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Pension and Profit Sharing

Robert W. Mumford

PENSION AND PROFIT SHARING

By ROBERT W. MUMFORD, Assistant Vice President, Michigan Trust Company, Grand Rapids, Michigan

Almost all of us are covered by a retirement plan of some kind, either under Social Security or under a private pension plan. We have all heard about the tremendous Social Security credit that is being accumulated by the Government from salary deductions that employees contribute to the Social Security fund and from the like amount deposited by employers. You probably know that now more than 90% of the jobs in the nation are covered by Social Security and that coverage is still growing. Social Security benefits are received by more than 8 million persons every month and the trust fund built up by the payment of Social Security taxes has grown to over $20 billion.

The benefits under Social Security are very substantial. For example, if a person makes $4,200 or more annually, he can expect a monthly check for $108.50 beginning at 65 and continuing as long as he lives. If the family consists of a man and wife and they are both over 65, total payments may be $162.80 a month or nearly $2,000 a year.

In addition to the retirement benefit, the worker is insured against the possibility of his dying and leaving a wife with dependent children under 18. For example, if a wife and 10-year-old child survive, they could receive as much as $162.80 per month for the next eight years (or even longer, under the 1956 amendments, if the child should be under a disability).

The worker is insured, too, under the 1956 amendments, against his or her own disability. If he becomes totally and permanently disabled, his maximum payments of $108.50 per month may begin as early as age 50. He could be sure of this income, either as disability payments or as old-age benefits, for the rest of his life.

This gigantic "pension plan" of the Government apparently has stimulated rather than lessened the growth of private pension systems. It has been during this very 21-year period of Social Security's existence that private pension plans have mushroomed. There were fewer than 1,000 pension plans and trusteed profit-sharing plans in 1935; today there are more than 30,000 and the number is increasing at the rate of several thousand a year. More than 22 million employees, it is estimated, are now covered by retirement plans other than Social Security.

How to explain the tremendous growth of, not just one, but both of these two means of providing retirement incomes? To put it simply, there are more older people now, and each of them has greater need for some kind of retirement plan than the older person in years gone by. People over 65 made up 4 per cent of the population in 1900. In 1950 the percentage was 8 per cent, and by 1975 it is estimated that it will be 11 per cent. If you apply these rising percentages against the increasing population, you will see that a very steep rise in the total number of people over 65 is taking place.

We just mentioned that the Social Security trust fund exceeds $20 billion. You may be somewhat surprised to hear that total deposits in private pension plans now actually exceed the Social Security credit. Deposits in these funds have reached the staggering sum of $25 billion. You can well understand that such a sum in the hands of trustees throughout the country has and will have great effect on the country's economy. A large portion of this total, possibly 25 to 30%, is invested in common stocks, which is a very beneficial thing to American industry. The balance is in bonds—both government and industrial, mortgages, notes, real estate, etc.

There are quite a number of methods that employers use to fund a retirement plan. Among these is the so-called thrift plan. Under this type of retirement plan the employee contributes x% of his compensation to a trustee. The employer agrees to contribute x% of his profits each year and this amount is allocated to the participants by the trustee on the basis of employee contributions.

Another type of retirement plan is the deferred profit sharing plan. Under this plan the employee ordinarily does not contribute (but he may) and the employer agrees to contribute x% of the profits in the plan each year. Usually this is allocated to the participants on the basis of compensation. However, often compensation plus years of credit are used to make the allocations.

Perhaps the most common type of all retirement plans is the Pension Plan used principally by big industry. Under this method deposits are made to either a trust company or an insurance company in an amount determined upon by an actuary, to provide funds to pay a definite benefit of a pre-determined amount at a future date when employees progressively reach 65.

Still another type of retirement is the Income Endowment method where an employer purchases an insurance policy on the life of a participant and pays a yearly premium. This policy has a retirement feature in addition to life insurance coverage.

A number of companies have established stock-bonus profit sharing plans. Under this type of plan the trustee holds only securities of the employer company, usually stock, and the employer may, when he makes his yearly contribution, pay in stock of the company. These plans will also provide that if the employer contributes cash that the trustee must immediately purchase stock of the company for the plan.

There are very substantial tax advantages to the employer and to the employee when a qualified plan is used. To briefly review these advantages they are as follows:

1. The employer contribution to a qualified plan is deductible as a business expense.
2. The employee is not currently taxed with his credits which he would receive under either a stock bonus or deferred profit sharing plan.
3. The fund created by employer and employee contributions is a tax-free trust. All earnings accrue to the benefit of the employees.

