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Howe P. Cochran

A DO-IT-YOURSELF KIT FOR DRAFTING A STOCK BONUS TRUST

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FOR many years erudite professors, brilliant students, and hungry lawyers have written profound "But, see" Law Review articles, diamond-studded with footnotes, about the hairline differences between identical cases that were tried by less brilliant practitioners than they. These articles proved to the readers, if any there were, the writer's intellectual superiority, but were useful principally as advertising media. I have often wondered what would happen if some ordinary lawyer would write a useful article without Latin or footnotes, without reference to a single case, and even without a spark of brilliance, dealing with a specific method of helping self, clients, and, in a small way, mankind. Now I'm going to find out. I note that lawyer Swados, who wrote a wonderful article for the *Fordham Law Review* chiding the tax laws, still has his measly little twenty-room office in Niagara Falls, so I can hope.

I used to lecture for the Practising Law Institute of the American Bar Association, and it was a happy experience. I usually had a well-filled lecture hall, but when I spoke on the subject I am now approaching, the crowd fell off to half; indeed, when just before the recess I mentioned that the next hour would deal with this subject, half the listeners went to the neighborhood bar and grill for the last hour. Yet this is one of the best fields of law practice for quick fees and for real service to the client and his workers. (Please forgive me for this misdemeanor in using the word "fees." I know that the suggestion of fees is taboo unless you have four names on your transom and twenty on your door.)

The subject is not tax law. But most lawyers think it is, since it comes under the Internal Revenue Code. It is not insurance law, nor is it insurance, but most lawyers think it is because insurance salesmen have well-nigh driven us out of the field. It's just plain, profitable, prolific, perpetual practice for such as we. All it takes is a little legal education, a little courage, a little patience, and a little arithmetic.

Well, here it is: it's pension, profit-sharing, and stock bonus planning, coupled generally with estate planning. (Please do not slam the door on your way out.)

Let me start by saying that this field is the playground of scoundrels. That is because it pays big fees quickly, long before the flaws in the bad plan are apparent. It follows from this that the honest, careful workman is needed, and you are it. You have an open field.

A less astute reader than you might think that this field is too small

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for his talents, or that it is too technical for his lack of talents, or that it's an insurance-selling matter. The lawyer who takes any of these positions merely rationalizes himself out of this huge field of service and of profit. The only defeatist position he can properly take is that the work is too exacting for a man of his great talents. Maybe that is why the mention of the subject empties the lecture hall.

The Magic of the Untaxed Dollar

You might ask: What is so important about pension, profit-sharing, and stock bonus plans? What makes these plans so attractive and so profitable to attorney and client alike?

That's easy. It's the magic of the untaxed dollar versus the twice-taxed dollar.

The real reason for such plans is that the client obtains greater security for himself and real security for all his employees. He cuts himself into two or, maybe, three independent, separate estates and, while one might fail, it is not likely that disaster will overtake them all. He makes his employees happy, provides for their future, and puts them in a position where they cannot afford to quit; and he assures the continued success of the business. He does all this without any cost (or, at worst, very little cost) to himself. It's the nearest thing to something for nothing since W.P.A.

Let's look more closely at the magic of the untaxed dollar. What is it, anyway? A dollar earned by a corporation above a bare minimum is taxed 52 cents by the federal income tax. That leaves 48 cents. The 48 cents does not belong to anyone who can spend it. It is eventually lost or declared as a dividend to the stockholders who *can* spend it. The principal stockholders, who usually are about fifty years old (or older) draw substantial salaries and are in the 59 per cent or 69 per cent bracket, or maybe even the 75 per cent bracket. The 48 cents is taxed to them at, let us say, 60 per cent. That leaves about 19 cents. The untaxed dollar was $1.00, but before it can be spent, it is taxed twice and then it has shrunk to 19 cents. It has shrunk to less than one-fifth of its original size.

If this corporation dollar could be pegged at $1.00 and allowed to earn interest tax free for, say, fifteen years, it would be somewhere near $1.50; and then if 60 cents of that $1.50 could be paid over to the principal stockholders in place of that measly 19 cents, wouldn't that be fine! Indeed, it would be magic.

That's what you're going to do. Here is how it's done. Take the $1.00 that is worth only 19 cents to the stockholders and put it in a pension, profit-sharing, or stock bonus plan as a full $1.00, where it will earn, tax free, a full dollar's earnings. Arrange matters so that each of the 19 cent dollars is worth, to the stockholders, let us say, 30 to 40 cents of the whole dollar. Arrange for the non-stockholder workers to get the remaining 60 or 70 cents of each dollar. The $1.00 now earns, say, 4 per cent, tax free, for workers and stockholders alike for, let us say, fifteen years, until the various workers draw down their interests in the fund. The aging principal stockholders retire (theoretically) and draw down their 30 or 40 cents out of every dollar, plus fifteen years' interest, or they let it ride until they actually retire or die. That's a big profit to all.

(To those who are still here—two words: "Don't leave.") I'm not going to tell about pension plans or profit-sharing plans. There are thousands of them in force, and smart lawyers keep on installing them for more and more of their progressive clients.

I'm going to tell only about stock bonus plans, of which there are just a handful in the country, whereas there should be thousands. I'll bet you a one dollar buck you will learn something you don't know but can "sell."

"What Is a Stock Bonus Plan, Professor?"

At this point someone calls out from the back row, "Say, Professor, what is a stock bonus plan and how does it work and what's that got to do with your magic dollar?"

Years of lecturing have taught me not to ignore a challenge from the back row. The fellows sitting there almost always know more than I. So I shall answer the Voice from the back row.

