



Connection

THE MID-ATLANTIC CHAPTER ESOP ASSOCIATION NEWSLETTER

OCTOBER 2004

Message from the President

You may recall the tale of the blind children encountering an elephant for the first time. The first child feels the side of the elephant and concludes that he must be touching a wall. The second runs her hand along the ivory tusk and concludes she is holding a spear. The third lays his hands on the trunk and concludes it must be a snake. The fourth feels the elephant's knee and concludes she is touching a tree.

An old blind man passes by and hears the commotion and confusion. He begins to laugh, remembering his first encounter with an elephant many years ago. Like these children, he then had mistakenly concluded that he could understand the whole of something when he had experienced only a part.

So when you hear or encounter the term "ESOP" what do you think? Can it be described in as many ways as the elephant in our story or is there some unifying description or phrase that represents the sum of all ESOP parts?

Of course, ESOP is merely the acronym for the words Employee Stock Ownership Plan, but if you touch an ESOP in one way it's a retirement plan. Touch it somewhere else and it's an effective exit strategy for the selling shareholder. Feel it yet again and it's a commitment to open book management and communication. Handle it once more and it may be company events like barbecues and breakfasts.

If we try looking at and experiencing all these ESOP parts together, perhaps the sum of these parts is really something we call *employee ownership*. This simple phrase *employee ownership* carries powerful connotations of workplace involvement, commitment, connection, and empowerment. In fact, the phrase is so potent that we seldom hear a company described as ESOP-owned – even if that term may be more accurate.

Employee ownership has been defined as a movement, a philosophy, a state of mind, and a way of doing business. It also can be described as the "workplace of we." In all events, it's the palpable feeling you get when you walk through the door of a company that's got employee ownership spirit.

I'm sure the employees at your company will have many different answers when they "touch" your ESOP. What's most important is helping them to see the whole picture and how the various pieces all fit together. Just remember, however, no matter how large and successful your ESOP, don't go changing the acronym to *Elephant* Stock Ownership Plan.

— Paul Horn

ESOPs "R" US Indeed at ESOP Mid-Atlantic Chapter Annual Conference

The Mid-Atlantic Chapter (MAC) of the Employee Stock Ownership Plan (ESOP) Association held its 11th annual conference titled ESOPs "R" US in Charlottesville, VA on Thursday October 14.

Conference attendees – a record 120 – participated in "toy-related" sessions including navigating the store aisles of ESOP administration, paying your repurchase liability at the checkout counter, and digging into the sandbox of S Corp. issues and regulatory developments. MAC mascot, Eddie ESOP (also known to his inner circle as Eddie the Elephant), was present at the registration desk to greet attendees.

Following breakfast, MAC President Paul Horn greeted the group and recognized our nine conference sponsors (see box) and the companies that sent five or more persons: Blue Ridge ESOP Associates, ComSonics, Experimental Pathology Laboratories, Gala Industries, Railside Enterprises, and Sonny Merryman. Well done!

A group activity followed where each table received a question on a subject like employee recognition or holding ESOP events. Each table did a fantastic job reporting back to the group and much humor and useful information was shared. The breakout sessions were great as usual including another edition of ESOP Squares with our ESOP experts making up the squares. ESOP Associated President Michael Keeling regaled us with tales from the legislative front and the recent passage of the American Jobs Creation Act of 2004 and its provision helping S Corp ESOPs. Michael told the group that when it comes to ESOP lobbying and Congress, it's always best to stay on the offense.

We remained in the main ballroom after lunch to hear Dick Duffy deliver inspiring words about purpose and commitment in the workplace and how "toys" need to be shared by management with all employees to make this happen.

We concluded the day with the Employee Ownership Foundation (EOF) raffle where we raised \$426! There were numerous prizes including the big three -- a digital camera, DVD player, and CD stereo.

Our Chapter Administrator Jennifer Abruzzo was instrumental in making the event a success as she worked with the hotel, sent mailings, put together brochures and signs, and ran the registration desk. Thanks also to all our great speakers. See everyone next year!



Dick Duffy explains "toy-sharing" to MAC attendees.

Tidewater Takes on S-Corp Anti-Abuse Test

August 26, 2004

The MAC Eastern Region held an Eggs 'n' ESOP breakfast in Virginia Beach to discuss Internal Revenue Code § 409(p), which deals with special S Corp anti-abuse rules. Presenters were Rick Mapp and Shad Fagerland, Attorneys with Equity Strategies, LLC in Norfolk, and Carolyn Zimmerman, Managing Director of Blue Ridge ESOP Associates in Charlottesville. The twenty or so attendees represented S-ESOP companies and practitioners from the Tidewater area.

The presentation gave an overview and history of § 409(p) and then discussed the test in general terms. Attendees heard these vital pieces of information:

- It is possible to structure S-Corp ESOPs to shield personal income, and such abuses led to these rules.
- Even "good" S-ESOPs can be caught in the snare of these rules.
- Your ESOP, and possibly your company, can be at risk if you do not pass the test.
- There are important parts of the test that are difficult to apply and for which further Internal Revenue Service ("IRS") guidance is needed.
- The IRS initially promised guidance by the end of August, but it has not yet appeared.
- While waiting for guidance, it is best to take a conservative approach, and apply the test in as strict a manner as possible.
- You should have a professional adviser run your test and show you what you can do to pass it if you have problems.