Investment of these funds has become much more complicated with the deposits constantly being made with Trustees. An important recent development has been the establishment of pooled trusts by several banks for the investment of pension and profit-sharing plan assets in a commingled fund. These special tax-free trusts are usually divided into two separate funds, one invested in fixed-income securities and the other in common stocks. This permits each participating trust to choose its own debt-to-equity ratio. Such pooled trusts enable small plans to enjoy the investment diversification usually available only to large plans and also permit them to be administered on a more economical basis.

Banks with a large volume of pension and profit-sharing trusts may also use their common trust funds for such pooling of investments. Our company has such a fund which we call Common Trust Fund A. This trust is invested in a balanced portfolio of bonds, preferred stocks, and common stocks on about the following ratio:

Bonds	40%
Preferred Stocks	10%
Common Stocks	50%

This trust currently yields approximately 4% in earnings. There is one feature in this account, however, and that is we may not invest over $100,000 of a particular trust in the trust fund.

Some employers invest a portion of their retirement plan fund in their own securities. When this is done, it is necessary that the Trustee apply for what is called a Determination Letter from the Treasury Department. In order to receive this letter the trustee must file the following information:

(1) Employer's balance sheets for last accounting period and for the taxable year ended prior thereto;

(2) Comparative statements of income and profit and loss for the last and four prior years;

(3) Surplus account analyses for the last five years;

(4) Reconciliation statements;

(5) Schedule showing the nature and amounts of the trust fund assets;

(6) And a detailed statement concerning the investment and the reasons for making it.

The reason for this is to determine whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of the employees.

Except as just mentioned, the Revenue Code has few restrictions on the manner in which retirement plans are invested. A qualified trust may invest in any securities permitted by the trust agreement to the extent allowed by local law. But again referring to the restrictions as mentioned above on dealings between the Trustee and the employer in employer's securities; the Treasury Department has set down a list of "prohibited transactions". They are as follows:

If the Trustee:

(1) Lends any part or all of its funds to its employer-creator without adequate security and a reasonable rate of interest.

(2) Pays any compensation to its employer-creator in excess of a reasonable amount for salaries or other compensation for personal services actually rendered.

(3) Makes any part of its services available to its employer-creator on a preferential basis.

(4) Makes a substantial purchase of securities or any other property from its employer-creator for more than they are worth.

(5) Sells any substantial part of its securities or other property to its employer-creator for less than it is worth; or

(6) Engages in any other transaction which results in a substantial diversion of the trust income or principal to the employer-creator.

If a pension, profit-sharing, or stock bonus trust engages in a prohibited transaction after March 1, 1954, it will be denied tax exemption, generally for taxable years beginning after the taxable year in which it was notified by the Internal Revenue Service that it had engaged in a prohibited transaction.

Tax exemption will then be lost until the trust can establish to the satisfaction of the Internal Revenue Service that it will not knowingly again engage in a prohibited transaction.

Satisfying the service will mean filing a new claim for tax exemption. The Trust will not be able to regain its exempt status until, at the earliest, the year after it files its claim. If there are any hitches, due to changes in the rules for qualification of a trust or otherwise, tax exemption may be lost for a longer period. In some cases loss of tax exemption may seriously imperil the continuation of the retirement plan. In all cases the value of the plan will be impaired.

But, as mentioned above, these prohibited transactions apply only to dealings by the Trustee with employer company securities.

Earnings from investments in a qualified retirement plan are especially important as they represent earnings in a tax-free trust. Increased earnings, for example, in a deferred profit-sharing plan, serve to increase benefits that can be paid to the participants upon retirement. Where retirement benefits are fixed, such as they ordinarily are in a pension plan, earnings become very important because they can reduce the cost of the plan to the employer. This is more concretely understood when you consider that a 1% increase in the interest rate will generally reduce the cost of pensions to the employer upward to 25%. This, as you can see, is a very important factor.

(Continued from page 14)

the Federal Reserve Bank do not actually arrive in New York the next day, but each Federal Reserve Bank has a stock of bonds which can be issued to replace bonds received at another Federal Reserve Bank. The bonds turned in are cancelled and twice monthly are forwarded to Washington, D.C. Then, of course, at the end of the month all of the Federal Reserve Banks reports must exactly coincide.