A stock bonus plan, as I refer to it here, is a plan under which a corporation (or a corporation and some or all of its employees, including stockholder-employees) deposits annually sums of money in a trust fund for the purpose of purchasing stock of the corporation from one or more of its stockholders, to be held for a number of years and then distributed among the employees concerned, including the stockholder-employees.

This definition is far too short for practical purposes as you will find from reading this article. It is just a quick answer to the Voice. Let me hasten on before the Voice sees the flaws in the definition.

The definition said "and then distribute it." It is generally planned to put up the annual sums, as to each employee, as long as he works. It is generally planned to distribute each employee's share to him at age sixty-five (unless he is still working, or unless he has not been in the plan ten years when he reaches age sixty-five), or ten years after he became a beneficiary, if that be later than age sixty-five; or annually, beginning some years after becoming a beneficiary; or in a lump sum; or, on severance or death, in a lump sum or over a period of years. The distribution among the workers and stockholder-workers is made on a fair and equitable basis, services and compensation considered.

Such plans as I am discussing are generally operated under a trust agreement; and the key men of the corporation, or even strangers, may be the trustees. The plans work just as well in small companies as in large ones, but are not attractive to sole proprietorships or to partnerships, since neither proprietors nor partners are allowed to be beneficiaries. Plans such as I am discussing must comply with the Internal Revenue Code so that contributions by the employer corporations are deductible and the trust income is tax free—otherwise the magic is lost. In plans that qualify under the Code, nothing is taxed to the beneficiaries until they get it. Even then, appreciation in the value of the employer's stock bought by the trust is not taxed until the stock is sold or exchanged by the beneficiaries holding it. Another advantage of such trusts is that benefits paid in a lump sum on severance or death are taxed at capital gains rates instead of as straight income.

"Why Would the Owners Put the Company's Money Into Such a Give-Away?"

At this point the Voice in the back row calls out: "Hey, Professor, why would the owners of any corporation put the company's money into such a give-away plan for the benefit of the faithful workers instead of taking it out as dividends and spending it themselves?"

The stockholders would adopt such a plan because of their choice of one or more of several reasons: (1) they can do it at a profit (100 points); (2) they can increase earnings of the company by creating employee effort (10 points); (3) they will so arrange matters, with your help, that they personally receive 40 per cent of the fund (100 points); (4) they set themselves up in separate estates that might survive even if their present estate fails (50 points); (5) they gain added security for themselves (50 points); (6) they create the machinery to keep the company alive for the benefit of their estates after they are dead (10 points); (7) they can be the trustees, and they can so arrange matters that distribution of any stock to employees is delayed ten years or more; thus they do not relinquish control (100 points); (8) the money syphoned off reduces the company's earnings, as a result of which the stock not sold has a much smaller estate tax value per share than it would otherwise have had. You see, in a closely held corporation, one of the principal criteria of value is the earnings. When some of the earnings are syphoned off into a bonus plan, the remaining earnings show a lower stock value under that criterion (25 points); (9) (very important) they set up a cash fund that can and will buy their stock quickly and at a fair price whenever, through death or any other cause, it becomes necessary to sell. This prevents hawking the stock on the street in order to sell it—and at a loss (25 points); (10) they can do it at a profit (100 points).

You will note that I have put a "point count" opposite each reason. This is my valuation of each reason, based upon experience with clients. I have used average clients. You will note that I valued Reason (1) at 100 points and Reason (2) at 10. If I were the client, I would value Reason (1) at 50 points and Reason (2) at 75. I would also value Reasons (8) and (9) at 100 points each. But I am not the client.

The Clients Can't Live Forever

The Voice in the rear calls out: "O.k., Professor. I hope the other boys understand you. Why don't you give us a ferninstance? We haven't got all night."

Let me hasten to give our vocal friend a "ferninstance" before he thinks of something else. Let's assume you are a bright young lawyer who has enough free time on his hands to read this *Fordham Law Review*. Let us assume you have a client. Your client is a fine little corporation. The corporation employs, let us say, fifty persons. There are two stockholders. Each owns one half of the stock. The two owners started young and their company started small. Now these owners are in the late fifties, and the company is prosperous and growing.

This is a perfect setting for a stock bonus plan unless the two owners are going to live forever or unless each has a son or sons as able and hard-working as he. Since one of these events never happens and the other does not seem likely in this case, you decide that you ought to advise this company to install a stock bonus plan.

The next time either of the owners asks you to the Ritz for lunch (he'd have taken you to the Automat except for that great tax gimmick, the expense account), you say, "Mr. Patrick, have you considered the future of this company?"

"Confidentially," he answers, "I have. When my associate, Mr. Homer, dies and Uncle Sam wants his estate taxes, I'm a-going to put the squeeze on that estate, and when the clouds blow over I'm a-going to own 100 per cent of our corporation. I been reading the estate tax law, and I find out that if an estate sells out within one year of death, the sales price of the stock becomes the estate tax value, that is, if the estate acts quick enough to make what the fuddy-duddies call 'an election.' So I'm going to buy the estate out cheap in that first year and tell Homer's widow what a big favor I did her by cutting that estate tax down to size."

You take another spoonful of your chocolate soufflé and say, very gently, "Well, Mr. Patrick, suppose you die first and Mr. Homer has also read the tax laws, what . . . ."

"I'm a-going to live to be ninety," says Mr. Patrick modestly.

