



Connection

THE MID-ATLANTIC CHAPTER ESOP ASSOCIATION QUARTERLY NEWSLETTER FEBRUARY 2005

Message from the President

I opened up a box of pears I received over the holidays and inside was a slip of paper. The paper contained the name of the employee who had packed the pears. (I would have been really impressed if it had the name of the person who *picked* the pears but that's another story.)

This got me to thinking – what if everyone had to place their name with the products or services they provided? Imagine a car with the names of the persons who helped assemble it in your guidebook or glove compartment. How about a restaurant meal where you also knew the name of the chef who prepared your plate?

Do you think this practice would create greater pride in workmanship and generate increased accountability? And, if so, wouldn't this be a natural fit for ESOP companies and their employee-owners?

I think the placement of your name with the product held in the customer's hand could spur increased attention to detail. (Putting an "800" customer service number on the same sheet of paper may help even further.)

In addition to raising employee attention levels, this name placement also may have other benefits. Importantly, it breaks down the invisible wall between the employee and the company by directly linking the employee to the purchased product or service. This is a powerful form of identification, certainly equivalent in my book to employees donning the company-provided shirt or uniform.

Once identified in this manner, employees are no longer faceless or fungible – nor can they hide. They are now directly associated with the customer -- regardless of their role on the assembly line or in the back office. It says I'm here and my work product matters to the success of my company.

My name is at the end of this column and I know that all of us at MAC take great pride and care in our stewardship of the ESOP movement.

— Paul Horn



ComSonics accepts their 2004 AACE award.

AACE 2005 - DEADLINE MARCH 1 Carolyn Zimmerman

It's time to put together your entry for the 2005 Annual Awards for Communications Excellence (AACE) competition! What, you ask, is AACE?

Every year, The ESOP Association sponsors a competition for companies on their ESOP communications to employees. Companies document their communications efforts and send them to a panel of judges who decide the awards. A series of prizes accompanies the crystal obelisk that is awarded to the winner of each category at the Awards Banquet held on Thursday night of the May conference.

The categories range from "Total Communications" arranged by size of company, to "External Advertising—Web Site." For a Total Communications entry, you would probably want to document and send in everything you did in 2004; for a Web Site, you only have to print the relevant sections of your web site and send it together with the web address to the judges. There are categories for Special Events and Promotions, Printed Materials, Video/CD, and others.

The AACE Program is one of the best ways to benchmark your communications efforts. Putting together your entry will help you develop a sense of what you have done through the year to help your employees understand the meaning of working for an ESOP company. You may see where you could have done more, or where you want to change things. All entries (with winners noted) are displayed at the May Conference in Washington, DC and at the July Communications Conference in Chicago. Looking at all of the entries together gives you a sense of what other companies are doing—it's a gold mine for ideas.

The AACE entry brochures were mailed in mid-January to your company. If you can't find yours, you may call the Association for another one, or go to www.esopassociation.org. Questions may be addressed to Pat Barnes, AACE Program Manager, (304) 876-1993.

The Mid-Atlantic Chapter has had numerous past winners, including Anderson & Associates, ComSonics, Social & Scientific Systems, CALIBRE, KCI Technologies, and Aspen Systems. **The deadline for RECEIPT of your entry is MARCH 1.** We are counting on you to represent the MAC in 2005!

AACE winners get a crystal obelisk and engraved certificate (great for display), 1 free registration to the D.C. conference, and 3 tickets to the awards banquet. Second place in a category gets 2 tickets to the banquet and a certificate. Set the pace, enter AACE.

MEMBER PROFILE:

MEDResponse

INCORPORATED

Med-Response, Inc. is a full line dealer of medical equipment and supplies to patients in the home environment with an emphasis on respiratory care and rehabilitation equipment. We service six counties in the southern West Virginia and southwest Virginia homecare market.

Med-Response, Inc. has been in operation since June 1978 and has grown to 4 stores and a corporate office with 40 employees. Our locations are in Princeton, Welch & Bluewell, WV (HQ) and Bluefield & Tazewell, VA. We serve an average of approximately 3,000 patients per year.

In 2003, the owners initiated the Med-Response, Inc. ESOP Trust and contributed the first shares in 2004. They initially sold 30% of the shares to the ESOP. The owners wanted a way to share the rewards of ownership with their loyal, hardworking staff that had served them over the years.

Management is in the process of bringing the staff into the ownership culture with an ESOP education committee. The committee is looking forward to participating in the MAC meetings and learning all they can about the ESOP so they can pass this knowledge on to the rest of the staff.

