Mueller Prost PC
CPAs + Business Advisors

MANUFACTURING & DISTRIBUTION

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COMPENSATION MATTERS

How to Hook Your Key Employees

Despite current unemployment figures, great manufacturing and distribution employees are hard to find. They're also hard to keep, whether due to aggressive "poaching" by competitors or simply more compelling offers elsewhere.

In times like these, you may want to put your money where your mouth is by implementing a key employee incentive program.

Who's Key?

The truth is some employees contribute more than others. This may be because of specific skills or education, important customer relationships, longevity with the company or business knowledge.

The first step in implementing a key employee incentive plan is to identify who should be included. Because these types of plans are typically non-qualified, it's OK to pick and choose participants. Figure out who is most "key" by answering this question: "If _____ left the company, I'd be disappointed and the business would suffer." Depending on the size of your business, you may have only one key employee or a handful.

What's the Competitive Outlook?

Is the current total compensation package for each key employee competitive for your industry in your market? This includes salary, health benefits, auto allowances, bonus arrangements and other perks.

If you can't answer this question, you need to do some benchmarking (your CPA can help) and figure out what other companies like yours are paying. If you are under-compensating your key employees, be sure to address that immediately.

What's the Incentive?

Assuming your key employee compensation is on par with that of your competitors, consider an incentive plan to sweeten the deal. The plan design should help keep these employees:

- Working at your company as long as you want them.
- Motivated to contribute to the bottom line.
- Interested in expanding their areas of responsibility.

Your incentive plan should align with your company's overall strategic plan (e.g., new process development or reduced waste). Define the actions and behaviors you want to see, and build the plan to promote those results.

What Does Success Look Like?

A good incentive plan includes measurable targets for each individual covered by the plan, with specific rewards tied to them. Some of the targets can be corporate goals such as increased customer satisfaction or growth, but others must be specific to the individual. In order for the plan to work, a substantial number of the success factors must be controllable by the individual. The plan must also be simple enough so that the individual can easily see how his or her decisions directly impact the goal.

For example, in a manufacturing environment, the head of operations' incentive plan may be based 40 percent on the company's overall target profitability, 30 percent on his or her department reaching certain quality goals, and 30 percent on his or her productivity numbers. Each of these three criteria would then have specific sub-targets attached, along with a defined bonus or other incentive.

What Are the Options?

Incentive plans come in many shapes and sizes. **Phantom stock** gives select employees the benefits of stock ownership without actually issuing any

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How to Hook Your Key Employees, Cont'd.

stock. Shares of phantom stock follow the value of real shares of company stock, and participants can be paid a "dividend" in the form of a cash bonus. When they eventually leave the company (on your terms), they would be paid over a number of years in a "buyout" of their vested phantom shares.

Stock appreciation rights give the employee the right to the cash equivalent of the increase in the company's stock value over a specific period of time. The rights are typically paid in cash over a number of years, but could also be paid in shares of stock.

In a **performance unit plan**, select employees are issued a number of performance units at zero value. The units increase in value as performance goals are met. At a certain point in the vesting period, the units can be redeemed for their new, higher value in cash.

Of course, all incentive plans have tax consequences and must be tailored specifically to the company and employees in question. One plan does not fit all, so be sure to discuss the options with your accountant.

Let us help you motivate and retain your key employees. Call us today at 314.862.2070 to discuss incentive plan options for your business.

IC-DISC:
A Practical Way for Exporters to Reduce Federal Income Tax

Historically, the Interest Charge-Domestic International Sales Corporation (IC-DISC) has been a tool for deferring income for U.S. tax purposes. In recent years, however, the IC-DISC has become a viable planning opportunity to *reduce* U.S. income tax liabilities utilizing the rate differential of ordinary income tax rates and capital gains tax rates on qualified dividends.

This tool is available for companies exporting goods manufactured in the United States, providing engineering or architectural services for construction projects outside the U.S., or leasing/renting property used by the lessee outside the U.S.

How It Works
Setting up and operating an IC-DISC is relatively straightforward: A separate U.S. corporation is formed in an IC-DISC friendly state that elects to be treated as an IC-DISC in accordance with the Internal Revenue Code. The U.S. operating company pays a commission to the IC-DISC and treats the commission as an expense, reducing its taxable income calculated at ordinary tax rates.

By statute, the IC-DISC is tax-exempt and pays no federal income tax on its distributed commission income. The IC-DISC pays a qualified dividend to its owners, which is currently based upon capital gains tax rates, thereby permanently reducing tax by as much as 20% (the difference between the maximum individual rate and the current capital gain rate).

Requirements of an IC-DISC
To be viable, the IC-DISC must meet several requirements:

- The IC-DISC must be a U.S. corporation with one class of stock of at least $2,500 of par or stated value.
- The corporation must elect to be treated as an IC-DISC within 90 days of incorporation.
- At least 95 percent of gross receipts of the IC-DISC must be qualified export receipts, and at least 95 percent of assets of the IC-DISC must be qualified export assets. Qualified export assets include export property, accounts receivable, temporary investments and loans to producers.
- The export goods must be manufactured, produced, grown or extracted within the U.S., and no more than 50 percent of the fair market value of the export property can be attributed to goods imported into the U.S.
- The export property must be sold or leased for direct use, consumption or disposition outside the U.S.

Flexibility a Plus
There are numerous ways to structure IC-DISC ownership and commission payments, and companies will want to consider which structure will fit their specific goals — reduction of U.S. income tax liabilities, potential elimination of double taxation of closely held C corporations, estate planning, asset protection or motivating key employees.