You already knew the time-honored maxim "Always cheat a dead man," and long ago decided not to live by it, and now you are learning the maxim of the estate planning field that "Every client knows *he* is going to live forever." I once planned an estate for a virile youth of sixty-five who had a son aged two years. I said to him that, while he was planning, he ought to set up a special fund for that boy to inherit when he reached twenty-one. My client answered that that was not necessary; he would attend to the matter himself when the boy reached twenty-one. "Maybe the boy won't know how to handle money," he concluded.

Let us now assume that you eventually sell Mr. Patrick and Mr. Homer the idea that neither is going to live forever, that the survivor is sure to cheat the estate of the one who dies first, and that a plan should be worked out right now to prevent such a calamity. I assure you that it is no easy task to sell the idea or to accomplish this feat.

You have now laid the background for a good stock bonus plan, for, while your idea might not accomplish the result you seek, it has a chance to do so, depending somewhat on you and largely on the events of the future. Anyway, it's a start.

You next take some reasonable steps, such as drawing up a contract, to insure that if Mr. Homer and Mr. Patrick decide to go ahead with your plan, they will not cheat you by hiring some cheap labor to work out the plan after they get all your ideas. If you think such a move is unethical and therefore decide not to make it, that's fine; there is no objection to your following your noble scruples to the poorhouse door.

After you have solved the problem so crudely discussed in the above paragraph, you explain to Mr. Patrick and Mr. Homer about the taxed dollar versus the untaxed dollar; explain about stock bonus plans, emphasizing (a) that you feel you can get 40 per cent of the fund for the two of them, and (b) how they can be big public-spirited citizens by telling their employees what they are doing for them, without mentioning the fact that it is all being done at a personal profit.

An Horrendous Document

After a while—a long while—Mr. Homer and Mr. Patrick tell you to go ahead and set up the plan. This you proceed to do at once, using a trust instrument, with Mr. Homer and Mr. Patrick and one other (perhaps yourself) as trustees. Such a trust instrument is an horrendous document about thirty-five legal-size pages long.

You meet one important problem the first minute of play. That is, you have to decide when the trust starts. It can start at the beginning of the company's current year, *even though there is only one day left in that year* (if you can execute the papers before midnight of the last day of the company's year), or it can start at the beginning of the company's next year; or, if you want to make things hard for the owners, the company, and yourself from now on to the end of your respective lives, you can do as the English, who picked April 5th as the end of the accounting year; you can pick any day you wish.

Well, anyway, you decide on an "effective date." You also decide on the taxable period of the company from which the contributions are to come, for example, effective date December 31, 1958, contributions to come from and apply to the calendar year 1958, to be accrued before December 31, 1958, and, in the first year, paid before December 31, 1958.

The foregoing two paragraphs show the safe path through a deep canyon; but if I wanted to write ten pages on the subject, I could show you a truly magnificent "But, see."

Don't Confuse Participation with Contribution

In setting out the terms of the trust you should make sure to provide, among other things, that after the company has earned a stated safety reserve, an amount of further earnings equivalent to (but not more than) 15 per cent of each permanent employee's (beneficiary's) pay (or as much of that amount as has been earned) shall be set aside for the purpose of buying some of the company's stock whenever it becomes available, holding it for a stated time (usually, as to each employee, not less than ten years after becoming a beneficiary), and then dividing it over a period of years among the beneficiaries in the proportion that the money set up to represent each such beneficiary's participation bears to the money set up for all such beneficiaries' participation. You knew when you started out that there is a difference between computing the contribution and computing the participation. You knew it because I am setting it out in tedious detail below.

The terms of the participation in the benefits of the trust should be such that the two stockholders together share 30 to 40 per cent of the fund; otherwise, there will be no fund at all. This sounds hard to accomplish, but, as a practical matter, it is quite easy, for each of the two owners draws much greater compensation than the other employees, and up to $3,600 (even $4,200) of each employee's pay can be excluded in computing the beneficial interest of each participant.

The idea is that the first $3,000 or $3,600 or $4,200 of each employee's pay is adequately covered by social security. That's the idea, and it's not a very good one. But you do not need to worry about whether the idea is good or bad because the right to make this arbitrary and highly discriminatory calculation is clearly set out in the Internal Revenue Code without even bothering to tell you why.

Thus, if including each employee (so far as participation is concerned) at full pay gives the two men, let us say, 20 per cent of the fund, then including each employee (for the purpose of participation) at full pay, less, say, $3,600, may give the owners 40 per cent of the fund. You can see that an employee at $5,000 a year, less $3,600, becomes a $1,400 participant. The $40,000-a-year "owner" at $40,000, less $3,600, is still a $36,400 participant—but don't be greedy. (In a pension plan, which must be actuarially sound, the age of the owners helps to solve this problem.)

To simplify the matter, let us take the two owners of your "fernin-stance" company at $40,000 a year each and the 50 employees at $5,000 a year each; and determine the *contribution* to the plan and the *participation* in the plan.

Here is what you would have as a basis for computing the *amount of the contribution:*

2 owners at $40,000 each	$80,000
50 employees at $5,000 each	$250,000
Total compensation of all employees	$330,000

If, therefore, you plan to make a maximum current contribution to the plan of 15 per cent of the total compensation of all beneficiaries, the amount to be contributed would be 15 per cent of $330,000, or $49,500. That is the total maximum contribution deductible under the Code.

Here is the way the *participation* would be computed and divided among the various beneficiaries:

First, you try a participation on the same basis as that used for computing contribution, for, just between us, that is the fairest way. But it turns out that that basis is not satisfactory, for it is plain that the $80,000 officers' pay divided by the $330,000 pay for all workers would give the officers less than 25 per cent of the fund. So you decide to try a different formula to determine *participation.*

Here is the first try. In computing *participation in the fund,* you eliminate all employees earning less than $3,000 and you deduct $3,000 from each beneficiary's compensation. Then you have (for the participation computation):

2 owners (basis $37,000 each)	$74,000
50 employees (basis $2,000 each)	$100,000
Total	$174,000

Under this formula the owners' share of the $49,500 would be computed at 74,000/174,000 and would be a little over 40 per cent. Better stop here. Better not be greedy. The Government may make you cut that 42½ per cent down a little before it approves the plan.

