



April 15, 2013

The Honorable Pat Tiberi  
106 Cannon HOB  
Washington, DC 20515

The Honorable Ron Kind  
1502 Longworth HOB  
Washington, DC 20515

Dear Congressman Tiberi and Congressman Kind:

On behalf of the Employee-Owned S Corporations of America (ESCA), thank you for the opportunity to submit comments to the Pensions/Retirement Savings working group reflecting the views and priorities of S corporation ESOPs relating to tax reform.

**Background on S Corporation ESOPs**

As you are aware, a Subchapter S corporation is a business entity that provides flow-through tax treatment to its shareholders. An employee stock ownership plan (“ESOP”) is a qualified defined contribution plan that provides a company’s workers with retirement savings through their investments in their employer’s stock, **at no cost to the worker**. ESOPs are regulated by the Employee Retirement Income Security Act (“ERISA”) just like pension funds, 401(k) plans, and other qualified retirement plans.

In 1996, in the Small Business Jobs Protection Act, Congress authorized the S corporation ESOP structure, effective January 1, 1998, with the goal of encouraging and expanding retirement savings by giving American workers a greater opportunity to have equity in the companies where they work.

In the Taxpayer Relief Act of 1997, Congress repealed the unrelated business income tax (UBIT) originally imposed on the ESOP for its share of S corporation income, enabling S corporation ESOPs to become a viable new business structure to benefit American workers. Fifteen years later, there are more than 2,500 S ESOP companies operating in every state of the nation, in industries ranging from heavy manufacturing to retail grocery stores, from construction to consulting. Because of the structure of S ESOP tax policy, S ESOPs are accomplishing exactly what Congress intended: generating unparalleled retirement savings for millions of workers, providing good and resilient jobs in high-performing businesses, and creating important macroeconomic benefits in their communities.

## **The Unparalleled Performance of S ESOPs**

Over the years, ESCA has worked closely with federal policymakers to ensure that S ESOPs hold true to their original purpose of encouraging broad employee ownership. We collaborated with members of your committee in 2000-2001 to craft anti-abuse rules that became section 409(p) of the Internal Revenue Code. These rules, enacted in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), now mandate that S ESOPs provide for broad-based employee ownership and establish strict repercussions for violations.

*As the report language for EGGTRA (H.R. Rep. No. 107-51, part 1, at 100 (2001) states: The Committee continues to believe that S corporations should be able to encourage employee ownership through an ESOP. The Committee does not believe, however, that ESOPs should be used by S corporation owners to obtain inappropriate tax deferral or avoidance.*

*Specifically, the Committee believes that the tax deferral opportunities provided by an S corporation ESOP should be limited to those situations in which there is broad-based employee coverage under the ESOP and the ESOP benefits rank-and-file employees as well as highly compensated employees and historical owners.*

Since enactment, Section 409(p) has been highly effective in ensuring that S ESOPs serve their purpose. As a result, S ESOPs have become perhaps the most effective retirement savings plan under federal law, and today the average S ESOP plan participant has between three and nine times saved in their ESOP account than they do in their 401(k) account.

Many studies over the years have documented why and how S ESOPs have proven to be so powerful for both workers and the economy more generally speaking:

A 2012 study by Alex Brill, tax advisor to the Simpson-Bowles deficit reduction commission and a former chief economist and policy director to the Ways and Means Committee, found that:

- Employment among surveyed S ESOP firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period.
- In the struggling manufacturing industry in particular, the S ESOP structure has buffered against economic adversity and job loss.
- S ESOPs have significantly expanded the pool of US workers who are saving for retirement, while also boosting company productivity – something that has greatly benefited their employee-owners.

Brill notes that “in the context of the current tax reform debate that seeks to curtail existing tax expenditures in favor of lower statutory rates, policymakers should recognize the evidence in support of S ESOPs and their positive economic contribution.”

Later this month, Brill will introduce a new study looking at the “Macroeconomic Impact of S ESOPs on the U.S. Economy.” Key findings from this not-yet-published report will reveal that

- **the number of S ESOPs and the level of active participation (number of employee-owners) have more than doubled since 2002.**
- **total output from S ESOPs and the industries they support is nearly 2 percent of GDP.**
- S ESOPs directly employ 470,000 workers and support nearly a million jobs in all.
- S ESOPs paid \$29 billion in labor income to their employees, with \$48 billion in additional income for supported jobs.