Commissions can also be calculated using a number of different methods. For example, the IC-DISC can be a buy/sell or commission-based entity. Commissions can be based on the qualified export gross receipts or profit margin. Subject to certain limitations, there are several options for maximizing the tax benefit.

By implementing an IC-DISC, companies exporting U.S. manufactured products for sale outside the U.S. can significantly reduce income taxes on export sales. However, proper planning is required to ensure the IC-DISC has been established correctly and to ensure the tax benefits are maximized each year.

Contact us today at 314.862.2070 to discuss your IC-DISC eligibility, potential costs and savings.

WORD TO THE WISE

Sales, Operations and Inventory Planning

You know you should be tackling it. But sales, operations and inventory planning seems like too big a job.

If this is the case at your company, you are not alone. Many manufacturing and distribution companies neglect this crucial task, but those who embrace it have reaped great rewards.

SO&IP at a Glance

Think of sales, operations and inventory planning (SO&IP) as a coordinated attack on out-of-control costs, irregular productivity and questionable margins. It's a way to address supply-demand balance, scheduling, product mix and production volume so that all of these elements are strategically synchronized and working together.

Without SO&IP, companies suffer from a host of problems: too-high inventory levels, poor customer satisfaction, unstable scheduling and last-minute orders. Generally, the manufacturing team blames sales for overpromising, and the sales team blames manufacturing for under delivering. SO&IP helps resolve this conflict and move toward coordinated teamwork.

A Process, Not a Project

The SO&IP process involves alignment in several key areas, so it's important to have the right people on the SO&IP team. In addition to the president/general manager, the players should include high-ranking representatives from sales, product engineering, materials/procurement, manufacturing, finance/accounting and human resources.

This team will take on the task of pulling apart crucial aspects of the business and putting them back together so that they are aligned, with each area committed to the same company-wide goals. Here are a few of the areas the SO&IP team should address:

Business planning. As Stephen Covey advises, it's wise to start with the end in mind. What's your vision and where do you want to take the business? Once you've identified your goals, all other decisions are easier because they move you either toward the desired outcome — or away from it.

Demand planning. How can you predict the future? Start by examining the past. Dig into your sales history and pipeline. Evaluate the market and emerging trends. Talk to your customers about their needs. Look inside your building, too. What's your plan for each product and product family? What's your distribution capacity?

Your demand plan will never be perfect, but by researching and asking the right questions, you will be much closer to a realistic forecast.

Operations planning. This step gets production, resources and supply all marching together to meet demand. Operations planning determines the appropriate production rates and resources required to meet the agreed-upon demand plan, taking into consideration the restraints of your labor and financing resources.

Materials and capacity planning. Many manufacturers already manage their materials and capacity effectively, but imagine how efficient you could be if your materials and capacity planning were more closely meshed with your demand and operations plan. When everyone up and down the line agrees to the same assumptions and parameters, this type of integration is possible.

When it comes to output, SO&IP involves constant monitoring and performance measurement. As your team examines its plan against performance, you can see where the plan is at risk and push to ensure that operations and sales agree on the commitments they've made to the company.

The Time Is Now

SO&IP can be a daunting process. But working through each area deliberately and thoroughly — especially with an internal team rather than outside consultants — will reveal significant information about how the company is working now and how it could work better in the future.

Our firm has hands-on experience with SO&IP techniques and can help you launch your SO&IP effort. Please contact us at 314.862.2070 to discuss SO&IP concepts.

ASC Opens the Door for More R&E Credit Claims

For 30 years, the federal research and experimentation (R&E) tax credit has allowed companies that have engaged in qualified R&E activities to reduce their Federal income tax liabilities. However, the complexity of the credit calculation and requirements to document its base amount (the amount in which taxpayers must spend prior to receiving the first dollar of credit) has discouraged many businesses from reaping the benefits.

To address this issue and encourage those companies to invest in qualified research, Congress enacted the Alternative Simplified Credit (ASC) in 2006. Prior to the enactment of the ASC, some taxpayers' credit benefit was minimal if their gross receipts were too large relative to qualified research expenditures, or if they could not document their expenditures in the base period of 1984-1988.

For tax years ending after December 31, 2008, the ASC equals 14 percent of qualified research expenditures in excess of 50 percent of the average qualified research expenditures of the preceding three tax years. Companies without qualifying expenditures for the previous three years can claim a credit equal to 6 percent of qualified expenses during the current year.

Which Method Is Best?

For some companies, the traditional R&E credit results in a larger amount of credit. They likely have the records available to substantiate their activities during the base period, and their gross receipts have not increased as a function of their qualified expenditures since the base period.

However, for those taxpayers that don't fit this fact pattern, the ASC takes gross receipts out of the equation and the base period is calculated using more recent tax years, making it particularly attractive for companies:

- Whose qualified expenditures have increased significantly;
- Whose qualified expenditures are relatively low in comparison to their gross receipts;
- Whose gross receipts have grown exponentially in proportion to their qualified research expenditures; or
- Who have acquired or disposed of companies or divisions making it difficult to calculate their base period.

The ASC must be elected or revoked on an originally filed income tax return (including extensions). Therefore, taxpayers considering the ASC for tax year 2011 should determine whether election is in their best interest prior to filing their 2011 tax return.

A temporary provision, the R&E credit is currently eligible for expenditures incurred prior to December 31, 2011. However, both sides of the aisle support the research tax credit and Congress has a history of retro-actively restoring it. Therefore, taxpayers will want to evaluate these implications when considering prior and future tax years.

For more information, please contact **John E. Oeltjen, CPA** at 314.862.2070 or joeltjen@muellerprost.com.