An Analysis of Executive Fringe Benefits

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AN ANALYSIS OF EXECUTIVE FRINGE BENEFITS

by

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1959
The thesis submitted by Robert Francis Riefke has been read and approved by three members of the faculty of the Institute of Social and Industrial Relations.

The final copies have been examined by the director of the thesis and the signature which appears below verifies the fact that any necessary changes have been incorporated and that the thesis is now given final approval with reference to content, form, and mechanical accuracy.

The thesis is therefore accepted in partial fulfillment of the requirements for the Degree of Master of Social and Industrial Relations.

June 1, 1959

Signature of Advisor
The purpose of this thesis is to analyze the four main types of executive fringe benefits. This is an important issue for both employers and executives because of the tax situation. Executives must earn $25,000 now in order to have the same amount of purchasing power as a person who earned $10,000 in 1939. In order to compensate today's executives more justly, modern management has turned to means other than straight salary, namely fringe benefits. The four most common types of executive fringe benefits are deferred compensation plans, stock option plans, executive pension plans, and executive bonus plans.

Deferred compensation plans are increasing in usage each year. They are becoming more popular because executives enjoy tax advantages from these plans. There are two types of deferred compensation plans, one for long-term purposes, the other for short-term purposes. Each has advantages and disadvantages. Long-term plans give an executive security and assures the company of the executive's talent for a long time. At the same time, however, the executive must remain with the company for many years before he will receive any deferred payments. Also, the company cannot
take any tax deduction until the payments are made. Under a short-term plan, an executive will collect his deferred payment after a short period of employment, usually three to five years. Also, the company does not incur any long range debts under this type of plan. However, the company may lose the service of a valuable man after only a short period of time. The executive who receives deferred payments under a short-term plan will probably be in a higher income bracket, and therefore the payments will be highly taxed.

The executive is the one who gains the most from deferred compensation plans. The company doesn't gain any tax advantage, but it is able to attract and retain top executive talent. This is especially true for small companies which cannot afford to pay high salaries. Another disadvantage to most deferred compensation plans is their inability to motivate young executives. In order to overcome this disadvantage inherent in deferred compensation plans, the companies should make them more flexible. That is, they should be arranged so that they motivate young and old executives alike.

The second type of executive fringe benefit analyzed is the stock option plan. Usage of this fringe benefit has also increased in recent years. It is popular (1) because of the tax advantage, (2) it also provides more of an incentive than cash, and (3) it does not require spending of company funds. There are two types of stock option plans, restricted and nonrestricted.
Restricted stock options must meet the requirements of the Internal Revenue Act of 1954, while unrestricted stock options do not. The main advantage of restricted stock options is that the money realized by the executive from the sale of stock is treated as capital gain. However, income gained from the sale of non-restricted stock options is treated as ordinary income for tax purposes. The main advantage in using nonrestricted stock options is that the executive may purchase them at far less cost than if he were to purchase restricted stock options.

Most experts agree that stock option plans should be offered only to those men who contribute to the profits and growth of the company. Also, in order for a stock option plan to really motivate executives, the company should participate in financing executive purchases of stock options. The biggest disadvantage in using a stock option plan as a fringe benefit is that it may appeal only to a certain type of executive. Therefore, stock option plans alone are not a sufficient means of attracting and retaining top executive talent.

The third type of executive fringe benefit studied is the executive pension plan. There are two main types of pension plans, qualified and non-qualified. Qualified plans must have non-discriminatory coverage, nondiscriminatory contribution and benefits, and permanency. This type is more popular because of tax advantages to both the employer and the executive. Non-qualified plans do not meet the above named requirements.
Therefore, a company may discriminate in favor of executives for pension coverage. However, either the executive must be taxed on the money set aside for him or the company cannot take any tax deduction. This is the big drawback in this type of pension plan. Generally speaking, the best kind of plan to use is a qualified plan. However, this should not be the only fringe benefit offered to executives because of the limitation on the amount they may receive from a qualified pension plan. Deferred compensation, stock options, or bonuses should also be offered in order to provide a better fringe benefit program.

The final form of fringe benefit studied is the executive bonus plan. Unlike the other executive fringe benefits which are increasing in usage, executive bonuses are decreasing in popularity. They offer no tax advantage to the executive, but the company does get an immediate tax deduction. Another reason why companies use bonuses as an incentive is that unlike deferred compensation and stock option plans, bonus plans can be reviewed every year. Therefore, the incentive value of bonuses is not spread out over a period of years. One of the most important items in administering a bonus plan is that the amount of bonus granted to an individual each year should be based on each individual's performance, rather than on length of service, salary or other factors.
The final item studied in this thesis is the cost of the various types of executive fringe benefits. Actual cost figures for such things as deferred compensation plans and stock option plans are not available. However, there are certain percentage figures available for pensions and bonuses. The latest figures indicate average pension costs as 5.1 per cent of a company's payroll. However, this figure includes employee, as well as executive pension plans. A recent survey on executive compensation indicated that the average bonus paid to an executive was 12.6 per cent of his salary. Other than these figures, statistics are not available on the costs of the four types of executive fringe benefits studied.

Fringe benefits for executives will probably continue to grow in kinds and costs. This seems to be the only means a company has to increase an executive's earnings, and at the same time, the company can save tax dollars not only for the executive, but in some cases, for itself too.
Robert Francis Riefke was born in Chicago, Illinois, April 10, 1931.

He was graduated from Quigley Preparatory Seminary, Chicago, Illinois, June, 1950. He attended St. Mary of the Lake Seminary, Mundelein, Illinois, St. Joseph's College, Rensselaer, Indiana, and graduated from the University of Loyola, June, 1956 with the degree of Bachelor of Science, Commerce.

From 1956 to the present, the author has been employed as Assistant Office Manager and Assistant Personnel Director of a leading electronic instrument manufacturer.

The author began his graduate studies at Loyola University in September, 1956.
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CHAPTER I

GENERAL BACKGROUND OF FRINGE BENEFITS

Fringe benefits are becoming increasingly important issues in the lives of both management and labor. No longer are the amount of direct wages and salaries the only factors which unions, executives, and personnel men study for their respective needs. They are now interested in the amount of indirect wages which they are receiving, and unions are perennially trying to increase these benefits through collective bargaining. Executives also give considerable thought to this idea, especially when considering their future with a company. Personnel men must keep abreast of the current policies of other companies, in order to make sure that their employers are keeping pace with others in this respect so that they can not only attract new skilled workers to their plant, but also so that they can retain their people in their present jobs.