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MARK your calendars

Mid-Atlantic Chapter April Conference

TOPIC: ESOP Spring Cleaning

DATE: Friday, April 8, 2005

WHERE: DoubleTree Hotel, Charlottesville VA

Legislative Update **Keith Robertson**

As you know, we focused on several pending bills in late 2004 that were favorable to ESOPs in the hope of gaining supporters among Virginia's U.S. legislators. Those bills included the Senate and House versions of the "Employee Stock Ownership Plan Promotion and Improvement Act of 2004", the "Employee Ownership for the Twenty-First Century Act", which would create a Presidential commission to study employee ownership, and the "United States Employee Ownership Bank Act", which would provide low interest funding to help employees purchase their companies and prevent their jobs from being lost.

You'll note I didn't state the bill numbers for this legislation. This is because all legislation will have to be reintroduced with new designations in the new 109th Congress. We understand that much of this effort will be handled by an emerging ESOP Champion, Rep. Nancy Johnson (R-CT).

It's also imperative that we find a Senate successor to retired ESOP Super-Champion John Breaux (D-LA), who himself was a successor to ESOP legend, the late Sen. Russell Long (D-LA). Who will fill these shoes? We in Virginia look to encourage our own Sen. George Allen (R-VA), who was a co-sponsor of Sen. Breaux's bill, to tie on the laces.

We also need to continue encouraging Virginia's House members that have shown support for ESOPs. These include Jo Ann Davis (R-1st), Eric Cantor (R-7th), Virgil Goode (R-5th), and Bob Goodlatte (R-6th). We now need to get Virginia's other seven Congresspersons signed on to these ESOP bills!

Let's not forget our other senator, John Warner (R-VA), who would be a powerful ally. While he is certainly occupied with other matters (as Chair of the Select Intelligence Committee and as a member of the Armed Services Committee), he is also a member of the Health, Education, Labor, & Pensions Committee. We need to continue seeking his support for all things ESOP.

I am also excited about an initiative to open a dialogue with the White House. After all, President Bush is touting an "Ownership Society"; what better way to promote ownership than through ESOPs? This initiative is being spearheaded by Rep. Johnson as well as Michael Keeling and his staff at TEA.

For now, keep your eyes on this newsletter as well as TEA's website for breaking news. And whenever anyone opens a discussion about the "Ownership Society", tell them that you're already a member; what better segue into discussing employee ownership. When significant developments occur, we'll notify the contact at your organization. If you'd also like your name included, please contact me at krobertson@comsonics.com, or call 540-434-5965.

Ed note: Keith's Virginia focus flows from his company's location in Harrisonburg, VA. Keith will work with MAC members in Maryland, West Virginia, and even the District of Columbia on getting their Congressional members to support ESOPs.

WHY IS MY TPA ASKING FOR THAT?

Mychelle Holloway, SES Advisors

S Corporations sponsoring an ESOP may wonder what has possessed their third party administrator ("TPA") to request endless amounts of new data. The TPA wants to know things like does Mr. 5% Owner have any cousins working for the company, does Mrs. Top Dog have a severance package, or does Miss CEO have a deferred compensation arrangement? Here's why TPAs are asking for this data and why it is essential you provide them with all this information.

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") increased job security for all ESOP TPAs. One item tucked into EGTRRA was new IRC section 409(p) that generally permits an ESOP to hold S Corporation stock *only* if the ESOP benefits a sufficiently broad group of employees. Four years later, the IRS continues to issue "guidance" under this section. **The most recent "guidance" came as a late December 2004 Christmas present packaged as proposed regulations.** As a result, TPAs had to send out exhaustive data requests to clients.

Your TPA will be asking you for copies of plans or agreements encompassing all forms of synthetic equity. A common form of synthetic equity is a *stock option*. Other forms of synthetic equity include *warrants* or certain kinds of *buy-sell agreements* between shareholders and related entities. Also included are *phantom stock plans*, often used to offset restrictions on ESOP participation by selling shareholders and their family members who elected section 1042 treatment (back in your C Corp. days). *SARs* (Stock Appreciation Rights), *SERPs* (Supplemental Executive Retirement Plans), *severance packages*, and traditional *cash deferred compensation plans* and employment agreements that provide for compensation or benefits to be paid more than two and half months after a person's employment ceases are all synthetic equity. **(Some deferred compensation arrangements in effect on the date the regulations were issued are "grandfathered" and do not count as synthetic equity.)**

