td>305</td>
<td>220</td>
<td>1946</td>
<td>1961</td>
<td>No</td>
<td>65</td>
<td>55 &amp; 20 yrs ser</td>
<td>1 yr service</td>
</tr>
<tr>
<td></td>
<td>Salaried Plan</td>
<td>91</td>
<td>40</td>
<td>1961</td>
<td>Yes</td>
<td>After 20 yrs ser</td>
<td>65</td>
<td></td>
<td>3 yrs service</td>
</tr>
<tr>
<td>Food Manufacturer</td>
<td>Pension Plan</td>
<td>200</td>
<td>130</td>
<td>1914</td>
<td>1946</td>
<td>No</td>
<td>65</td>
<td>None</td>
<td>Age 25 &amp; 5 yrs service</td>
</tr>
<tr>
<td>Manufacturer</td>
<td>Pension Plan</td>
<td>450</td>
<td>225</td>
<td>1937</td>
<td>1967</td>
<td>No</td>
<td>65</td>
<td>55</td>
<td>1 yr service--salaried &amp; non-union</td>
</tr>
<tr>
<td>Utility</td>
<td>Pension Plan</td>
<td>25000</td>
<td>25000</td>
<td>1920^</td>
<td>1913^</td>
<td>Yes</td>
<td>65</td>
<td>Men 60 &amp; Women 55</td>
<td>Regular employment with company</td>
</tr>
<tr>
<td>Banking</td>
<td>Pension Plan</td>
<td>364</td>
<td>175</td>
<td>Unknown</td>
<td>1952</td>
<td>Yes</td>
<td>65</td>
<td>55</td>
<td>Age 25 &amp; 1 yr service</td>
</tr>
<tr>
<td>Savings &amp; Loan Association</td>
<td>Pension Plan</td>
<td>60</td>
<td>43</td>
<td>1885</td>
<td>1960</td>
<td>No</td>
<td>65</td>
<td>None</td>
<td>Age 25 &amp; 3 yrs service</td>
</tr>
</tbody>
</table>

^Predecessor companies had plan in operation.
technically speaking, a profit-sharing arrangement. This means that, of the firms answering the questionnaire that maintained some type of plan, thirty-eight percent of them were profit sharing in nature. Seventeen of the firms had a pension plan in existence which represents seventy-one percent of the twenty-four maintaining some type of qualified plan. The percentage of the two plans in existence total in excess of one hundred because of the fact that two companies maintained both a profit-sharing and a pension plan. Also one firm established a separate pension plan for each of its hourly and salaried employees.

Table 2 sets forth some of the basic information provided by all of the firms answering the questionnaire. Most of the information supplied in this table is self-explanatory. However, in a few instances the number of employees shown represents only the company employees working in Nebraska. In other cases the number of employees represents the total employment both within the State and without.

In looking down the column relating to the number of employees in the plan, in many instances it appears that only a small portion of the employees benefit from
these plans. However, in only one questionnaire did any firm indicate that any eligible employees elected not to join the plan. Accordingly, one can assume that eventually most of the employees will come under the provisions of the plan once they have satisfied the age and/or years of service requirement as designated by the plan.

In two instances, the plan provided coverage for a certain type of employee and the number of employees shown for the company represents the total company employment figure. It should not be inferred that the rest of the employees are not covered by any type of plan because, on the questionnaire, it was stated by one company that union personnel came under another plan and the information submitted related only to management people. In further analyzing Table 2, it is obvious that the adoption of qualified deferred compensation arrangements did not become popular until some time in the 1950's.

Only one profit-sharing plan was integrated with Social Security, while five pension plans had benefits that were integrated. Most of the plans had some minimum period of service that had to be fulfilled before becoming eligible, and in a good number of the plans there was some restriction relative to age before a person could become
eligible.

Table 3 is a statistical supplement to Table 2 of firms maintaining profit sharing plans. In reviewing this table it must be kept in mind that an attempt was made to use all of the information supplied even though it was not real informative in certain cases.