You draw the trust so that the remainder of the fund not included in the stockholder-worker's participation goes to the non-stockholder employees, who put up nothing.

If you or your clients do not like this idea, the plan can be made contributory. Let us say, each beneficiary will be required to put in one dollar for every five dollars put in by the company for his account. This is very attractive to both company and employee, for the company can say, and the employee will know, that for one dollar put into the plan, the employee will have six dollars and twenty-four cents' credit at the end of the year instead of the one dollar and four cents that he would have at the Building & Loan. But, in drawing a plan, don't try to run if you can't walk. Don't forget, either, that one dollar put up by the ordinary worker costs him about one dollar and twenty cents of earnings while one dollar put up by the stockholder-worker as his contribution costs him over three dollars of earnings. But, as I say, don't try to run if you can't walk.

I hope I have made it clear that the company's contribution to the trust is computed on the basis of a maximum of 15 per cent of each beneficiary's compensation, whereas each beneficiary's participation in the plan is *not* based on that computation. Each beneficiary's participation is based in this instance on the proportion of the entire fund that his compensation, less $3,000, bears to the total compensation of all the beneficiaries, after deducting $3,000 from each. So I do not make it clear. Please read on as I try again. Example:

A	earns	$4,000
B	earns	$6,000
C	earns	$50,000
	Total	$60,000

The *contribution* would be 15 per cent of $60,000. That would make the *contribution* $9,000.

The participation in this instance would be computed as follows:

A	$4,000 – $3,000 =	$1,000 base	
B	$6,000 – $3,000 =	$3,000	
C	$50,000 – $3,000 =	$47,000	
	Total	$51,000	
A gets	1,000/51,000 or		$176.47
B gets	3,000/51,000 or		$529.41
C gets	47,000/51,000 or		$8,294.12
			$9,000.00

Thus we have:

	Basis of Contribution	*Basis of Participation*
A	$600.00	$176.48
B	$900.00	$529.42
C	$7,500.00	$8,294.10
	$9,000.00	$9,000.00

Ten Thousand Questions

At this point you stop a minute in your trust-drafting and take stock. You find that, up to this point, you have settled a small handful of the ten thousand questions that must be answered in drawing your trust and inaugurating this plan. You have (a) decided to include all permanent employees earning over $3,000 a year, (b) not forgetting our two stockholder-workers (c) who are going to get back over 40 per cent of the whole fund—you hope; and you have (d) arranged to put up 15 per cent of the current compensation of the (e) permanent employees, with trustees, provided, (f) a reasonable reserve has been earned and the 15 per cent has been earned above that reserve; and (g) you have set up a formula for participation which differs from the method of computing the contributions and which, as stated above about seven times, materially favors the stockholders over the other employees.

In your analysis you look to see how much of a start you have really made:

Take (a) above. What (or who) is a permanent employee? You have to define him. In defining him, you have to remember to make provision for persons not now permanent employees who will become permanent employees. Later on in the trust you have to make some provisions for disability, death, severance for cause, and severance otherwise. And, most of all, you have to make some provision to prevent hostile employees or ex-employees from getting a couple of shares of stock and destroying the peace and prosperity of all.

Now take (b). Your definition of a permanent employee *must* include the stockholder-workers if you wish to continue in the successful practice of law; and don't forget that these harsh rules you want to make to govern the rights of workers are going to govern the stockholder-workers also. So don't be too cruel.

Take (c). That over 40 per cent is high. Better spell it out clearly and cross your fingers. Uncle Sam's sharp-eyed boys are not going to overlook it. If they cut you down to 35 per cent as a condition for approving the plan, I advise you to take it. They will probably suggest not excluding the first $3,000, but instead giving one-fourth the benefits to the first $3,000 that are given to earnings over $3,000, or they might suggest other adjustments. Before you say yes, go home and figure out the effect of the change.

Take (d). Current compensation of the permanent employees means here everything the employees make. That includes overtime and everything else. If it should happen that in the *participation* you do not mean to include bonuses or overtime, you must spell it out clearly when you define *participation,* which is based on the formula you select and *not* on the actual compensation. (That makes eight times I have said it.)

Take (e). Permanent employees here are the same persons called by the same name above. They are the beneficiaries of the plan, and should be called by that name. If you call them beneficiaries, it will be less confusing.

Take (f), the reasonable reserve. It is unwise to commit your client to any plan that pays the profit-sharing or the stock bonus contributions out of the *first* earnings. The company has to be allowed to make a living, to save against hard times, to expand, and even to make up deficits of bad years before dividing profits. So it is necessary to provide a reserve (say $60,000 in this case) that the company must accumulate each year and keep for itself or use to pay dividends before it has to put money in trust for its employees. To the $60,000 mentioned above should be added enough to make up any deficit piled up in the years between the installation of the plan and the current year.

Take (g). The difference between the method of computing the amount of the contribution and of computing the method of participation is most important. Be sure you set it out in detail and particularity when you draw your trust.

I have tried to point out to you that each of the thousand problems you meet has a hundred facets. You have to think of them or discover them in some other trust or learn of them the hard and expensive way.