Synthetic equity can even include a *split dollar life insurance* arrangement where premiums and benefits are divided between the employer and the employee. To further complicate matters, synthetic equity also includes rights to acquire stock or similar interests in *any related entity* of the S Corp. Due to the confidentiality of some of these benefits, the HR department may not know about incentives issued to key employees. **To be safe, HR should have senior management verify that all forms of synthetic equity are being reported to the TPA.**

Certain family members must be aggregated for purposes of determining ownership of stock and synthetic equity. IRC section 409(p) expands on the family definitions we are familiar with under IRC section 318. The expanded definition requires HR to be aware of family relationships not normally monitored and includes aggregation of the person, the spouse, ancestors or lineal descendants of that person or spouse, siblings of the person or the spouse, the lineal descendants of those siblings, and the spouse of any person listed above.

Failing section 409(p) is not an option. During a "failing" year (the so-called non-allocation year where disqualified persons hold too much stock or synthetic equity), IRC section 4979A imposes a 50 percent excise tax on any ESOP allocation and any synthetic equity owned by a disqualified person. Even if no allocation is made that year to a disqualified person, in a non-allocation year the 50% excise tax applies to all *deemed owned* shares held by the

ESOP for the disqualified persons (includes allocated and unallocated shares still held in suspense). The amount of any prohibited allocation is treated as a distribution to the disqualified person, which means the FMV of their ESOP account balance is included in their gross income.

Your plan document should be amended to prohibit allocations to disqualified persons during a non-allocation year, but the plan could still lose its tax-qualified status if prohibited allocations occur (for failure to operate the plan according to its terms). If you can argue your way out of this, the plan still may fail to satisfy IRC section 4975(e) -- in simple terms meaning it ceases to be an ESOP and it loses its prohibited transaction exemption for loans by the employer to the plan. This could result in additional fines and excise taxes.

In summary, cooperate fully with your TPA so that your test can be performed accurately. **If you are contemplating any change in corporate structure, issuing or changing any form of synthetic equity, or hiring family members of senior personnel – check with your TPA or ERISA counsel before implementing such changes.** Most S Corps. sponsoring ESOPs will have no problems with IRC Section 409(p) - but you should have the test done every year to be sure you remain compliant.

Dear Dr. ESOP:

I worked at Wild & Wonderful Co. (W&W) for many years but recently left when my spouse took a job in a different city. W&W has been doing well and has great ESOP benefits but I was told I couldn't start receiving any of my benefits for several years. Why do I have to wait so long to receive all my ESOP benefits?

*Signed,
Waiting for ESOP*

Dear Waiting for ESOP:

Unlike a 401(k) account, where you can request payment soon after termination of employment, W&W has to come up with the cash to repurchase your shares – either from the ESOP (so the ESOP can pay you cash) or from you directly (your put option). This repurchase obligation can be significant and, like all significant future cash outlays, should be forecast to the extent possible.

Delaying the start of distributions (up to six years) for so-called vested terms like you gives the employer an opportunity to forecast these future cash flows. Paying benefits in installments (as much as five years) can further extend this time period. Managing this process and minimizing surprises hopefully will help keep the stock price moving in the right direction. If there were no delay, you could have a situation of a mass layoff following loss of a large contract. Having to pay these former employees in full in the subsequent year could exacerbate the company's cash flow problems.

In all events, it sounds like a distribution delay for you may be advantageous if the stock price keeps going up since each year's payment must be based on the current FMV.

Welcome New MAC Members 2005*

CORPORATE MEMBERS

Avitecture, Inc.
Sterling, VA

GST, Inc.
Greenbelt, MD

Noesis, Inc.
Arlington, VA

PROFESSIONAL MEMBERS

Mr. Brent S. Solomon, MSF, CPA, CVA, Reznick Group, P.C., Bethesda, MD

Ms. Janet Singletary Thomas, Hirscher Fleischer, Richmond, VA

Mr. Keyvan Rafei, Professional Planning Association, Inc., McLean, VA

Ms. Mary P. Holley, Advanced Funding Solutions, LLC/Northwestern Mutual, Roanoke, VA

AFFILATE MEMBERS

Tri Tech Laboratories, Mr. Gary Shanks, Lynchburg, VA

** Please let us know if we missed you.*

Make sure MAC has your current e-mail address—please send an e-mail to jen@kinex.net today!

Jennifer L. A. Abruzzo
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