Brill’s study on the macroeconomic impact of S ESOPs echoes key findings of a 2008 University of Pennsylvania/Wharton School of Business report, which found that S ESOPs contribute ***\$14 billion in new savings for their workers each year beyond the income those workers otherwise would have earned***, and that S corporation ESOPs offer workers greater job stability and increased job satisfaction. The study also found that S corporation ESOPs’ higher productivity, profitability, job stability and job growth generate a collective ***\$19 billion in economic value that otherwise would not exist***.

The Brill and University of Pennsylvania studies reinforce other important evidence about S ESOPs that show how powerful they can be.

In a 2010 Georgetown University/McDonough School of Business study, two leading tax economists, former Treasury Department officials Phillip Swagel and Robert Carroll, reviewed the performance of a cross-section of S corporation ESOP companies during the early part of the prior recession and found that these companies performed better than other equivalent companies in terms of job creation, revenue growth, and worker retirement security. Specifically, Swagel and Carroll found that:

- **Companies that are S corporation ESOPs are proven job-creators, even during tough times.** While overall U.S. private employment in 2008 fell by 2.8%, employment in surveyed S corporation ESOP companies rose by 2%. Meanwhile, 2008 wages per worker in surveyed S corporation ESOP companies rose by 6%, while overall U.S. earnings per worker grew only half that much.
- **S corporation ESOP companies provided substantial and diversified retirement savings for their employee-owners at a time when most comparable companies did not.** Despite the difficult economic climate, surveyed S

corporation ESOP companies increased contributions to retirement benefits for employees by 19%, while other U.S. companies increased their contributions to employee retirement accounts by less than 3%.

The National Center for Employee Ownership (“NCEO”) found that S corporation ESOPs are a major force in providing retirement security to workers. A 2005 NCEO survey reported that S corporation employee-owners had ESOP account balances **three to five times higher than the U.S. average for 401(k) plan participants**. For S corporation employee-owners nearing retirement, ESOP account balances were **five to seven times the average**. Some 80 percent of companies surveyed by NCEO offer their employees more than one qualified retirement plan.

These retirement savings figures are particularly striking when one considers that **nearily 46% of working Americans do not have access to an employer-sponsored retirement savings plan**. All employee-owners do have a plan (with many having more than one) and that plan is wholly funded by their companies.

This data combined with personal experiences that Members of Congress have had through visiting employee-owned companies and meeting employee-owners, led to a core group of Committee members believing that more can and should be done to preserve and expand employee ownership in S corporations to provide the benefits of this structure to more working Americans. Last Congress, Representatives Dave Reichert (R-WA), Ron Kind (D-WI), Charles Boustany (R-LA), Earl Blumenauer (D-OR), Erik Paulsen (R-MN), and Bill Pascrell (D-NJ) introduced H.R. 1244, the Promotion and Expansion of Private Employee Ownership Act.

Among other things, this legislation would:

- **Encourage owners of S corporations to sell their stock to an ESOP**
- **Provide additional technical assistance for companies that may be interested in forming an S corporation ESOP**
- **Protect small businesses that become ESOPs from losing their SBA certification**

Last Congress, 95 members of the House cosponsored this bipartisan bill, with a total of 17 bipartisan Ways and Means Committee sponsors. We understand that the measure’s lead sponsors look forward to reintroducing this legislation later this year, and we anticipate that there will be a Senate bill reintroduced (S. 1512 in the 112th Congress) this week with a strong bipartisan group of cosponsors, including several who sit on the Finance Committee.

As the Ways and Means Committee and your working group move forward on comprehensive tax reform to spur economic growth and job creation, we look forward to continuing this important dialogue about a retirement savings plan that is working and enabling hundreds of thousands of Americans to achieve the American dream at

work. It is imperative to retain and encourage this retirement savings vehicle that works as Congress intended, and indeed to find ways to extend this benefit to other companies and workers who can benefit from this exceptional structure.

Thank you for your continued consideration and support of our views.

Sincerely,

A handwritten signature in black ink that reads "Stephanie Silverman". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Stephanie Silverman  
President & Executive Director

*The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.*