National Tooling & Machining Association

NTMA

PRECISION

Business Management Advisory

For Precision Custom Manufacturers

AC20 **File: ACCOUNTING AND FINANCE**

PROVIDING BENEFITS FOR KEY PEOPLE AFTER TAX REFORM

SUMMARY

Many employers have provided benefit plans to their employees as a common practice. The typical plan would cover a number of employees, but favor the higher compensated key people. Until the series of tax reform bills passed in recent years, an employer probably utilized a pension or profit sharing plan to achieve these benefits. The government changed the rules so that a qualified plan now has uniformity of benefits, greater lower echelon participation, and higher turnover costs. Some key changes are:

- **limiting the maximum benefit allowed,**
- **limiting the maximum contribution that may be made,**
- **tightening the rules on early retirement, and**
- **on 401(k) plans, tightening the dependence that higher paid executive's contributions have to lower paid employee's participation levels.**

In short, you, the employer, can not provide as much for your key people as you use to under qualified plans. The question remains, aside from qualified plans, is there another avenue to explore in benefit design that will allow freedom of choice? The answer is a "non-qualified plan". In a sense, a non-qualified plan can provide any benefit that a qualified plan can, but without any limits on benefits, contributions, participation, or retirement dates.

Why the freedom of design on non-qualified plans? Because, unlike qualified plans, we are not asking the government for immediate tax favors. Rather, we use certain other tax advantages that in the long-run may exceed the qualified plan. The basis of all non-qualified plans is the concept of "constructive receipt," which means that an employee is taxed on money from his employer only when he has received it or has discretionary access to it.

Many different designs have been employed in non-qualified benefits plans. The most popular in recent years is a shared cost plan not unlike the 401(k) concept. Employers have taken a liking to having employees participate in building their own benefit plan.

A plan scenario might have the employer making a specific contribution, the employee putting aside some of his own money, and the employer matching the employee's investment.

The difference, however, is that the employer's matching is not a contribution. We call it an allocation of corporate assets since it REMAINS A CASH CORPORATE ASSET in a major departure from a qualified plan, the employer gets continuing access to his allocations into the plan and upon employee termination, death, or retirement, a full cash disbursement.

The employee gets to elect his level of funding, an extraordinary rate of return (tax-free), and options at retirement ranging from a lump-sum to a level income, or to selectively withdraw funds as needed. As long as the employee has no access to the employer's matching allocations (which remain a corporate asset), he has no constructive receipt of these monies and no tax liability.

The employee can, however, access whatever amount he has accrued as his share of the plan at any time. This means that, you, the employer can:

- Cover any employees you wish from one to everyone.
- Select the amount you wish to fund on an employee by employee basis.
- Set any retirement dates you wish.
- Add an employee whenever you wish.
- Change an employee's benefit without regard to any other employee's benefit.
- Have no limits on benefits-lower paid employees can elect not to participate without effecting higher paid employee's benefit levels.
- Have no impact to corporate surplus and will not reduce available working capital.

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- Provide the executive with options at retirement - a lump sum, a level income, or a readily available personal asset as a source of quick cash.
- Reimburse the corporation for all its allocations on behalf of an executive upon his death, retirement, or termination.

- Be split-funded with the employee participating in his retirement funding, or can be fully funded by corporate dollars - the choice is yours.
- Requires no long term promise to pay and, thus, accrues no benefit liability on your corporate books.
- No annual administration required.

It is precisely this freedom that makes this plan a true employee incentive. This concept is known as Zero Impact Plan, because it is structured to have no impact to the corporation.

This BMA was prepared by Independent Pension Services, Inc., Coral Gables, Florida, an employee benefit consulting firm.