A. IMPORTANCE

Fringe benefits are a very important part of the wage and salary "package." They have three characteristics. They increase directly or indirectly the monetary income of employees; they benefit the employees directly and primarily, rather than the employers; and they may increase the employers' total labor
costs. Actually, by using fringe benefits instead of direct wages for compensating executives, a corporation spends less and the executive gets more.²

B. SCOPE AND METHOD OF STUDY

This paper will concentrate on a critical analysis of executive fringe benefits which are somewhat different in nature from employee benefits. This type of executive compensation is becoming more and more popular, mainly due to tax provisions which have an effect upon the net income of highly paid men. Because of today's tax laws and the increased prices, an executive must make $25,000 in order to have the same amount of purchasing power as a person who made $10,000 in 1939.³ In order to overcome this inequity which exists between the income of comparable executives in 1959 and 1939, modern management is turning to other forms of compensation for executives, namely, fringe benefits.

This thesis is devoted to analyzing the plans for deferred compensation of executives, the tax advantages to both employee


² See Table 1, Page 3.

TABLE 1
FRINGE BENEFIT METHOD SAVES MONEY

<table>
<thead>
<tr>
<th>Executive Income Level</th>
<th>Amount to be Paid for Benefits</th>
<th>Added Salary Needed to Provide Sum in Col. B*</th>
<th>After-Tax Cost of Salary Increase Method</th>
<th>After-Tax Cost of Benefit Method</th>
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<td>1,500</td>
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<td>720</td>
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<td>8,000</td>
<td>3,840</td>
<td>960</td>
<td>2,880</td>
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*Does not include tax deductions by executive for benefits cost to him. Source: Research Institute of America, Inc.

and employer from this type of payment plan, and to an analysis of executive stock option plans, executive pension plans, and executive bonus plans. These items are the chief kinds of fringe benefits for executives. Of course, there are many other types of executive fringe benefits which are also used to help compensate top management. Paid club and association dues and memberships, health and welfare plans, physical checkups, special vacation allowances, and many other fringes are used by industry to help attract and hold key men. To try to analyze all of these in this work would be too large an undertaking. Therefore, this paper will concentrate on the more important types of executive fringe benefits.

Attempts to obtain enough pertinent information from individual companies were not successful. Therefore, information for this work has been gathered from studies and published material on executive compensation, including many current periodical articles covering the subject of executive fringe benefits. It will also include plans of executive fringe benefit programs which are used by certain companies. Some of the original sources used were Dartnell, Arch Patton's Study on Executive Compensation, a study by the National Industrial Conference Board, and a research study on executive pay plans by William Casey.
CHAPTER II

DEFERRED COMPENSATION

One of the most popular forms of executive fringe benefit is the deferred compensation plan, due mainly to the tax advantage of deferring part of the executive's income to the years after retirement when his total income is less and his income tax rate will be lower. ¹

A. DEFINITION

Deferred compensation can mean that some part of his bonus or share of the profit is set aside for future payment to the executive, such as a salary continuation after retirement. It can mean that a portion of his high salary is being set aside by payments to a fund which the executive will not collect until retirement.

Deferred compensation was not always an important factor in the total income for executives. There was a time when an executive would rather take a $100,000 salary now, instead of $50,000 now and $50,000 deferred. This was due to the prestige factor. He would rather say that he had a $100,000 a year position, even

though in the long run most of it was going to the government through taxes. Now, however, due to the present tax structure, the prestige factor is less important. ²

B. INCREASED USAGE

In Arch Patton's most recent survey of executive compensation and fringe benefits, he found that there is a definite increase in the number of companies using deferred compensation plans for their executives. In 1957, one-third of the reporting companies had some kind of deferred compensation plan, while only 26 per cent used them in 1956 and 17 per cent in 1955. ³

C. TYPES OF DEFERRED COMPENSATION

There are two chief types of deferred compensation plans which are in use today. One is used for long-term purposes while the other is for short-term purposes. The long-term plan is designed: (1) to give the executive and his family security and a future income and (2) to give the company the benefit of the executive's continued service. ⁴ Connected with this type of plan

²"Ideas Shift on Executive Pay", Business Week (June 16, 1956), 85.


there is usually a contractual agreement between the company and
the executive stating that upon retirement the executive will not
enter into competition with the company or will not go to work for
any competitor. Also, the executive promises to be available for
consultation should the company request it. There is usually,
also, a clause in the contract that if the executive should leave
the company before the stipulated time, he would not be able to
take any of the deferred payment with him.5

An example of this type of plan is the contract which Stewart
Warner had with its president, James Knowlson, who died recently.
They agreed to pay him $12,000 a year for the rest of his life and
after his death, $10,000 a year to his wife for life. However, he
had to fulfill his present contract, serve as a consultant after
he retired and he could not engage in competitive activities.6

A deferred compensation plan for short-term purposes differs
from the above in that a company may desire the services of an
executive for only a short period of time, rather than until
retirement, or the executive may not wish a long period contract.
The executive, therefore, usually contracts to work for a company
for three to five years and, possibly to consult for a term of
three to five years more.7 This plan must also meet the

5Ibid.
6Ibid., p. 40.
7Ibid., p. 42.
requirements of the long-term plan if tax evasion accusations are to be avoided. Short-term plans are advantageous to the employer because they do not incur long-range obligations. The executive also benefits because his obligations to a company are not as extended. The disadvantage to the company is that they may have an executive working under this type of arrangement whom they may want to retain. However, after his contract is over he is free to leave and he still collects benefits from any deferred compensation plans under which he was covered. There is a disadvantage to the executive because his future will not be as secure under this type of plan. Also, since he is not working until retirement, his income after he leaves the company will probably still be fairly high, so that his deferred income will still be taxed at a high rate.

D. LEGAL REQUIREMENTS OF DEFERRED COMPENSATION PLANS

In offering salary continuation plans to its executives, the company must, according to the experts, be very careful of the way in which the contract reads. It should not appear that the plan has been instituted to evade taxes, but only to avoid them.\(^8\) There must be present in the contract some of the following factors: a need of the company to use in its business the funds which are being deferred; inability to pay a salary as high as the executive should make; making the deferred compensation contingent

\(^8\)Dartnell, Executive Compensation (Chicago, 1956)
upon the executive being with the company when the payments fall due; making payments of the deferred income contingent on good work performance; need of the executive for future payments in order to give him security during a time when his financial status will be uncertain.\(^9\) If the above clauses are included in the contract, experience shows that the tax advantage of deferred compensation may be preserved. That is, his deferred payments will not be taxed until received and they will be taxed at a lower rate if the executive is not earning his present high salary and, therefore, he will be in a lower income bracket.\(^10\)

The case which tested the legislation on deferred compensation is the \textit{Howard Veit} case. It concerns a contract which was entered into by Mr. Veit and his employer, M. Lowenstein and Sons, Inc. Mr. Veit was considered so valuable to the company that his employers paid him a base rate, plus 10 per cent of the net profits. In 1940 Mr. Veit's contract was set up so that the money which he would receive from the net profits would be given to him on a deferred basis beginning in 1941 and for five years thereafter. The contract was questioned by the Internal Revenue Department and it contended that Mr. Veit should have declared

\(^9\)George Thomas Washington and V. Henry Rothschild, \textit{Compensating the Corporate Executive} (New York, 1951), p. 180. (Actually, the tax laws on deferred compensation are not yet crystal clear, and there are not enough tax case decisions to be perfectly sure on the subject.)