I shall now mention a few important items; and suggest that you consider each of them, as well as all problems, as though they were personal to you. To do this you must first consider yourself as the owner of the corporation that is inaugurating the plan. Then you have to consider yourself as a beneficiary of that plan. If you consider the problem as one involving an owner (who is you) and as one involving a beneficiary (who is you) you will see many of the problems before it is too late.

Four Great "Must Nots"

There are four great "must nots" in these plans: (1) such trusts cannot discriminate against the ordinary worker in favor of the supervisors and the more highly paid employees, except in cases where the Code expressly allows such discrimination, such as deducting the first $3,000, $3,600, or $4,200, or giving reduced benefits to the first $3,000, $3,600, or $4,200 of wages; (2) such trusts must be administered solely for the benefit of the beneficiaries; (3) such trusts must be drawn so that nothing can come back to the employer; (4) such trusts must not enter into any transaction that the Code expressly defines as a "prohibited transaction." You really don't need to be warned about these transactions because you would know a trust of this sort ought not to enter into them; but now you are on notice that some transactions are expressly prohibited, so check on the Code before you stray away from the four-lane paved highway.

Let me digress to tell you that whenever Congress enacts a section of a tax law that the Internal Revenue Service does not like, the Internal Revenue Service makes its own rules to void the acts of Congress. One of the provisions of the Internal Revenue Code that the Internal Revenue Service does not like is the one that allows "wages," as defined in the Social Security laws, to be deducted or used as a means of greatly reducing the benefits of the lower paid employees in computing participation in plans of this sort. There is much to be said for the views of the Internal Revenue Service. So be on your guard.

I must repeat that the greatest deductible amount that can be put into such a plan in any one year is 15 per cent of the total compensation for that year of all the beneficiaries of the plan. If, perchance, too much is put up in any year, the excess can be deducted in the following year or years, and if too little is put up one year, the deficiency can (perhaps) be put up the next year. (Do I have to tell you that this is dangerous ground; and do I have to add that, before it is too late, you ought to consult the Internal Revenue Code and the decided cases if you meet this problem?)

Vesting of Beneficiaries' Interests

One of the most important things about trusts of this sort is the vesting of the beneficiaries' interests. You see, the Government is justly apprehensive that there might be some plans under which a large number of the beneficiaries might be unjustly discharged shortly before the time for payment to them comes around. In such cases, the remaining beneficiaries (principally the stockholder-workers) might claim the whole fund. It is, therefore, usually required that title to the beneficiaries' share of the fund must vest in the various beneficiaries at the earliest reasonable date. In pension plans this usually means in practice that each beneficiary's interest shall vest at the rate of ten per cent a year, so that, at the end of ten years, each beneficiary shall have a fully vested interest in the funds put up for him and in the earnings of such funds, even though they might not be payable to him at that time. Under a stock bonus plan the vesting can be slower, because discharged or severed employees do not make very satisfactory stockholders. A good plan is to pay the first year's contribution made for each beneficiary to him during his eleventh year, and so on until a specified date, or until his fund has been paid to him. (In contributory plans, the employee's contribution must always be his, plus interest earned by it. No waiting time is allowed, but when he draws it down, he is *out*.)

Another good idea, quite aside from vesting, is to allow the trustees to pay any given beneficiary in cash if they think he might become a disagreeable or hostile stockholder.

Before I leave the subject of vesting too far behind, I should point out that vesting should take place differently for beneficiaries who stay on, for those who are laid off for want of work, for those who quit, and for those who are discharged. You must be fair to all. Uncle Sam's diligent watchdogs will make sure you are.

There is another important point. Under these trusts the trustees cannot be given the wide authority and discretion that ordinary trustees have, lest they favor the stockholder-workers in the company.

The Union's Part

If there is, or might be, a union, the trust should be drawn in at least two documents, one for the union men and one or more for the others. Then, if the union demands to take over, it can be allowed to do so without calamitous results. The union will not run its part of the plan as well as you run your part. The thing you will have to watch is that the union may run its part so badly that the whole plan is disqualified.

Please note this important item. If the company wants the trust to cover only non-union employees, it can be drawn that way. Never fear, the union members will get what is due them one way or another. You don't have to *give* them stock in the company.

The Other Clauses

Employee benefit trusts contain bankruptcy clauses, amendment clauses allowing any amendment necessary to conform the trust to the requirements of the Internal Revenue Code or to the requirements of the Internal Revenue Service officials; amendment clauses allowing amendments for any reason except such amendments as will change retroactively the benefits of the various beneficiaries, or will render the trust taxable, or will render the contributions to the trust non-deductible. The trust should also contain a separability clause.

From the discussion of the provisions of the trust up to this point, you get a glimpse of the difficulties of the problem.

In the appendix to this article I have made an outline based on several approved trusts that are similar to one that has already bought and paid for three-tenths of a large manufacturing concern. And at the risk of having evil men say I am soliciting your account, I promise to send you a model trust if you ask me to do so, and to help you with advice concerning your *first* case. The practice of law is no field of endeavor for moral cowards, and so I add that I am not afraid of what evil men might say.

To tell you the truth, I do not see how a young lawyer can handle his first case of employee benefit planning without help or without making near-fatal mistakes. If, however, he can't handle his second case *alone,* he is in the wrong field. (Hey! That sentence was nearly a "But, see," wasn't it?)

The trusts found in the decided tax cases had to be taken to court for interpretation and for determination of tax status. Do you want to copy one of them and take your trust to court?

Even after you get your first plan in motion, you must get rid of the thousand and one bugs that are born of the plan or crawl around in it to distress you. I advise you to seek help from the Government authorities (Internal Revenue Service). They are always glad to help you. Or ask me. I'll tell you, if I know.