There will be some doubt as to the meaning of some of the information shown. However, the writer attempted to make the table as meaningful as possible consistent with the data received. It is apparent that, of the firms adopting the profit-sharing arrangement, no firm required an employee, as a condition for joining, to contribute excessively to the plan. For the most part, no employee contribution was required or if it was, it represented a relatively small percent of his total salary. The company contribution in the majority of cases was based in some manner on the participant's earnings. From a review of the vesting provisions, it is apparent that the firms are fairly liberal in this regard. In all cases where it is determinable from the answers supplied, an employee's account balance will be entirely his in fifteen years or less except in one case where it would take twenty years.
<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Basis of Contribution Employer</th>
<th>Basis of Contribution Employee</th>
<th>Basis of Allocation of Company Contribution</th>
<th>Method of Allocating Forfeitures</th>
<th>Vesting</th>
<th>Methods of Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dairy &amp; Snack Foods</td>
<td>Variable % of pre-tax profits after dividend requirements</td>
<td>None</td>
<td>Participant's earnings</td>
<td>Participant's yrs of service</td>
<td>None 1-3 yrs; 10% per yr thereafter</td>
<td>Lump sum; periodic payments; purchase of annuity</td>
</tr>
<tr>
<td>Industrial Distributor</td>
<td>From 15-33% of pre-tax profits after deducting 5% of net worth</td>
<td>None</td>
<td>1 unit each $100 regular annual salary; ½ unit for each yr of service</td>
<td>Ratio of participant's acc balance</td>
<td>10% per yr</td>
<td>Lump sum</td>
</tr>
<tr>
<td>Smelter &amp; Refiner</td>
<td>5% of pre-tax profits not to exceed 15% of participant's wages</td>
<td>None</td>
<td>1 unit each $100 annual salary</td>
<td>Unknown</td>
<td>None 1-6 yrs; graduated thereafter</td>
<td>Purchase of annuity (including joint &amp; survivor); lump sum in certain instances</td>
</tr>
<tr>
<td>Banking</td>
<td>Certain % net profits</td>
<td>None</td>
<td>Unknown</td>
<td>Unknown</td>
<td>20% per yr</td>
<td>Lump sum</td>
</tr>
<tr>
<td>Construction Machinery Dealer</td>
<td>Match employee's contributions not to exceed 10% of profits</td>
<td>2-5% of wages</td>
<td>Match participant's contribution</td>
<td>Participant's yrs of service</td>
<td>% ea yr not provided; 100% after 10 yrs</td>
<td>Lump sum or some other method at employee's discretion</td>
</tr>
<tr>
<td>Flour &amp; Feed Manufacturer</td>
<td>10% after-tax profits not to exceed 15% of participant's salary up to $6000</td>
<td>2% of pay not to exceed $120 yearly</td>
<td>1 unit for each $250 annual salary up to $6000. 1 share for ea yr of service</td>
<td>Ratio of participant's acc balance</td>
<td>20% under 2 yrs; 2-3 yrs 25%; 10% per yr thereafter</td>
<td>Lump sum; monthly payments; purchase of annuity</td>
</tr>
<tr>
<td>Professional Services</td>
<td>25% of pre-tax profits</td>
<td>None</td>
<td>1 unit for ea $100 of salary; 2 units for ea yr of service</td>
<td>Ratio of participant's acc balance</td>
<td>30% after 3 yrs; 10% per yr thereafter</td>
<td>At employee's discretion</td>
</tr>
<tr>
<td>Department Store</td>
<td>Determined yearly by company's Board of Directors</td>
<td>Option 2-10% of earnings</td>
<td>Ratio of participant's earnings for prior year (not to exceed $20,000) to total of all participants</td>
<td>Same as allocation of company contribution</td>
<td>None 1-6 yrs; 6-2/3% per yr thereafter</td>
<td>Lump sum; monthly payments or any other manner determined by Committee and the participant</td>
</tr>
<tr>
<td>Insurance</td>
<td>Co matches the 1st 1% of participant's contribution + 50% of his contribution in excess of 1%</td>
<td>1-5% of current monthly compensation</td>
<td>Refer to basis of contribution--employer</td>
<td>Same proportion that co contributions were allocated for the yr of termination</td>
<td>None 1-5 yrs; 5 full yrs 25%; thereafter graduated to 100% after 15 yrs</td>
<td>Lump sum; monthly annuity or any settlement option available in individual life insurance policies then being issued by the company</td>
</tr>
</tbody>
</table>
Most of the plans provide for a lump sum distribution upon retirement. Accordingly the employee has the option of obtaining all of his money at the favorable capital gains rates. However, in most of the plans it is also possible for him to choose some type of annuity payment, and as a result he would only be taxed, assuming the proper elections were made, at the time he receives the annuity. This could, in certain cases, be less costly than paying the capital gains tax on a lump sum distribution.