\(^10\)"\textit{New Pay Ideas Help Hold Executives}," p. 68.
his income from the net profits when reporting his 1940 income
taxes. The service wanted to apply the doctrine of constructive
receipt of money to Mr. Veit.11 However, the Tax Court decided
in favor of Mr. Veit and ruled that this doctrine could not be
applied against the deferred compensation due him.12

E. TAX ADVANTAGES AND DISADVANTAGES

It has been pointed out that the deferred compensation plans
offer a distinct tax advantage to the executive. However, a com-
pany does not gain any tax advantage by using this kind of fringe
benefit for executives. No tax deductions can be taken by the
company until the money is actually paid to the executive.13

However, by use of these plans a company may attract and hold
good executives. This is especially true of small companies that
do not have the income to pay large salaries to their top men.
The executives agree to salary continuation plans, whereby they
will receive 20 to 50 per cent of their annual salary spread out
over a period of time after they leave the job. By means of this
method of payment, the small companies can get management person-

11 The doctrine of constructive receipt means that all money
earned by a person in one year, even if he will not receive it
until later years, is taxable in the year earned.

12 The Tax Court of the United States Reports, VIII (Washing-
ton D. C., 1947), 809-821.

13 Dartnell.
nel at a lower initial cost. It is really the executive who gains a terrific tax advantage by the deferred payment. With competent legal and insurance guidance, a deferred compensation plan can be arranged so that the individual and the company can get maximum dollar value. It must be a specific plan, not subject to the uncontrollable factors that are present in stock-option and profit-sharing plans. It provides a means of retaining the services of present executives and their valuable advice after retirement.

F. OTHER DISADVANTAGES

One of the biggest disadvantages, common to both long-term and short-term deferred compensation plans, is their inability to motivate the young executive by the promise of deferred compensation twenty or twenty-five years away. He is more concerned with a high salary immediately to help pay off the mortgage on his home, to acquire basic needs, and to keep a high standard of

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15 See Table 2, Page 12. Here are comparisons of an executive's after tax income when he takes an annual increase of the stated amount during a 10 year period, with the amount he keeps if the increase is deferred and paid over a 10 year period after retirement. (The table assumes continuation of current tax rates, and that other income equals deductions and exemptions in the years before and after retirement.)

**TABLE 2**

**DEFERRED RAISES SAVE ON TAX**

<table>
<thead>
<tr>
<th>Income Level</th>
<th>Annual Raise</th>
<th>Raise Total</th>
<th>Gov't. Takes</th>
<th>If Paid Currently</th>
<th>If Raise Deferred</th>
<th>Saves by Deferral</th>
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</thead>
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<td>$76,300</td>
</tr>
</tbody>
</table>

*"New Pay Ideas Help Hold Executives", p. 35.*
living for himself and his family. Also, the prospect of remaining in the same company for such a long period of time is sometimes not too attractive to the young executive. Yet, he realizes that each year he builds up more and more money in this deferred fund for the future and he is hesitant to leave the company and, thereby, lose his benefits. In some cases he may even stay with a company even though he dislikes his job or the company in order to collect his deferred compensation.

The company also is at a disadvantage in contracting to pay deferred income to executives. If it should have a bad profit year, it still has to pay the deferred compensation to the executives.

G. SUGGESTIONS FOR IMPROVEMENTS

Because of the disadvantages in most deferred compensation arrangements, those who have studied the problem believe there is a definite need for more flexibility in the plans, if they are to really fulfill their purpose in motivating men and at the same time, ease the financial burdens of the company. Therefore, the experts feel that deferred compensation plans should be arranged and administered so that all executives are motivated by them and so that the company will not suffer adverse effects if losses are suffered by the company. Cited as a good example of a flexible

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deferred compensation plan is the one which the Beltone Hearing Aid Company in Chicago offers to all its middle and top management personnel.19

The Beltone plan is set up as a deferred-compensation, profit-sharing plan based on the amount of money each participant earns over $4,200 annually. Each year, depending upon the profit situation, the Board of Directors decides upon some per cent of the money he earned over $4,200. It is set aside for each executive and put into a trust fund for him. For instance, if an executive earned $10,000 in a year and the Board of Directors voted for a 10 per cent share of the amount earned over $4,200, in this case, $5,800, $580 would be set aside that year for the executive. All the money is given to the executive upon his retirement from the company, either in a lump sum, by installments, or as a life-income annuity, depending upon his wishes. If the executive decided to leave the company or if the company terminates his services, he will receive from 10 to 100 per cent of the money accumulated in the fund for him, depending upon his length of service. If he was with the company one year, he would receive 10 per cent of the money in his account, two years 20 per cent, three years 30 per cent and so on up to ten years service. Any time after ten years he will receive whatever amount has

19Information concerning this plan obtained from legal description of the Beltone Deferred Compensation Plan, dated November 1, 1954.
accrued in his account. Also, if the participant died before retirement, his deferred compensation would be given to his designated beneficiary.

Under this plan if an executive does leave, he will still enjoy benefits from the deferred compensation plan. As mentioned before, in many deferred compensation plans if a person leaves he loses all that has been set aside by the company for him. This plan provides motivation for young, as well as older management men.

Also, the company is not legally bound to put aside money each year for this plan. It depends upon the profit each particular year, so that if it has a poor year, it does not have to pay into the deferred salary fund. This also provides an incentive to executives to help produce increased profits. Another advantage to the company is that each year, as money is put into the deferred compensation plan, it can be taken as a tax deduction.

