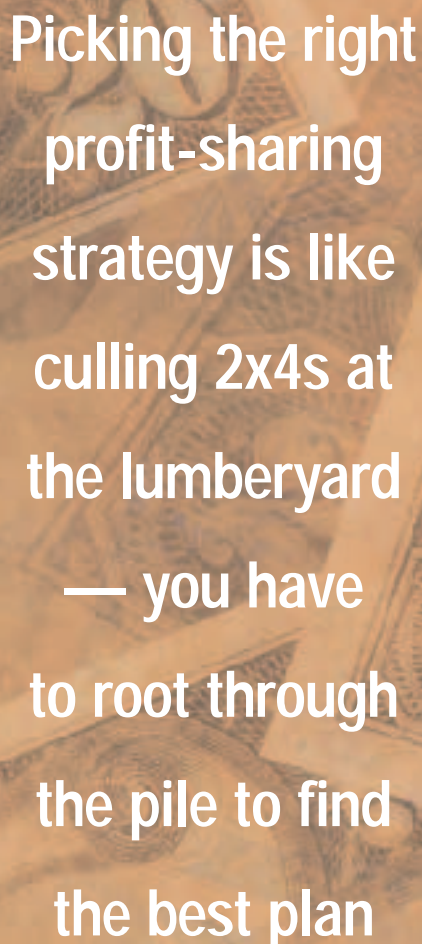


# CHOOSING A Profit-Sharing Plan

**O**ver the last year or so, I've spent a lot of time researching a profit-sharing plan. One reason is that at the age of 43, with 20 years in the business, I've begun to think about retirement more frequently. A profit-sharing plan is a good way for a business owner to put some additional money away, but my main reason for forming a profit-sharing plan was to attract and keep key employees. In my very competitive skilled-labor market, I hoped that profit-sharing would be another aspect of my company that separated us from the crowd. I also wanted my existing employees, some of whom aren't so far from my age, to have a vehicle that could give them a head start on their own retirement planning.

Initially I was worried that I might not be able to make regular contributions to a profit-sharing plan. Everyone in this business knows that some years are better than others, and some years aren't any good at all. I was also concerned about the administration of the plan. I didn't want to spend a lot of office time managing the plan. Already the time spent on non-income-related items such as health insurance, regulatory agencies, and telephone calls from Hollywood agents exceeds my comfort level.

With these goals and concerns in mind, I set out to design a plan that would address my needs. There are many different kinds of profit-sharing



Picking the right  
profit-sharing  
strategy is like  
culling 2x4s at  
the lumberyard  
— you have  
to root through  
the pile to find  
the best plan

by R. Craig Lord

plans, and individual features can be combined to create a custom plan that fits a special set of requirements. Because all of the plans differ on vesting, participation, loans, payouts, and other features (see "Key Terms," next page), it's important to seek advice from an investment professional.

My financial advisor wanted to steer me toward more well-known plans like SEP-IRA and 401k. Both plans have low administrative costs, but neither one was right for me. The SEP-IRA involves pre-tax contributions made by the employer into individual IRA accounts for each employee. Because these accounts are in the employees' names, however, all participating employees would be 100% vested from day one. That didn't meet my goal of attracting long-term employees, since it provides no incentive for an employee to stay with my company for the long haul. I favor deferred vesting, which requires employees to wait a specified period of time before 100% of the money is available.

The 401k plan is popular and easy to set up (most payroll companies now offer 401k administrative services), but it also has some disadvantages. In a 401k, employees are also fully vested from the beginning because they contribute their own pre-tax dollars to the plan. The employer can also make contributions, which can be linked to amounts or percentages contributed by employees. The downside is that if

employee participation levels are not high enough, the employer may have to make across-the-board contributions.

### Flexible Plan

I settled on a simple profit-sharing plan that both addresses my goals and answers my concerns. First, the contribution amount is totally discretionary. As the employer, I decide each year on the total amount to contribute to the plan. This means I'm not locked into a minimum contribution and I can reduce the amount during a slow year.

Deferred vesting is also included in my plan. The graduated vesting schedule for employee accounts starts at 20% after two years and rises to 100% after six years. In other words, a person who leaves his or her job after two years only gets 20% of the money in his or her account; someone who stays six years or more has access to all of the money. This is the feature that I hope will influence employees to make a career with my company. An added bonus for people who stay is that partially-vested employees forfeit the unvested portion of their money

if they leave early, and that money is split among the remaining participants.

This plan also helps me to reward key employees. Money is assigned to each eligible employee's account based on a ratio with Social Security contributions. This means higher-paid employees receive a larger share. Since key employees are likely to be paid at a higher rate, the plan enables me to sweeten the pot at the end of the year.