The data relating to pension plans, as answered in the questionnaire, has been summarized in Table 4. It is possible, in most cases, to arrive at what an individual's annual pension would be under the various plans. Naturally in a questionnaire of this type there is room for some misunderstanding and in certain cases there was not enough information included to make the description under the normal retirement benefit formula column meaningful in every case. Most firms maintaining a pension plan did not require that the employee contribute anything towards the cost of the plan. And, in those instances where a contribution was required, it was nominal in relation to the employee's salary.
<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Normal Retirement Benefit Formula</th>
<th>Employee Contribution</th>
<th>Past Service Covered Under the Plan</th>
<th>Vesting</th>
<th>Medium of Funding</th>
<th>Methods of Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dairy &amp; Snack Foods</td>
<td>$2.25/mo x yrs of service</td>
<td>None</td>
<td>Yes</td>
<td>None</td>
<td>Trusted</td>
<td>Monthly benefit for life</td>
</tr>
<tr>
<td>Banking</td>
<td>Approx 40% of avg. of high 5 yrs of last 10 yrs of service</td>
<td>None</td>
<td>No</td>
<td>Age 55 with at least 10 yrs service</td>
<td>Trusted</td>
<td>Monthly annuity</td>
</tr>
<tr>
<td>Sheet Metal Fabricator</td>
<td>.7% of avg. of high 5 yrs + 1% of earnings over $6600</td>
<td>None</td>
<td>Yes</td>
<td>None</td>
<td>Unknown</td>
<td>Retirement benefits</td>
</tr>
<tr>
<td>Heavy Equipment Dealer</td>
<td>25% of avg. basic mo. salary while in plan</td>
<td>3% of basic salary</td>
<td>No</td>
<td>15 yrs service 75% 20 yrs 100%</td>
<td>Insured</td>
<td>Life annuity 10 yrs certain or joint &amp; survivor annuity</td>
</tr>
<tr>
<td>Insurance--Life &amp; Health &amp; Accident</td>
<td>1/2 avg mo salary of last 7 yrs</td>
<td>None</td>
<td>Yes</td>
<td>4% of fund for each yr's service after age 25</td>
<td>Insured</td>
<td>Installment refund or joint &amp; survivor annuity</td>
</tr>
<tr>
<td>Meat Slaughtering &amp; Processing</td>
<td>Monthly payment of $3.25 x yrs of service or 1-1/8% x total earnings of credited service divided by 12 whichever is greater</td>
<td>None</td>
<td>Yes</td>
<td>15 yrs service &amp; reached normal or early retirement age or separated from employment with 15 yrs service at age 40 or older</td>
<td>Trusted</td>
<td>Monthly payments for life</td>
</tr>
<tr>
<td>Utility</td>
<td>1% of 1st $4200 annual salary 2% balance above $4200</td>
<td>1/5 total cost</td>
<td>Yes</td>
<td>Age 40 &amp; 10 yrs service</td>
<td>Insured</td>
<td>Retirement benefits</td>
</tr>
<tr>
<td>Feed Dehydration</td>
<td>Unknown</td>
<td>None</td>
<td>Yes</td>
<td>None 1-5 yrs; 5% per yr thereafter</td>
<td>Unknown</td>
<td>Retirement benefits</td>
</tr>
<tr>
<td>Transportation</td>
<td>Between 1/2 &amp; 2/3 avg annual salary for highest 5 yrs</td>
<td>None</td>
<td>Yes</td>
<td>None</td>
<td>Unfunded</td>
<td>Monthly payments</td>
</tr>
<tr>
<td>Utility</td>
<td>1/5% x yrs of service (40 max) x avg. mo. salary for highest 10 yrs.</td>
<td>3% of 1st $300 mo earnings &amp; 4% of excess</td>
<td>Yes</td>
<td>20 yrs service or 15 yrs at age 55 or 10 yrs at age 60</td>
<td>Trusted</td>
<td>Retirement benefits</td>
</tr>
<tr>
<td>Type of Business</td>
<td>Normal Retirement Benefit Formula</td>
<td>Employee Contribution</td>
<td>Vesting</td>
<td>Medium of Funding</td>
<td>Methods of Distribution</td>
<td></td>
</tr>
<tr>
<td>-----------------------</td>
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<td>---------------------------------</td>
<td></td>
</tr>
<tr>
<td>Insurance--Life &amp; Health &amp; Accident</td>
<td>$2\times1st 20 yrs service plus 1% next 15 yrs x avg. of last 5 yrs salary</td>
<td>None</td>
<td>10 yrs service 50%; thereafter inc 5% per yr</td>
<td>Insured</td>
<td>Retirement benefits</td>
<td></td>
</tr>
<tr>
<td>Manufacturing Hourly Plan</td>
<td>$28 per yr x yrs of service to 2/1/61 &amp; $30 per yr after 2/1/61</td>
<td>None</td>
<td>Yes, 5 yrs 25%; 10 yrs 50%; 15 yrs 75%; 20 yrs 100%</td>
<td>Trusteed</td>
<td>Life annuity 10 yrs certain; joint &amp; survivor annuity; social security retirement option</td>
<td></td>
</tr>
<tr>
<td>Salaried Plan</td>
<td>1% x yrs service on 1st $400 mo salary + 1% x yrs service on salary in excess of $400, salary used in avg of last 5 yrs</td>
<td>Approx 3% of salary in excess of $4800</td>
<td>Yes</td>
<td>Trusteed</td>
<td>Discretion of Trust Committee</td>
<td></td>
</tr>
<tr>
<td>Food Manufacturer</td>
<td>22% mo salary at age 60</td>
<td>None</td>
<td>No</td>
<td>20 yrs service 100%</td>
<td>Insured</td>
<td>Life annuity 10 yrs certain</td>
</tr>
<tr>
<td>Manufacturer</td>
<td>$2.75 per mo x yrs of service on earnings up to $6600 + 1% x yrs of service on earnings over $6600</td>
<td>Yes--amount unknown</td>
<td>Yes, After 15 yrs</td>
<td>Insured</td>
<td>Retirement benefits</td>
<td></td>
</tr>
<tr>
<td>Utility</td>
<td>1% x avg annual pay for the last (or highest) 5 yrs x yrs of service reduced by 1/3 of primary social security benefits; subject to minimum mo pension</td>
<td>None</td>
<td>Yes</td>
<td>Trusteed</td>
<td>Monthly payments &amp; in some cases payments can be paid to surviving annuitant</td>
<td></td>
</tr>
<tr>
<td>Banking</td>
<td>1% x yrs of service x avg salary for high consecutive 5 yrs out of last 10 yrs reduced by 1/3 of primary social security benefits</td>
<td>None</td>
<td>Yes</td>
<td>Trusteed</td>
<td>Retirement benefits</td>
<td></td>
</tr>
<tr>
<td>Savings &amp; Loan Association</td>
<td>30% of avg income for last 5 yrs service</td>
<td>None</td>
<td>Unknown</td>
<td>None</td>
<td>Insured</td>
<td>Monthly payments</td>
</tr>
</tbody>
</table>
Most of the pension plans had a provision covering an employee's past service with the company and this is desirable, especially for the older employees. This provision, however, adds to the cost of maintaining the plan. Such a provision does satisfy at least one of the major requirements for establishing a plan in that it tends to increase pension benefits so that they do, in fact, provide for something more than a token retirement payment. Some of this increased cost is "borne," figuratively speaking, by employees who leave the company. By reviewing the vesting column, it can be seen that a large percentage of the plans do not have any type of vesting, and in many others the vesting takes place only after a substantial number of years with the company. Accordingly, to the extent that contributions have been made for employees that, in essence, will never receive anything from the plan as a result of early termination, it serves to reduce the amount of the pension cost that the employer will have to bear for the ones that stay until retirement age.