One disadvantage to this kind of plan is that it does not insure a company that an executive will stay with it until his retirement; another is that the executive does not know each year if he will get anything and if he does get something, the amount is uncertain.
CHAPTER III

STOCK OPTION PLANS

A. HISTORICAL BACKGROUND

Another popular fringe benefit for executives is the stock option plan. This kind of plan usually provides that an executive may purchase shares of company stock at a future date at the present market price or lower so that, if the price of the stock rises, he will find it profitable to exercise his option to buy.¹

This kind of plan was first introduced on a large scale around the early 1900's and became more popular in the 1920's. It was used as a means of creating employee loyalty.² However, during the depression the value of most stock decreased so that no one could profitably exercise his option and, therefore, the popularity of this type of fringe benefit faded. With economic recovery, the stock option plans were again revived and were popular until 1945, when the Supreme Court handed down an adverse ruling concerning the tax advantages of stock option plans in the


²Washington and Rothschild, Compensating the Corporate Executive, p. 121.
famous Smith case. After this, stock option plans were sparsely used until the Internal Revenue Act of 1950 was passed to change the tax treatment of stock option plans to the benefit of the executive. The profit gained from exercising stock options could now be treated as capital gain, rather than as ordinary income, providing certain restrictions were met.

After that there was a substantial increase in stock option plans and, today, such plans are becoming even more popular in the field of executive fringe benefits. A 1957 survey of executive compensation shows three out of every five companies reporting used stock options as a form of executive fringe benefits. This was a modest increase over 1956.

B. REASONS FOR POPULARITY

There are several reasons why these plans are becoming more popular. They have the same tax benefit as deferred compensation in that the executive does not have to pay taxes until he exercises his option in a restricted stock option plan. Also, salary

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3Cases Adjudged in the Supreme Court of the United States (Washington, 1946), CCCXXIV, 177-182.


6Patton, Annual Report, p. 131.
raises may not provide an incentive while stock options do, without using corporation funds. Finally, when executives purchase stocks, additional funds are invested in the business.  

C. LEGAL REQUIREMENTS OF RESTRICTED STOCK OPTION PLANS

There are two basic kinds of stock option plans, restricted and nonrestricted. Restricted stock options must meet certain legal requirements as set up by the Internal Revenue Law of 1950, amended in 1954. The rules are as follows. (1) The stock option must be given for reasons connected with the person's employment. Therefore, an employer may discriminate as to who will receive the option. At the same time, however, he may not give any stock options to anyone not regularly employed by the company. (2) The option price must be at least 85 per cent of the fair market price at the time of the option. However, if the option price is 95 per cent, all income gained upon the sale of the stock will be treated as capital gain. If the option price is less than 95 per cent, all or part of the income gained, depending on the option price, might be taxable as ordinary income rather than as capital gain. (3) It is nontransferable, except at death, and exercisable only during the employee's life. (4) An employee cannot own more than 10 per cent of the voting stock. (5) To gain the tax advantage, the stock taken under the option cannot be sold within two years from the date of option or within six months after purchase.

7Dartnell, Executive Compensation.
The option must be used by the employee while working for the employer, or within three months after termination. The option must be exercised within ten years.

D. ADVANTAGES OF RESTRICTED STOCK OPTION PLANS

One of the biggest advantages of restricted stock option plans is the avoidance of high income tax rates. Here again, however, a company must be careful to show that tax avoidance is desired for the executive, not tax evasion. If the above regulations are met, the income realized by the sale of the stock will not be taxed at more than 25 per cent, the long term capital gain rate. This, then, is a definite advantage to the executive.

The company, however, does not gain any corporate deduction from its taxes when stock options are granted. However, it does give the executive extra compensation and incentive without requiring additional outlays of cash. The only cost to the company is dividends paid on the stock purchased and a modest dilution of outstanding stock.


The second kind of stock option is the nonrestricted type. These stock options do not meet all the requirements of the law. For example, a company may offer an executive a stock option at a price which is less than 85 per cent of the fair market price. This would make the stock option a nonrestricted one. The Internal Revenue Department has ruled that any income derived from the sale of nonrestricted or unrestricted stock options will be taxed as ordinary income at the progressive rate, depending on the present income status of the executive.\textsuperscript{12}

By using a nonrestricted stock option plan for compensating executives, it is possible the company and the executive can both enjoy advantages which they could not have if they used restricted options. Caution must be exercised in drawing up a contract for nonrestricted stock options, so that they do not appear to be compensatory in nature. If arranged properly, the executive's investment can be lower than 85 per cent of the fair market price. On the sale of nonrestricted stock options, the company has certain tax advantages because it may consider the profit which the executive makes as deductible since it is treated by the Internal Revenue Service as an increase in income to the.

\textsuperscript{12} Washington and Rothschild, p. 145.
executive. Thus, depending on the aims of the company and the executive, the nonrestricted or restricted stock option plans can be used to gain certain advantages. However, neither is free from disadvantages.

G. PROBLEMS IN USING STOCK OPTION PLANS

Although there have been and still are some restricted and nonrestricted stock option plans which are offered to all employees, the trend seems to be away from this. It is doubtful, according to most experts, whether employees with modest incomes should be allowed to take the risk of uncertain stock option plans. Their need is more for security than for speculative profits. Stock options are best for the employer when they are limited to top executives or key personnel. They should be restricted to those men who contribute significantly to profits and growth. Since a stock option should be allowed to gain in value over a period of time, it has been stressed that executive groups which average in age fifty-five or under are the best kind of participants in the plan. A survey of these types of plans made in 1954 showed that executives were included in all cases,

15 Casey and Lasser, Executive Pay Plans, p. 16.
16 Casey, p. 35.
in fact, that most of these plans were directed at this group.\footnote{17} Therefore, in administering stock option plans for executives, companies are warned there is always the problem of who should participate, how far down in the hierarchy should the distribution be made, and what are the reasons for drawing the line where it is drawn.\footnote{18}

Different companies use different norms. In a survey conducted by the National Industrial Conference Board on executive stock ownership plans in 1951, the following factors were used by the companies in deciding who would be eligible for the plan. The executive's present and future worth to the company was considered. His responsibility for future growth development and the financial success of the company was another factor. His position was definitely taken into consideration. A final factor was the company's past experience with the individual relative to his contribution to the financial success of the company.\footnote{19}

Another item experts point out, which should be given consideration, is the manner in which the plan is administered. The main purpose of using stock option plans is to provide an incentive to the executive. In order to do this, the option must

\footnote{17}{Ibid.}

\footnote{18}{Dean Charles C. Abbott, \textit{The Executive Function and Its Compensation} (University of Virginia, 1956), p. 37.}

\footnote{19}{National Industrial Conference Board, \textit{Executive Stock Ownership Plans} (New York, 1951), p. 16.}
provide the proper amount of motivation. There should also be
enough stock options left to give to the new executives who come
to the company or who are promoted from within to more responsible
positions. Also, stock options, if available, should be offered
to the lower levels of executives if they are in a position to
afford them and if they will soon be able to move into more
responsible positions.20