Recording of Transactions

This is a very brief picture of the bond business as it applied to one firm. The actual bookkeeping or recording of transactions is very routine as per any business. There is a Journal where all transactions are recorded and the buys and sells are posted by customer. Then there is a Security Ledger where these same transactions are posted by issue. This provides a check to see that all deals have been correctly recorded for debits, credits and profit are balanced each day.

It is very important that a record be kept of the numbers of all bonds handled because sometimes a check is made on bonds which have been lost or stolen. Under California law, the firm would not be liable for buying a stolen bond if there had been no way of knowing it was stolen. Occasionally notices are received from the F.B.I. listing numbers of stolen bonds and if such a bond is then accepted, the firm would be liable. By keeping the numbers of the bonds it may help by checking back as to where the bond was purchased and so on until the person who introduced it into the market as a stolen bond is located.

Recently a stolen bond matured and was turned in for collection in New York. By number it was traced to Los Angeles where it had been turned in with a block of bonds from a local bank. Our firm had sold some of this issue to this bank and so it necessitated our checking back on the numbers of this issue for about six or seven months to see if we had had it. Our checking proved that we had not. You can see that we must be reasonably sure that a customer who is not known to us is the rightful owner of the bond.

As regards the recovery of a lost or stolen Treasury bond, the decision of replacement is handled entirely by the Treasury Department in Washington after investigation. If they establish that a replacement should be made, it would be done as to principal only. No claim for any coupons claimed

(Continued on page 18)

IDEA EXCHANGE

By MILDRED SWEM, Los Angeles, California

Computation of Average Monthly Balance

The following formula (in this example taxpayer made payments for eight months) can be used in computation of the average monthly balance where there is no increase in principal and monthly payments do not change:

Balance on 1st day of 1st month of period	$2,351.04
Less: Amount of monthly payment times ½ of number of months paid less 1	3½
	$336.00
Average monthly balance	$2,015.04

The results of the formula are the same as the formula given by Internal Revenue, but the formula is shorter and saves time.

—Ruth Alles Ehringer, San Diego

Group Insurance Claim Control

Keeping the records of hospital and doctor claims for personal and dependent coverage of our 1200 odd employees has always been a problem.

We have evolved a record form on which is recorded before the claim is mailed to the insurance company: Employee's Name — Serial No. — Address — Department — Date Last Worked — Date Saw Doctor — Date Due Return — Date Returned — Supplementary Reports. We also list the Number of Days in Hospital — Special Services — and Doctors Fees.

When a check is received from an insurance company we list: Date Received — Check Number — Payment from — to — Amount of Check. These records are then maintained in transfer binders for ready reference to old claims.

—Margie G. Gaines, Atlanta

Support for Salesmen's Expenses

Encourage your sales people to help you keep supporting records on expense deductions by distributing to each a 6 x 8 inch envelope every week which is printed or mimeographed with headings for easy tabulation. The heading should include the sales person's name and the period covered. It will have columns for the common expenses, which may include the date and: tips, parking, phone, meals, gifts, individual and company entertained, and other. The total of each line will be the amount expended in connection with that particular client on a given day.

Into the envelope go the miscellaneous substantiating receipts which can be checked against the itemization on the outside. The envelope is used to support the expense account payment to the sales person and helps immensely to get the cooperation of sales personnel to collect and keep the small substantiating receipts needed to support deductions for such sales expense.

—Theia Cascio, Los Angeles

Ink Erasure Tip for Typists

Have you ever wished for a cleaner or speedier method of erasing a figure as you reach for a couple of bottles of ink eradicator or an ink eraser that you knew would leave a smear?

Get a small bottle that will easily fit in your desk drawer in a handy place, fill bottle with household bleach and apply to the area to be erased with a toothpick. Don't press too hard. The toothpick prevents too much smearing and allows you to erase as small an area as you desire.

—May Carlson, Los Angeles

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(Continued from page 17)

to be on the bonds would be recognized. In case a bond is totally destroyed by fire, there is no recovery. If any portion of the bond has been saved from the flames, a claim may be filed.

As is true in any phase of accounting work, new problems arise each day which must be solved and this keeps the work interesting and progressively educational for the accountant.

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(Continued from page 12)

amount of time required to transfer its stock constitutes approximately 20% of a transfer clerk's weekly time, but the company estimates the savings to the company are adequate to pay the full salary of the clerk performing the operation. For this reason, the transfer of its own stock in its particular case has seemed to be justified by the economy in the operation.