We saw under the methods of distribution for profit-sharing plans that the majority of them provided for lump sum distributions upon retirement with the option in many
cases of purchasing an annuity. However, the lump sum distribution method does not appear to be provided for in most of the pension plans. This question was not completed in many of the questionnaires returned, and it was assumed that, in those instances, the plan merely provided for some type of retirement benefits. Most of the firms that did reply to this question indicated that the retiree would receive a payment for life with the option, in some cases, of taking a joint and survivor annuity.

Nearly all of the plans, both pension and profit sharing, provided for an annual contribution with the exception that a few pension plans provided for monthly contributions to a trust.

There were several reasons advanced for using the particular type plan that was adopted by the company, but the general consensus for profit-sharing plans was that they provided an incentive for the employees to put forth their best effort for the company and also to attract and retain competent help. Pension plans, on the other hand, were adopted to provide some type of retirement income to enable the employee to retire at normal retirement age for
the best interest of both the company and the employee. A few indicated that a pension plan had been adopted on the advice of pension consultants. There did not seem to be any obvious reason why a company chose a pension plan in preference to a profit-sharing plan or vice versa. A pension plan, in some cases, was the only type of arrangement that would be possible for certain companies. Companies maintaining profit-sharing plans are of a general type, refer to Table 2, in which their profits are, at least to some extent, geared to the ups and downs of the economy, and in those cases a profit sharing plan is most adaptable. However, many companies maintaining pension plans also fall into this category. Each company has to decide for itself which plan it should adopt, and it is rather hard, if not impossible, from facts supplied on a questionnaire to make judgments as to why a company adopted a particular plan.