Stock option plans are referred to as fringe benefits or
executive compensation. However, they are really privileges
rather than payments since the executive must invest his own
funds. This is a distinct disadvantage in stock option plans
because when the time comes to purchase stock, the executive may
have no funds available to do so.21 In order to overcome this
issue, there has been recent trends in management thinking to try
some type of financing of stock option purchases for its execu-
tives. A company may help its executives exercise their stock
options by means of a loan or by an installment payment arrange-
ment with the stock as pledged collateral.22 Also, stock options
could be financed by long-or short-term bank loans or by personal
financing through payroll deductions. No matter what type of

20Casey, p. 35.
21Rothschild, p. 137.
22Herman C. Biegel, How to Compensate Executive Employees
financing is used, it is urged that the company take an active part in order to ascertain that the executives receive the full advantage of the stock option plan.23

Of course, the biggest disadvantage inherent in either type of stock option plan is the fact that there is no guarantee that the stock market value will increase. Therefore, if this is the only executive fringe benefit which a company will offer its executives, it might not prove to be enough incentive to attract or retain them. It is conceivable that not all executives are inclined to invest in stocks. This kind of incentive may attract only a certain kind of personality and would fail as an incentive for all others. It has been found that any stock option plan of itself does not necessarily mean that it will be enough of a fringe benefit to attract and retain top flight talent.

23Rothschild, p. 144.
Pension plans are probably the most common form of fringe benefits, both for employees and executives. According to a Dartnell survey in 1956, of executive fringe benefits, there were twenty-seven thousand qualified pension plans in existence. The total assets of all pension plans were twenty billion dollars and this was increasing at a rate of two and one-half billion dollars per year.\(^1\) Nine out of ten companies contacted in Patton's annual survey of executive compensation reported pension plans of one type or another.\(^2\) Although there is little difference in the coverage of pension plans offered to executives and those offered to employees, in certain cases executives receive extra benefits from these plans. For a more detailed analysis of pension plans in general, consult the Prentice-Hall study *Pensions and Profit Sharing*.\(^3\)

\(^1\)Dartnell, *Executive Fringe Benefits* (Chicago, 1956)


A. LEGAL REQUIREMENTS OF QUALIFIED PENSION PLANS

There are two main types of pension plans, the qualified and the non-qualified. A qualified plan must meet the following requirements of the Internal Revenue Law: it must have nondiscriminatory coverage, nondiscriminatory contributions and benefits and permanency. This kind of plan is the most widely used.

B. TAX ADVANTAGES

One of the reasons why qualified pensions are so popular is due to tax benefits derived from these plans for both the company and the employee. The employees are not taxed until they receive their share of the money, but payments made by the company to the pension fund are immediately deductible. If for some reason the pension is given to the employee in one year, it is taxed as capital gain rather than as ordinary income. Survivorship payment from a qualified pension plan may be exempt from estate tax. Finally, the trust does not pay income tax on the money it secures from its funds.

Under a qualified pension plan the executives derive extra benefits because larger contributions can be made for them since they are older and make more money. In other words, although


5"New Pay Ideas Help Hold Executives", p. 73.
there can be no discriminatory coverage of employees under this plan, a company can reward the people covered by the plan on the basis of their compensation.

Neither shall a (pension) plan be considered discriminatory within the meaning of such provisions (of the Internal Revenue Code of 1954) merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation or the basic or regular rate of compensation of such employees, or merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 3121 (a) (1) differ from the contributions or benefits based on employee's remuneration not so excluded, or differ because of any retirement benefits created under State or Federal Law.  

Therefore, the executives, since they have the higher salaries, will receive more benefits.  

C. NON-QUALIFIED PENSION PLANS

The other type of pension is the non-qualified type. Non-qualified pensions, of course, are those which do not meet the requirements of the law. They may contain certain provisions which would compensate the executive to a greater extent than allowable. Also, the money for the retirement allowance is not put into trust funds, but is retained in a company reserve. Finally, the coverage of a non-qualified plan need not be as inclusive as a qualified plan.

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7Biegel, How to Compensate, p. 4.

Executives receive extra benefits from a non-qualified pension plan because the plan is not restricted in the amount of benefits that are made available to high level employees. Under a non-qualified plan, executives can receive whatever amount of money the company would want to set aside for them. Also, a non-qualified plan may actually prove to be cheaper in the long run when the purpose is only to give a few people a retirement income. That is, a company would not be forced to cover all its employees, but only those that it wishes, such as top executives.\textsuperscript{9}

D. DISADVANTAGES OF NON-QUALIFIED PENSION PLANS

Of course, this type of plan has tax deduction disadvantages. If the company wants to use the payments to the reserve as tax deductions, the executives suffer because they must be taxed currently on the contributions for income which they won't receive for many years to come. They, undoubtedly, are in a higher income tax bracket now than they would be when they receive the pension and the net income gained from this type of arrangement would thus be quite a bit less. If the executive is to be relieved of this taxation, then the company must forgo the tax deduction until the funds are actually disbursed to the executive.\textsuperscript{10} The uncertainty of the future profits of the company and the future income tax requirements make this arrangement very disadvantageous to most

\textsuperscript{9}Ibid., p. 27.

\textsuperscript{10}Prentice-Hall, Inc., sect. 13031.
companies. However, despite these disadvantages, some companies do use this kind of plan in order to give their executives better fringe benefits.11

E. USES OF PENSION PLANS

As was noted before, pension plans are becoming more and more popular from both the employee's and the employer's viewpoint. In many cases they are used in addition to other types of fringe benefits and in other cases they are used to replace some fringe benefits. One company which had no pension, but did have a bonus system for rewarding executives, upon studying the situation, discovered they were actually losing money by granting the bonus instead of having a pension plan.12 The company, as well as the executive, benefited when a pension plan was initiated.13

The use of pension plans for recruiting, as well as keeping, executive talent is not a new idea. As a matter of fact, it is almost taken for granted. Instead of questioning a company if it has a pension plan, the question now is how much does it offer its prospective executives.

The question of which kind of pension plan should be used, qualified or non-qualified, depends upon the aim of the company. Many firms wish to cover all their people under a retirement plan,

11Ibid.