Government Approval

Maybe I had better return to the subject. At long last and after about fifteen or seventeen typings, the trust instrument is finished. Mr. Patrick and Mr. Homer have approved it; the company has held a meeting and voted the trust; it has been signed, sealed, and sent to the Director of Internal Revenue for approval. It should be added here that it was voted subject to such approval, but look out—such a vote might void the deductibility of the contributions. Better get it all done at once, and before the year is over.

You will understand that there are two ways to obtain government approval. One is to draw the trust and submit it with a letter stating that if approval is indicated, the trust will be executed; and the other is to execute the trust and then submit it. The former is the better procedure, but often the time element makes the latter method necessary. Either way, and in due time, the matter eventually comes before three hard-faced, suspicious government employees, one of whom is either a learner or a too-long employee of the government and is as full of *nyets* as Molotov used to be, and two of whom are as smart and efficient as all hell. When you have finished with this trio, you will have done the trust over three or four more times, and it will be a better trust.

After much work and worry the trust will one one day suit you and your clients and the Government, and will be approved. That is the day for a big party at company expense. Maybe I ought to say, simply, "That will be the day!"

Now your clients can tell their employees all about how the company is giving the workers a stock interest in the company "for free." In fact, you are required to advise the workers of this plan. It is a condition precedent to putting the plan into operation. In the notice to the employees you are not required to mention the fact that all this is being done from a selfish motive, and at a personal profit to the stockholders.

I suggest that this plan be put into operation with as much fanfare as conditions and employee relations permit. Among the publicity moves I suggest you circulate a printed brochure carefully setting out the terms of the trust, both good and bad.

Let me warn you that, during the first three years the plan is in effect the employee response will be negative or even hostile. After three years, when each employee is told the amount of his balance in the fund, the employee attitude will undergo an enthusiastic change for the better. But don't forget, there will always be two loud-voiced soreheads who will give the company a hard time around the corner bar and grill, until they die or are discharged. If they die under the plan, their widows will love you.

TEN YEARS LATER

Now let us assume that ten years have elapsed. It is now 1968. You are going to have to assume that no benevolent dictator has taken over the country, that no deep depression has occurred and still persists, that the civil war between the liberal, godlike bigots and the reactionary ungodly bigots did not occur or has been concluded, and that no foreign despots have come and conquered us.

The fund is in cash because no stock has ever become available. Neither of the stockholders has died. They are both over sixty-five now. The fund is now more than four hundred thousand dollars. That is a very successful plan. The cash balance could have been twice that amount, but over the ten-year period the company did not make enough profit in some years to put up the full 15 per cent of compensation; indeed, the company had, in that ten years, encountered two small-profit years, one loss year, and one year that it took to make up the loss year's deficit (a circumstance for which you were wise enough to make necessary provision in the trust), but still the contributions that were put up, plus tax-free earnings of the fund, created this net balance of more than four hundred thousand dollars. Let's look at the fund:

Total contributions were	$341,250
Total earnings of the fund were, for the fund was safely invested in good securities. You remembered that I said "Don't be greedy," and you had learned from your own practice that "The man who wants 7 per cent and his money are soon parted."	68,240
Total to date	$409,490

What did it cost the two owners to put up this fund? Well, it cost the company $341,250, paid out of money that had not been taxed. The owners' real share in that $341,250 was about 25 cents on the dollar. You see, this was a small company, and the magic of the untaxed dollar, as explained earlier in this article, was not so potent as it would have been in a larger company.

Considering the stockholder's share at 25 cents on the dollar instead of about 19 cents, as is the usual case, their real net interest in the fund was about $85,312. Not so spectacular as in a larger case, but enough.

What is the share of our two heroes in the $409,490 fund, created by them *at your suggestion,* in exchange for this cost to them of $85,312? It will have increased to more than 45 per cent, since forfeitures by those who did not stay increased the share of the remaining participants. It will be more than $180,000, and it is theirs; nobody can take it away from them.

It is true that the owners will each owe a tax when they draw down their share of the fund, but that tax can be held down to less than an aggregate of $45,000.

Therefore, at the worst account, these two men have made a profit of more than $50,000 net, above taxes, on an "investment" of $85,000 in a plan that gave the other workers more than $225,000.

Well then, who really put up most of that $400,000 fund? Taxes put it up. Or let us say Uncle Sam put it up; or let us say *we* did. We didn't feel it, so we are not upset about it.

While considering the costs and the profits, let's not overlook one of the most valuable by-products of this plan. There won't be any strikes in that plant, and very few workers will ever quit; and some day the non-owner workers may own the plant. (If you have installed a pension plan also, this company is the best place in town to have a job.)

Eleven Years Later

Still it was the stockholder-owners who hired you. Perhaps they are not even remotely interested in the welfare of their workers; except, maybe, they have heard about unions. So let's follow the fortunes of the two owners under this plan, bearing in mind that they are already way ahead of the game.

During the eleventh year one of the principal stockholders died. His share in the company was worth, as nearly as government formulas could be applied and other data considered, more than half a million dollars. His other assets, including his interest in the stock bonus plan, and his home, were worth $250,000. His will, which you drew, took advantage of the marital deduction. Still the estate owed a large estate tax and had little cash with which to pay it.

(An interesting study could be made as to whether this estate tax is higher or lower on account of your plan, for you could argue that contributions to the plan cut down company earnings and made the stock less valuable under government taxing formulas for valuation, but you would have to make that argument in the face of the fact that this company did much better year after year as the plan succeeded and as the workers realized more and more what good jobs they had.)

