



April 6, 2015

Honorable Mike Crapo
239 Dirksen Senate Office Building
Washington, DC 20515

Honorable Sherrod Brown
713 Hart Senate Office Building
Washington, DC, 20515

Dear Senator Crapo and Senator Brown:

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

ESCA represents private, employee-owned companies operating in every state across the nation, in industries ranging from heavy manufacturing to grocery stores to school photography. The rapid expansion of S corporation ESOPs in recent years is testimony to the fact that these companies are a dynamic and growing part of our economy. We would respectfully suggest to the committee that a vital means of promoting both economic growth and retirement security for working Americans is to expand the availability of S corporation ESOPs for more companies and their workers.

Today, S corporation ESOPs are doing exactly what Congress intended when it created them in the late 1990s: generating economic activity, creating jobs, and promoting retirement savings. By any measure, these companies have been a remarkable success story: truly a bright spot in an economy characterized by sluggish growth, anemic job creation, and worker insecurity. Through the S ESOP structure, privately-held companies across the United States have given policymakers a successful blueprint for how to provide access to the American Dream to hundreds of thousands of workers. In short, these companies have provided a model for expanding and strengthening the middle class.

It stands to reason that companies with employee stock ownership plans have displayed a vitality lacking in other sectors of our economy. An ownership stake in one's place of work is not only a spur to greater productivity, but inspires greater loyalty and identification with the fortune of the business. For workers in S corporation ESOP firms, what is good for ownership is good for them by definition.

Expanding the availability of S corporation ESOPs for more companies and their workers would not only boost the retirement savings of countless more Americans, but would

also create more (and more long-term) jobs, generate more productivity, and encourage the formation of businesses that are more stable and successful because they provide their employees with the kind of built-in incentives conducive to loyalty and productivity.

As the Finance Committee contemplates measures to reform the Tax Code and increase access to retirement savings, we urge Senators to support tax policies that expand the availability of long-term retirement savings opportunities and economic growth through S corporation ESOPs.

Background on S Corporation ESOPs

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. Seventeen years later, there are more than 2,600 S ESOP companies operating in every state of the nation.

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 gave rise to 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 foster broad-based employee ownership. 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 significantly more money saved in their ESOP account than they do in their 401(k) account, even though most 401(k) plans long pre-existed these ESOP retirement accounts.

The Unparalleled Performance of S ESOPs

Many studies over the years have documented why and how S ESOPs have proven to be so powerful for both workers as a retirement savings and economic security tool, and how they have contributed substantially to communities and the broader national economy.

New data compiled by Ernst and Young's Quantitative Economics and Statistics (QUEST) practice shows that **S corporation ESOPs outperformed the S&P Total Returns Index in terms of total return per participant by an impressively large margin (62%)**, net assets of S ESOP accounts in the aggregate increased over three-fold, and retirement distributions to workers in S ESOPs totaled nearly \$30 billion from 2002 to 2012.

In a study released in June last year, data compiled by the National Center for Employee Ownership (NCEO) shows that private employee-owned businesses have strikingly fewer loan defaults than other businesses. **NCEO finds that the default rate on bank loans to ESOP companies during the period 2009-2013 was, on average, an unusually low 0.2 percent annually.** By contrast, mid-market companies in the U.S. typically default on comparable loans at an annual rate of 2 to 3.75 percent. The tenfold difference between the economic strength of employee-owned companies and other businesses highlights the fact that **private businesses which are owned by their employees have the incentives and vision that makes them more stable, more successful, and better for employees as well as the larger economy.**

A 2012 study by Alex Brill, a top 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.

In his study, Brill noted 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.**”

In 2013, Brill produced a follow-on study entitled “Macroeconomic Impact of S ESOPs on the U.S. Economy.” Key findings of that broader assessment revealed 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.**
- **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 was built upon findings issued in 2008, in a 2008 University of Pennsylvania report, whose authors 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%.

In the last Congress, your Finance Committee colleagues Senators Ben Cardin and Pat Roberts again introduced bipartisan legislation, S. 742, the *Promotion and Expansion of Private Employee Ownership Act of 2013*, that will:

- ***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***
- ***Ensure small businesses that become ESOPs retain their SBA certification***
- ***Acknowledge the importance of preserving the S corporation ESOP structure in the Internal Revenue Code***

The bill had 22 bipartisan cosponsors (13 Democrats, 8 Republicans and 1 Independent), including six members of the Senate Finance Committee. We thank you both for cosponsoring the bill last Congress. Senators Roberts and Cardin plan to reintroduce the same bill later this month.

We hope you will seriously consider moving these provisions as part of a tax package that promotes economic growth and retirement savings for working Americans. As the Finance Committee and your working group move forward on comprehensive tax reform to spur economic growth, job creation, and retirement savings, 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 your support for S ESOPs and the employees who own them.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephanie Silverman", 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.