13See Table 3, Page 30.
TABLE 3a

ADVANTAGES OF A PENSION PLAN OVER CASH BONUS FOR RETIREMENT

(Assume taxable income of $10,000 and annual bonus of $1,000)

### BONUS PLAN

<table>
<thead>
<tr>
<th>Year</th>
<th>Bonus</th>
<th>Tax</th>
<th>Balance after Investment</th>
<th>3% on Interest</th>
<th>Balance at end of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>$1,000</td>
<td>$361.00</td>
<td>639.00</td>
<td>$19.17</td>
<td>$6.93</td>
</tr>
<tr>
<td>2nd</td>
<td>1,000</td>
<td>361.00</td>
<td>1,290.24</td>
<td>38.70</td>
<td>13.97</td>
</tr>
<tr>
<td>3rd</td>
<td>1,000</td>
<td>361.00</td>
<td>1,953.97</td>
<td>58.61</td>
<td>21.15</td>
</tr>
<tr>
<td>4th</td>
<td>1,000</td>
<td>361.00</td>
<td>2,630.43</td>
<td>78.91</td>
<td>23.48</td>
</tr>
<tr>
<td>5th</td>
<td>1,000</td>
<td>361.00</td>
<td>3,319.86</td>
<td>99.59</td>
<td>35.96</td>
</tr>
</tbody>
</table>

### PENSION PLAN

<table>
<thead>
<tr>
<th>Year</th>
<th>Deposits</th>
<th>Tax</th>
<th>Balance after Investment</th>
<th>3% on Interest</th>
<th>Balance at end of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>$1,000</td>
<td>None</td>
<td>$1,000.00</td>
<td>$30.00</td>
<td>None</td>
</tr>
<tr>
<td>2nd</td>
<td>1,000</td>
<td>None</td>
<td>2,030.00</td>
<td>60.90</td>
<td>None</td>
</tr>
<tr>
<td>3rd</td>
<td>1,000</td>
<td>None</td>
<td>3,090.00</td>
<td>92.72</td>
<td>None</td>
</tr>
<tr>
<td>4th</td>
<td>1,000</td>
<td>None</td>
<td>4,183.62</td>
<td>125.50</td>
<td>None</td>
</tr>
<tr>
<td>5th</td>
<td>1,000</td>
<td>None</td>
<td>5,309.12</td>
<td>159.27</td>
<td>None</td>
</tr>
</tbody>
</table>

TOTAL ACCUMULATION: 20 years - $27,676.50
25 years - $37,553.00 30 years - $49,002.70

*AI, Austin Kelly, III, "Is Your Company Bonus Plan Modern", Office Executive, XXXIII (April 1958), 20.*
but at the same time they wish to reward their top men to a greater extent. Others just want to cover their executives. Still, others want to compensate all their employees equally.

In general, the best kind of plan for a company to use is the qualified type which allows equal benefits to all employees based on compensation and years of service. However, it has been shown that if this type of plan is going to be used, a company must implement its pension program with some other types of fringe benefits for the executives in order to attract and hold desirable talent. By offering a stock option plan, a deferred compensation plan, or a bonus to executives, in addition to a pension plan, a company can offer an executive a means of preparing for his retirement so that he will enjoy a standard of living as close as possible to the one he had while working. A qualified pension plan alone cannot do this.
CHAPTER V

EXECUTIVE BONUSES

A. USAGE

One of the best known and often discussed executive fringe benefit is the bonus. This was one of the first executive benefit used in the business world, and although it may be declining in popularity, there still are several companies that use it to attract and retain executives. Back in the 1920's, 60 per cent of the companies were giving bonuses; by 1956, only about 45 per cent of the companies paid them.¹ Last year, an American Management Association survey of executive compensation revealed that only 39 per cent of the companies had management bonus plans.²

The experts agree that the decline in the popularity of bonus plans is due partially to the tax bite which executives suffer and partially to the increase in popularity of other kinds of executive fringes, such as stock options and deferred compensation. However, there are still some companies that pay out large sums of

¹Perrin Stryker, "The Executive Bonus", Fortune (December 1956), 130.

money in bonuses each year. The most famous of these is the Bethlehem Steel Corporation. Other companies who have used executive bonus plans with success are General Electric, General Motors, Du Pont, and Sears and Roebuck.\(^3\)

**B. ADMINISTRATION OF BONUS PLANS**

Even though there has been much discussion recently concerning the merits and demerits of using bonus plans, most companies who use them agree that they can serve a useful purpose if handled properly.\(^4\) To make a bonus plan work, certain principles should be followed. (1) The bonus should be substantial. (2) It should be based on performance, not salary. (3) It should be available to all executives above a certain level instead of limiting it to certain departments.\(^5\) Also, companies should be decentralized, so the responsibility for profits can be pinpointed. By the use of improved accounting systems, the efficiency of a top management person can be determined. Also, certain standards of performance must be established, so that accomplishments of individuals can be determined.\(^6\) If these conditions are met, experts agree that bonuses will properly motivate executives to produce

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\(^4\)Stryker, p. 12.


\(^6\)"A Sharper Eye on Bonuses", p. 112.
the profits in which they will share. In order to make sure that
the bonus plan is providing incentive, consultants state that the
company should watch two groups of men, the top 15 to 20 per cent
of the executives who turn in the best performance and the bottom
15 to 20 per cent of the executives who did the poorest. They
should check to see if the progress of the top men is encouraging
or if the executives at the bottom are still persistently lagging.\(^7\)

C. ADVANTAGES AND DISADVANTAGES

There are two reasons why a company is better off sometimes
offering a bonus system for executive compensation, rather than
offering deferred compensation or stock option plans. Reasonable
compensation in the form of a bonus may be deducted by the company
for income tax purposes.\(^3\) Also, the bonus plan can be reviewed
every year. If profits are not produced, the bonus need not be
paid. This cannot be done when using deferred compensation or
stock option plans.\(^9\)

However, inherent in any bonus plan, there is the danger that
it will be taken for granted. Also, in many cases there is no way
of determining the profit produced by many management persons in
order to give the proper amount of bonus.\(^10\) As far as the

\(^7\)Ibid., p. 188.

\(^8\)Prentice-Hall, Inc., Federal Tax Handbook 1958 (Englewood

\(^9\)Stryker, p. 128.

\(^10\)Ibid.
executive is concerned, the obvious disadvantage is the high tax rate on the bonus. It is considered as ordinary income and taxed at the progressive rate. The only advantage is that he has money available to him every year, rather than having to wait to future years for payment.