Faced with the necessity of raising money to pay estate taxes and other charges, the dead man's executors sold one-fourth of his stock to the stock bonus plan, leaving enough money in the fund to buy one-fourth of the stock of the other owner when he dies. This is probably the greatest value of the plan, for you have provided the executors with a willing buyer able to pay cash. Thus you have performed the greatest possible service to all concerned. Have you ever handled an estate that owned stock in a closely held corporation and had to sell the stock to pay the estate taxes? If you have, I don't need to tell you how hard it was to find a buyer or how great the eventual losses turned out to be.

By this time you are one of the trustees of the plan and are co-executor under the wills of each of the stockholders, and so you undertake the job of preserving the rights of the estate of the one who died. This takes some doing and, if you are honest, you will be a very busy man. Of course, if you are a wee little bit crooked, you can really shellac the company and the estate and even the living stockholder. I hope this is not the case, for if it is, I have done a great disservice in writing this article.

A Commercial

Now I'm going to declare a station-break and put in a commercial for *you*.

This was your first such plan. It was a small one. Mr. Homer and Mr. Patrick were your Number One clients, and your only ones. You had seen that their corporation needed a plan of this sort; and so you "sold" (excuse the horrid word—many lawyers who have no clients pretend that *you* should not suggest to *your* clients things which they should do—it's unethical—your duty is to help them *after* trouble comes) —sold it to them.

The next plan you installed was for four men who were not your clients but who knew they needed a plan and, finding their own lawyer ignorant of the process, or cold to it, or personally superior to that class of practice, retained you. They had heard of your work. After they had worked with you for a while, they began to see how good your work really is, and then they retained you as their counsel in *all* legal matters. They had other counsel who, as I have mentioned, were a little too selective about what work they handled and what work they refused as being too easy or too difficult for them. I am happy to be able to say that you survived the subsequent bitter complaints made by the other law firm to the sympathetic ear of the Grievance Committee.

You made a fee of $2,500 for installing the first plan, and it has paid you fees of $1,000 a year and will continue to do so for the rest of your life. The pension plan you later installed for the same corporation paid a fee of $5,000 and $2,000 a year from then on, and it, too, will continue to pay as long as you live.

The second client for whom you installed a plan paid a fee of $10,000 and will pay $2,500 a year as long as you keep the account. The other work you did for them paid you $60,000 over the nine years since they gave you their account. I am happy to say that I can now mention these fees, and it is not unethical to do so. I could not mention them earlier in this article, for at that time you did not have those four names on your transom and those twenty on your door.

After those first two cases got into full operation you became known around the county and then around the state as a "big employee-benefit-plan lawyer" and also as an estate planner and then as a tax lawyer, and finally by the super-pseudonym of "Corporation Lawyer."

Before the first ten years were over you were an harassed old man with a switchboard in your twenty-room office suite, two telephones beside your bed, two ulcers, and an unhappy wife. You had a brilliant future that you were destined never to enjoy because of that heart condition your doctor warned you about. You had a large staff of lawyers and other employees who were making so many mistakes for you that you could not afford to make a single one for yourself. You were gathering in more fees than you could possibly spend; but Nature's method of checks and balances came to the rescue and helped you spend the fees all right. Didn't you have that huge payroll to meet every Friday night, and that big rent bill, and all those beautiful federal taxes to pay? You know what the Bible says about "those who live by the sword." You were the envy of every lawyer in the state who, because of his small and pleasant practice, had a chance to get a full night's sleep pretty nearly any time he wanted one. They never suspected how much you would give for just four hours of happy unworried slumber. Every lawyer in the state hated you and called you bad names—that is, every lawyer except one other fellow who read this article and heeded it and was too busy to hate anybody. How, they asked, could a gommel like you have built up such a wonderful practice if he hadn't stolen most of it from more ethical brother lawyers and handled it in an unprofessional manner? And all the while you were still looking for that four hours of peaceful sleep and your wife was packing her trunks and suitcases; and now she's gone.

Do not let this glance into your brilliant future make you impatient to get there too soon.

I forgot to tell you that by the end of the first ten years you were the prospective executor for nearly a hundred estates and active executor for ten. You were also guardian for more than two hundred and ten horrible little some-day-to-be-rich second and third generation monsters, descendants of the beneficiaries of the various trusts you had drawn.

Come to think it over, maybe it would be better if you would stick right now to your good old earthy police court practice where a five-dollar fee is a fee.

End of commercial.

Sections of the Internal Revenue Code of 1954 covering the subject matter of this article are: §§ 401-02, 404, 501, 503, 505, 1361. Government rulings of interest are: T.D. 6203, 1956-1 Cum. Bull. 219; Rev. Rul. 163, 1957 Int. Rev. Bull. No. 16, at 10; Rev. Proc. 12, 1956-1 Cum. Bull. 1029.

APPENDIX

Outline of Profit-Sharing and Stock Bonus Plan

Inducement.—Name and describe parties: employer, trustees. Purpose: to set up a profit-sharing and stock bonus plan, administered by trustees, conforming to requirements of Internal Revenue Code so trust will be tax free and contributions deductible. All parties are citizens of the United States. Trustees agree to accept the duties of their office.

The Trust.—An employees' trust is hereby established. Employer agrees to accrue on its books and pay trustees before the end of current year blank dollars as a contribution to this trust, applicable to and deductible out of this year's income.

The Plan.—To take from employer's profits and deliver to trustees for the sole benefit of beneficiaries certain moneys under the following formula: first, deduct from profits of the year for which a contribution is to be made the sum of blank dollars as a reserve for the benefit of the company. Then use the remaining profits in an amount up to but not exceeding 15 per cent of total compensation of all the beneficiaries as a contribution to the plan. Earnings: define them. Insert a provision for recapturing losses following loss years or years before reaching earnings to be used as a basis for making any further contribution.