This survey did serve to illustrate that many Nebraska firms do have qualified plans in existence. It is also apparent that several thousand Nebraska employees will no doubt someday be beneficiaries under these plans. While it is recognized that the ratio of covered
employees is very low, it must be remembered that many of these plans have not been in existence for a great length of time, and based on the eligibility requirements, it appears that many more employees will become eligible in the years ahead. As stated before, in only one instance did anyone elect not to come under the provisions of a company plan and in that case only ten employees were involved.

Even though the results of the survey related principally to two types of plans, pension and profit sharing, it should be noted that the variations in those plans can be truly infinite. In no case were the basic features of the plan identical for any of the responding firms. This is as it should be since these plans should be tailor-made to fit the company and to serve the long-range goals that management has set for itself.
SUMMARY

Even though there is much present criticism of private plans, it is almost certain that they will continue to grow in the future. Representative Martha Griffiths in her article, "What Is Wrong with Pension Plans?" is very critical of the way some plans are apparently administered. Aside from the operation of the plans themselves, she even expresses concern that at some future date much of the nation's wealth will be in the hands of fiduciaries. She states, "Doesn't the accumulation of these funds, which will amount by 1980 to 280 billions of dollars, really amount to transfer of the control and manipulation of the nation's wealth to fiduciaries?"\textsuperscript{33}

Apparently she is concerned with the fact that many businesses and maybe even the economy can be manipulated by managers of the funds created under these plans. At any rate Representative Griffiths does bring out many points

\textsuperscript{33} Representative Martha Griffiths, "What Is Wrong with Pension Plans?", \textit{NAM Reports}, XII, No. 16 (April, 1967), p. 23.
of interest and, if she is correct, there will undoubtedly be more government regulations of the private plans.

As late as 1964 a government publication had this to say:

During the next two decades, the coverage of private pension plans is not expected to increase at the same rate it has in the past two decades. A slowdown in the rate of growth is already evident. Private pension plan coverage, however, will continue to grow, possibly doubling from 1960 to 1980—a rate of increase substantially greater than the expected rate of increase in the labor force.34

Everyone is aware of the increased attention that our government is giving private plans recently, and we can expect increased activity on the part of industry in an attempt to temper governmental action in this area.

An article in Nation's Business entitled "Will Washington Ruin your Pension Plan?" contained this statement concerning the future of private plans:

The three biggest threats, as watchers of private pension plans see it, are:

1. "Runaway social security" which would substitute governmental coverage for the combined public/private retirement coverage now in effect.

2. Regulatory legislation, part of which is

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stemming from a controversial 1965 Cabinet Committee report to the President.

3. And a proposal by the Internal Revenue Service to change the formula for "integrating" private pension plans with social security.\(^{35}\)

The above articles were mentioned merely to remind administrators that, when attempting to establish the best possible plan for their companies, they must also keep abreast of the changing government attitude in this area. While it is true that most major companies have some type of qualified deferred compensation plan, one can observe from reading in this general area that businesses are getting extremely concerned as to how to maintain a private plan in the face of almost staggering increases in social security charges. It does, in fact, seem that the government is attempting to eliminate the combined public/private coverage now in effect and in its place substitute an all-governmental program.

Congressional probers are coming up with examples which indicate that in some cases only a few of the many "covered" employees under private plans actually are able to receive any benefits from them at retirement age. Some

\(^{35}\)"Will Washington Ruin your Pension Plan?", Nation's Business, April, 1967, p. 41.
of the problem no doubt stems from the fact that the employer is not very profitable or, even worse, goes out of business. In other instances, as a result of slow or no vesting, employees with many years of service who terminate their employment prior to retirement age find themselves without any pension benefits. While pension plans have been referred to primarily, the government interest in this area also extends to other private retirement and welfare programs.

Finally, it must be remembered that the Internal Revenue Service is not the only governing body which is interested in private employee benefit plans. There are various state laws to be concerned with and in most instances union contracts which will have to be reviewed to avoid conflicts and even the possibility of overlapping of benefits. In addition, the Welfare and Pension Plan Disclosure Act and other labor laws will have to be given consideration.
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