D. THE BETHLEHEM STEEL BONUS PLAN

One of the oldest and most famous executive bonus plans is the Bethlehem Steel Plan. Charles Schwab originated it in 1905. His theory was to pay minimum base salaries, but large bonuses to those who contributed to the success of the company. Bethlehem Steel continued to give large bonuses, varying in size, depending upon profits—until 1931. In that year, the large amount of bonuses were made public. As a result of the disclosures, the public discovered that since 1918 Mr. Eugene Grace had received an annual average bonus of $314,993 and that in 1919, his total compensation was $1,635,754. Because of this, stockholders demanded that the bonus plan be changed. This was done and the income of the Bethlehem executives was brought into line with those of the managers of comparable companies. Schwab continued to give bonuses, but since they had to be made public, inordinate amounts could not be given. Then in 1936, the bonus plan was replaced by a Special Incentive Compensation Fund into which was to be paid 5 per cent of the company's net income after all deductions. From this fund the executive would receive one-fifteenth of cash dividends paid to the stockholders. Thus,
making management's reward dependent directly on the stockholder's return on invested capital.11

E. THE HEWITT-ROBBINS BONUS PLAN

Some companies offer group bonus plans to their executives because they feel that they are more effective than individual plans. The Hewitt-Robbins Company has such a plan. They feel that individual employees will not try for high bonuses because of the stigma attached to eager beavers. Therefore, their bonus plan stresses group incentive. The company is divided into three groups for purposes of the incentive bonus. Each individual in a group is given a certain amount of points based on salary increase into a new job classification, or a salary increase within a job classification. Points are also given for each year of service. The total points for all the workers of the group are added together and based on the total points, bonuses are distributed to the groups as a whole and to the individuals for their contribution to the bonus.12 The management of Hewitt-Robbins feels that this is much better than the individual bonus idea because nobody can be sure of receiving a bonus. An executive cannot presume he will receive a bonus; he must work for it.13

11Washington and Rothschild, Compensating the Corporate Executive, pp. 385-386. See also, Baker, Executive Salaries and Bonus Plans, pp. 210-211.

12"Bonuses Geared to the Group", Business Week (July 16, 1955), 52.

13Ibid., p. 54.
CHAPTER VI
COSTS OF EXECUTIVE FRINGE BENEFITS

Fringe benefit costs are continually rising and the prospects are that they will continue to rise. Although cost figures have been gathered and estimated for employee fringe benefits, costs of executive fringe benefits such as deferred compensation plans and stock option plans are not available.\(^1\) As far as pension plans are concerned, the latest estimates indicate that companies that have pension plans for their employees pay on the average of 5.1 per cent of their payroll for this fringe benefit.\(^2\) However, this figure includes pensions for employees as well as executives. No separate estimates have been published of executive pension costs.

A. SAMPLE COSTS OF PENSION PLANS

An idea of what the dollar cost of a pension plan could be in one company (Table 4) is shown by the schedule of cost which The Anaconda Company must meet for its pension fund. This plan is non-contributory and covers sixty-five hundred salaried

\(^1\) Information in a letter to author from Dean H. Rosensteel, Director, Executive Compensation Service, American Management Association, January 28, 1959.

\(^2\) Fringe Benefits, p. 18.
personnel, including all executives. The retirement age is either sixty-five or sixty-eight. The benefits are payable monthly and are equal to one-half of one per cent of the first forty-two hundred dollars of a person's annual salary and one-half of one per cent of the next eighty-five hundred dollars and three-fourths of one per cent of the balance, all multiplied by the number of years of continuous service. The plan bases the annual salary on the five year period immediately preceding retirement. From the table on page thirty-four, it can be seen that costs of just one kind of fringe benefit for salaried personnel is high.4

B. COSTS OF OTHER KINDS OF FRINGE BENEFITS

There are many other kinds of fringe benefits which executives enjoy besides deferred compensation, stock options, or pension plans. Although they may not seem significant, they too can run into large sums of money.5

3Dartnell, Executive Fringe Benefits.
4See Table 4, Page 39.
5See Table 5, Page 40.
### Table 4a

**Estimated Cost to Anaconda Company for Pension Plan**

*(Covers 6,500 salaried persons)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Retirement - Age 65 (Maximum Cost)</th>
<th>Retirement - Age 68 (Maximum Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1955</td>
<td>$3,096,000</td>
<td>$1,669,000</td>
</tr>
<tr>
<td>1956</td>
<td>3,527,000</td>
<td>2,006,000</td>
</tr>
<tr>
<td>1957</td>
<td>4,042,000</td>
<td>2,372,000</td>
</tr>
<tr>
<td>1958</td>
<td>4,469,000</td>
<td>2,900,000</td>
</tr>
<tr>
<td>1959</td>
<td>4,994,000</td>
<td>3,267,000</td>
</tr>
<tr>
<td>1960</td>
<td>2,668,000</td>
<td>2,037,000</td>
</tr>
<tr>
<td>1961</td>
<td>2,882,000</td>
<td>2,064,000</td>
</tr>
<tr>
<td>1962</td>
<td>3,121,000</td>
<td>2,145,000</td>
</tr>
<tr>
<td>1963</td>
<td>3,402,000</td>
<td>2,273,000</td>
</tr>
<tr>
<td>1964</td>
<td>3,555,000</td>
<td>2,404,000</td>
</tr>
</tbody>
</table>

*Non-contributory plan*

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*Dartnell, Executive Fringe Benefits (Chicago, 1956)*
### TABLE 5b

**Costs of Specified Fringe Benefits**

<table>
<thead>
<tr>
<th>Expense</th>
<th>President ($4,800)</th>
<th>Chief Financial Executive ($2,200)</th>
<th>Chief Sales Executive ($4,800)</th>
<th>Chief Personnel Executive ($2,500)</th>
<th>Chief Manufacturing Executive ($1,800)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance, including</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>entertainment</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Premiums</td>
<td>350</td>
<td>350</td>
<td>350</td>
<td>230</td>
<td>350</td>
</tr>
<tr>
<td>paid on life insurance policy</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Periodical physical</td>
<td>90</td>
<td>70</td>
<td>70</td>
<td>70</td>
<td>60</td>
</tr>
<tr>
<td>checkups at company expense</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Club membership dues</td>
<td>560</td>
<td>550</td>
<td>550</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Association membership dues</td>
<td>230</td>
<td>160</td>
<td>160</td>
<td>75</td>
<td>80</td>
</tr>
<tr>
<td>Payment toward</td>
<td>1,950</td>
<td>1,600</td>
<td>1,700</td>
<td>1,500</td>
<td>1,000</td>
</tr>
<tr>
<td>automobile, plane or boat</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vacation with family,</td>
<td>1,400</td>
<td>800</td>
<td>900</td>
<td>400</td>
<td>750</td>
</tr>
<tr>
<td>expenses paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Business trips, with wife's</td>
<td>1,000</td>
<td>1,000</td>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>expenses paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

*Sample not large enough to draw sound conclusion.*

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b*Fringe Benefits for Executives*, *American Business Magazine*, Survey of the Month (March 1956)
CHAPTER VII

SUMMARY AND CONCLUSION

Ever since World War II, the use of fringe benefits as a part of compensation programs has spread rapidly. All studies of this issue have indicated the continual growth in kinds, size, coverage and costs of fringes. Because they do mean so much to the worker, as extra compensation, and to the employer, in added labor costs, fringe benefits deserve important consideration from employees, executives and industries.