### Approval and Administration

Finding a plan that has the features you want is just the first step. The law requires that you choose a plan administrator, get the plan approved, and put an investment vehicle in place.

I designated my accountant as the plan administrator. I could have chosen to administrate the plan myself, but having my accountant record the contributions and perform all the plan bookkeeping also keeps the paperwork out of my office, where I already have enough to do just running my company.

The particulars of every profit-sharing plan must be approved by the Internal

## Key Terms

One of the first hurdles in choosing a profit-sharing plan is understanding the terminology. Here are some of the most common terms you'll encounter:

**Vesting.** An employee is considered "fully vested" when 100% of the money in his or her name is available to that employee should he or she retire or leave the company. Plans that use contributions deducted from employee paychecks are fully vested from the beginning. If the plan is funded with company contributions, however, employees may be partially vested for a period of time before becoming fully vested. For example, an employee who leaves after two years of participation in

a plan may receive only 20% of the funds in his or her account. In some plans, leftover funds from partially vested employees who leave the company are redistributed among the accounts of remaining participants. On the other hand, if the owner shuts down the business, everyone is automatically 100% vested.

**Deferred participation.** This refers to a waiting period before an employee becomes eligible for the plan. Participation can also be adjusted to include only full-time permanent workers.

**Integration with Social Security.** Payments to eligible participants in the plan can be based on employee Social Security contribu-

tions. This allows greater payments to higher paid employees.

**Loans.** Certain plans allow participants to borrow for approved needs, such as home purchase, college tuition, or a medical emergency. The circumstances and terms under which an employee may borrow against his or her account are clearly spelled out in the plan.

**Payout options.** When designing a plan, you must choose how to distribute the proceeds when an employee retires. The two options are incremental (monthly or annual) payments, which require the company to maintain the account after the employee has retired, and a lump sum payment.

Revenue Service. To custom-build a plan would have required the services of an attorney and could have become fairly expensive. Instead, I opted to purchase an approved plan from a company that specializes in developing and maintaining approved plans. For an annual fee of \$150, I get use of the plan, plus automatic updates when any law changes affect the plan.

The final step required selecting an investment vehicle for the money in the plan. My accountant cautioned me against making the investment decisions myself. He felt that, in the event the investments did not perform well, having an independent investor would protect me from any possible complaints about mismanagement. I followed his advice and interviewed numerous investment firms before settling on a company that specializes in mutual funds. This company offers six different asset allocation models at varying levels of risk. I chose an aggressive portfolio that I hope will grow rapidly. As my employees and I get closer to retirement age, I'll switch to a less risky investment model. The annual fee for this service is 1.5% of all assets. I can change the asset allocation plan any time at no cost.

After all of the choices had been made and the plan was put in force, I invited all of my employees to a company luncheon with my accountant present. We explained the plan and passed out copies of the rules and regulations to each employee. Each employee also receives an annual statement showing the current year's contribution and the accrued value of his or her account.

My employees had known for a while that I was working on a profit-sharing plan, so they weren't surprised. It's too early to say whether it will influence their decision to stay with my company, but they were grateful to have a stake in the fruits of their labor.

### The 5% Solution

The money to fund the plan will come from a systematic savings plan I started years ago after reading the book *The Millionaire Next Door* by Thomas J. Stanley and William D. Danko. Following the plan, I take 5% of every check that comes in the door and place it in a money market account. This year, I'll take some of that money and use it to fund the profit-sharing plan.

The 5% deposits start to add up. Soon, your money market account frees you from the stubborn banker who is having trouble granting you an unsecured credit line, or from the problem customer who thinks you should buy your final payment from him by granting a discount. You can tell them both to take a hike because you have three weeks' payroll saved up.

The mechanics of this savings program are simple. Keep taking the 5% and replace what you borrow from the account before paying any other bills. If you need some incentive to get started, do the math: On a volume of \$500,000, the 5% savings adds up to \$25,000. Wouldn't it be nice to have that in the bank at the end of the year?



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## A Profit-Sharing Profile

**T**ait Co./Tait Roofing is a 27-year-old remodeling firm based in Moorestown, N.J. It is a well-respected firm with an excellent reputation. Laurence C. Tait is the president of the company and has always been a good source of advice for me. Larry's profit-sharing plan, which is very similar to the one I selected, has been in

place for about 20 years. "The more incentives you can give to an employee the better," Larry says. "In an industry that has notoriously high levels of turnover, we may have the longest tenures of employees around. We have several employees with 12 to 15 years of employment."

Making contributions on an

annual basis for 20 years can really build up a nest egg. Several of the employees of Tait Co./Tait Roofing have individual balances exceeding \$100,000.

"I feel the profit-sharing plan has worked," says Larry. "It's part of a combination of things you do to keep key employees."

— R.C.L.