Trustees' Acceptance of Trust.—Trustees agree to take the money and handle it according to terms of the instrument, for the sole benefit of the beneficiaries.

Beneficiaries.—Define them. Usually provide for a waiting period of, say, two or three years before becoming eligible. Some provide for a five years' waiting period.

Benefits.—The easiest and fairest method of dividing the benefits is on the basis of the proportion that the contribution based on each beneficiary's compensation bears to the total contribution. This may not be feasible, for stockholders do not have to inaugurate a plan, and will not do so unless it suits them. Schedule A attached to the trust shows the amount of the original contribution and the proposed participation of each beneficiary. This schedule shows the meaning and intention of the trust. A new schedule should be required to accompany each year's contribution. It should be prepared in the same manner and on the same basis as Schedule A.

Handling of Funds.—The funds should be conservatively invested until an opportunity to buy employer's stock at a fair price arises, and should then be invested in such stock. Profits should be credited as income. An account should be kept for each beneficiary who should bear his share of losses and be credited with his share of profits.

Further Contribution by Employer.—The employer is not obliged to make any further contributions; but unless it decides otherwise, or under the formula no contribution is indicated, it should be required to make a contribution each year according to the formula.

SUSPENSION OR ABANDONMENT OF PLAN.—The trust survives even if the plan is suspended or abandoned, unless the Internal Revenue Code decrees otherwise. Suspension or abandonment shall not work any forfeiture on any beneficiary.

DISTRIBUTION.—Distribution may be made in cash or in kind. At the discretion of the Trustees, in proper cases, on severance, distribution may be made in a lump sum instead of over a period of years. Otherwise, distribution is made as follows:

DEATH.—To beneficiary's designee or estate, but not sooner than ten years after deceased beneficiary became a beneficiary and over a period of not less than ten years.

RETIREMENT.—To beneficiary at actual retirement but not sooner than age 65 or ten years after becoming a beneficiary, if that be later; then over a period of years not less than ten in number.

SEVERANCE FOR CAUSE.—On severance for cause before ten years under plan, a beneficiary forfeits all to other beneficiaries.

SEVERANCE NOT FOR CAUSE.—On severance not for cause, before ten years under plan, a beneficiary's fund is his, but payable only after age 65 or ten years a beneficiary if that be later; then over a period of not less than ten years.

VOLUNTARY SEVERANCE.—Same as severance for cause.

SEVERANCE FOR ANY REASON, AFTER TEN YEARS UNDER PLAN.—After ten years under plan a beneficiary's fund is his, but payable over a period of ten years beginning at age sixty-five or ten years after becoming a beneficiary if that be later.

NORMAL OR PERIODICAL.—On the eleventh year, the first year's contribution, if any, with profits less losses; and so on until all is disbursed. This applies only on election given thirty days before end of tenth year.

IN GENERAL.—All unpaid funds earn interest and share losses of the trust. Trustees may rely on advice from the employer as to cause of severance. Trustees shall make no loans to beneficiaries.

SEPARABILITY CLAUSE.—Any clause which violates the Internal Revenue Code is void but shall not invalidate the trust or any of the other provisions of the trust.

RIGHT TO REVISE.—The parties shall have the right to revise the trust to conform to the Internal Revenue Code, Regulations and Rulings, and for any other proper reason.

INTERPRETATION.—Interpretation favoring tax-free status must govern; otherwise rules of law of the state govern.

OTHER RIGHTS AND DUTIES OF TRUSTEES.—Trustees shall defend the trust as a tax-free employees' trust. Trustees shall use all principal and profit or trust for sole benefit of beneficiaries. Trustees shall be governed by terms of trust as to maximum and minimum number of Trustees. Trustees shall serve without compensation from the trust funds. Employer pays their charges and expenses. Trustees shall have right to appoint additional Trustees, not to exceed maximum provided in trust. Trustees shall have right to maintain bank accounts for trust funds. Trustees may designate one or more signing Trustees to execute papers necessary to the administration of the trust, and to sign checks on the Trustees' bank accounts. Trustees may delegate clerical and operational duties to bonded employees of the company. Trustees may resign on written notice to the other Trustees. Surviving Trustees may appoint successor Trustees up to maximum allowed by trust. Trustees shall have all powers not specifically granted which are necessary to carry out the purposes and intent of the trust. Trustees shall have right to interpret trust. Trustees shall have right to borrow funds from employer if such funds are required in the administration of the trust. Trustees are liable only for gross negligence or wilful misconduct.

PERSONS DEALING WITH TRUSTEES.—May assume that a signing Trustee's signature is authorized by the Trustees; need not inquire into application of any money paid to the Trustees.

CLAUSES GENERAL TO TRUSTS.—Spendthrift clause. Upon alienation of his interest, his bankruptcy, etc., beneficiary loses vested interest in funds contributed for his benefit, but Trustees, in their discretion, may use some or all of the funds held for the beneficiary for his maintenance or support. Masculine pronouns refer to female beneficiaries as well as male. Employer's intent is to continue plan, but is not committed to make future contributions. Duration of trust—usually endures for twenty-one years after death of last surviving original beneficiary, unless terminated prior to that time under other provisions of the trust. Where allowed by state law—forever. On dissolution, funds otherwise not disposed of under trust terms are divided among beneficiaries in proportion to total employer contributions made for their respective benefits. Distribution governed by general distribution provisions of the trust. Effective date of trust specified. Name of trust. Acknowledgment.