Much has been written and many studies have been taken on the kinds and costs of employee fringe benefits such as vacation, hospitalization insurance plans, and sick benefits. This paper, however, has concentrated on executive fringe benefits which are somewhat different from employee fringe benefits.

One of the ideas behind executive fringe benefits is to help present day management attain as much purchasing power as his counterpart in the early twentieth century. Due to the present day tax laws, this is almost impossible if only straight salary methods of compensation are used. Therefore, other means have been found: the use of fringe benefits for executives. This paper has analyzed four main fringes: deferred compensation, stock options, executive pension plans, and executive bonuses.
A. SUMMARY OF DEFERRED COMPENSATION AND SUGGESTIONS FOR USAGE

Deferred compensation plans are very popular with both executives and employers. Deferred compensation means that an executive will take part of his salary now and the balance spread out to be paid in years when his income will not be as high and, therefore, his tax rate will thus be lowered.

Deferred compensation can be used for short-term or for long-term purposes. Long-term deferred compensation is used to assure the company that the executive will remain with them, as well as to assure the executive of security in the future. The company must be careful that this kind of plan does not evade taxes, but rather avoids them. Deferred compensation for short-term purposes is used when the company wants the executive's service for only five or six years, or when the executive himself does not want to bind himself to one company for the rest of his life.

The advantages in using deferred compensation for executives mostly favors the executive, rather than the company. The executive does not get taxed for the deferred compensation until he receives it, when his income will probably be much lower and, therefore, his income tax rate will also be lower. However, if the executive leaves the company, he cannot take any of the deferred payments with him.
The company gets no tax deduction until the money is actually paid out, when it might not be in a financial position to meet this obligation. However, the company may realize a great benefit from using this form of executive compensation. It can attract and hold executive talent without paying high salaries. This is an especially distinct advantage for the small company who is in dire need of executive leadership, but who cannot compete with giant corporations paying higher salaries to executives.

There is another disadvantage to using deferred compensation, and that concerns the young executives. They are not easily motivated by promises of deferred income in the distant future. To overcome these disadvantages, these plans can be made more flexible by allowing an executive to take at least part of his deferred compensation with him if he should leave the company. If he should want to leave, the thought of losing all his deferred compensation would not force him to stay. While there, he will try hard to increase his share in the fund.

To benefit more from deferred compensation plans, the company should set up this kind of a plan into a trust fund arrangement, so that they can gain a tax advantage when they put the deferred compensation into it. Also, the amount of the deferred salary should be based on the profits of the company to provide an executive with more incentive to increase his share. Also, under this
type of arrangement, the company need not worry about making deferred compensation payments during poor years since the money will already be set aside in a trust fund.

B. SUMMARY OF STOCK OPTION PLANS AND SUGGESTIONS FOR USAGE

Another popular kind of executive fringe benefit is the stock option plan. Although this form of a fringe benefit has undergone some periods of unpopularity, today, due to the tax benefits allowed, it is again quite popular. When restricted stock options are exercised, the income gained is treated as capital gain, rather than as ordinary income. It is believed they provide more of an incentive to the executive than does a cash payment. Stock option plans not only do not use corporation funds, but bring more capital into the company.

There are two kinds of stock options, restricted and non-restricted. The difference is that restricted stock option plans must meet the requirements of the Internal Revenue Act to be assured of favorable tax treatment. However, it must be clearly indicated that tax avoidance is the aim of these plans and not tax evasion.

In using nonrestricted stock option plans, the company and the executive risk the loss of tax advantages which are present under restricted stock option plans. The income gained from the sale of stock from a nonrestricted stock option will be treated as ordinary income and, therefore, the tax rate will be higher depending on the income of the executive.
No matter what kind of stock option is granted, the company does not gain any tax advantage, although it does give extra incentive to the executive without paying cash for it. Although some companies offer stock option plans to all their employees, it is best to offer this fringe only to top executives who can exercise the most influence for the prosperity of the company. To insure real benefits from such a plan, the company should provide means to help finance the purchase of the stock by the executive when he wishes to exercise his option.

It has been found that stock option plans may appeal only to a certain type of executive and not to others. Therefore, any program should not be limited to stock option plans as the only fringe benefit for executives.

C. SUMMARY OF EXECUTIVE PENSION PLANS AND SUGGESTIONS FOR USAGE

The third form of executive fringe benefit analyzed in this paper is the executive pension. Companies try to maintain qualified pension plans in order to gain tax advantages for themselves and for the executives. Under these plans, the company may make tax deductions as it puts money into the pension trust fund. At the same time, the executive is not taxed until he receives the benefits from the pension fund. At that time, it is expected that his income will be considerably less and, therefore, the tax cost will not be as great.
By using a non-qualified plan, the company and the executive lose tax advantages, but the company may grant executives any amount of benefits it desires and the plan need not cover all the employees.

Probably the best course for a company to follow is to use a qualified pension plan which covers all its employees. In order to reward executives more, it can institute other forms of executive fringe benefits such as deferred compensation, profit sharing bonus or stock option plans. The company will thus gain the tax advantage of using a qualified pension plan, and will provide the executives with extra compensation for retirement purposes.

D. SUMMARY OF EXECUTIVE BONUS PLANS AND SUGGESTIONS FOR USAGE

The final form of executive fringe benefit analyzed in this paper is the executive bonus. While other forms of executive fringe benefits have been increasing in usage, the bonus has been declining in popularity. This is partially so because bonus payments are taxed as ordinary income to the executive. Therefore, executives in high income brackets realize very little income from large bonuses. However, despite this disadvantage, some companies find it advantageous to use bonus plans because of the tax advantage to them and, also, because they can review the bonus plan every year. However, bonuses are too often taken for granted by the employee, and therefore lose their incentive value. Also, many companies do not have any sure way of evaluating the
the contribution of management personnel to the profit of the company. Some companies grant bonuses on the basis of salary or length of service. Neither of these factors should enter into consideration on granting bonuses. In order for a bonus plan to succeed, it must be given to executives on the basis of their performance. Companies must also develop some means of evaluating management personnel, so that each executive will share in the bonus according to his contribution to the profits and growth of the company.

E. SUMMARY OF COSTS TO DATE

Cost figures for the executive fringe benefits which have been discussed here are hard to ascertain. However, there are cost figures available for other types of executive fringe benefits.

The average dollar amount of these benefits for the chief executive is $10,000, for the average chief sale executive, $8,500, for the average chief financial executive, $6,700, for the average chief personnel executive, $5,100, and for the average chief manufacturing executive, $4,300.

Fringes will probably continue to grow in the future because they seem to be the best means which a company has to recruit and hold top executives. By saving the executives from high income tax costs, they increase his lifetime income, and usually save the company tax dollars.
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