Until further IRS guidance occurs, providers and S-ESOP companies are doing their best to comply with § 409(p). Most practitioners think the test will be pretty much unchanged by the IRS, although we hope to have clarification of the "gray" areas.

MAC Capital Region Tackles ESOP Issues

August 10, 2004

Peter Briggs, a Managing Director of Shareholder Strategies, spoke at a breakfast meeting for the Capital Area of the Mid-Atlantic Chapter of the ESOP Association. Mr. Briggs spoke on a wide array of topics selected by the audience. These topics included Mergers and Acquisitions (and the use of an ESOP), recent changes in legislation, seller financing, and the utility of the Section 1042 rollover given the current capital gains tax rates. Many thanks to Peter Briggs for his time and knowledge and a special thanks to Ernst & Young for hosting the event at their offices in Tysons Corner.



MAC golfers relax after successful completion of 2nd annual tournament organized by Rick Mapp.

MAC Western Region Eggs & ESOP

September 23, 2004

The Western Region held a breakfast meeting at the new ComSonics manufacturing facility in Weyers Cave, VA. CEMSI (ComSonics Electronic Manufacturing Services, Inc.) is the manufacturing arm of long-time MAC member ComSonics, Inc. This facility was created as a result of growing business opportunities at ComSonics, from both the sale of its cable TV test products and the provision of electronic manufacturing services for many other industries.

The present ComSonics facility in Harrisonburg, VA was busting at the seams in 2003. The manufacturing department was spread throughout the building, using every available square foot of real estate. A solution was needed and the move to Weyers Cave was the answer. ComSonics relocated approximately 45 of their 175 employees to the newly leased and renovated facility.

Hosts Keith Robertson and Sonny Lasam (Truck & Equipment, Inc.) put together a continental breakfast for the 22 attendees. The meeting was a short discussion and Q&A by EAC Chair Mike Nesselrodt about the various things ComSonics does to communicate among its facilities in Florida, California, Indiana, and Weyers Cave. Mike spoke a great deal about the many revisions that have been made to their committee guidelines in order to provide EAC representation at each new facility.

After the meeting, CEMSI employees Matt Dean, Broc Powell, Marjorie Quillen, and Mary Pruitt conducted tours of the manufacturing area. Attendees were shown some very progressive automated manufacturing processes performed on very small electronic devices, with robotic equipment placing various types of components, some the size of a grain of pepper!



Keith Robertson speaks to breakfast attendees prior to the plant tour.



Legislative Roundup

On October 11, 2004, Congress passed H.R. 4520 (American Jobs Creation Act of 2004) and the President signed the Act on October 22nd.

The S Corp. ESOP provision in the Act is retroactive to the effective date of January 1, 1998. This provision would permit S Corps. sponsoring an ESOP to use distributions from current earnings on both allocated and unallocated ESOP stock to pay the loan used by the ESOP to acquire stock for the employees. Prior IRS position had limited this approach to unallocated stock only.

This change is important for S Corps. with large ESOP loan payments that might otherwise run up against the IRS deduction limits that are not as generous as for C Corps. The Act also increased the number of eligible S Corp. shareholders from 75 to 100. In the benefits community, the Act is likely to be best remembered for its significant impact on tightening the rules for nonqualified deferred compensation plans.

In other legislative news, Senator Breaux's S. 2298 (ESOP Promotion and Improvement Act of 2004) has three co-sponsors, Senators George Allen [VA], Mary Landrieu [LA], and Blanche Lincoln [AR]. It has numerous provisions benefiting ESOPs including extension of section 1042 treatment to S Corporations and repeal of the 10% penalty on passed-thru S Corp. distributions. Senator John Warner has expressed interest in the bill but has yet to add his signature. All Virginia MAC members are encouraged to contact his office and urge him to support this legislation. Maryland MAC members should contact Senators Paul Sarbanes and Barbara Mikulski.

A corresponding house bill, H.R. 4796, introduced by Rep. Cass Ballenger [NC], has six co-sponsors, Representatives Eric Cantor [VA-7th], Virgil Goode, Jr. [VA-5th], Nancy Johnson [CT-5th], Ron Paul [TX-14th], Todd Russell Platts [PA-19th], and Dana Rohrabacher [CA-46th]. Again, we all need to contact our local representatives and urge them to sign onto this important bill.

Some older pieces of legislation continue to stall due to the election year hubbub, namely H.R. 1778, which will create a Presidential Commission on Employee Ownership, and H.R. 2969, which will establish an employee ownership bank within the Department of the Treasury to help employees purchase

their companies rather than see their jobs moved offshore. However, ESOP advocates are optimistic that all of these pieces of legislation will move forward during the next congressional session.

Everyone should bookmark the website of the Thomas Register maintained by the Library of Congress (<http://thomas.loc.gov/>). Use this site to find out the details of any piece of legislation. For other questions please don't hesitate to contact either Keith Robertson (krobertson@ComSonics.com) or Rick Mapp (rcmapp@kaufcan.com), or visit The ESOP Association's website at <http://www.esopassociation.org>.

Congratulations to ESOP companies American Systems Corporation (Chantilly, VA) and Social & Scientific Systems, Inc. (Silver Spring, MD) on the nomination of their CEO's, Elliot Needleman (ASC) and Mary Frances leMat (SSS), as Midsize Company Executive of the Year by the Greater Washington Government Contractor (GWGC) Awards.

Congratulations also to former DynCorp CEO and now SSS Chairman Dan Bannister on his election to the GWGC Hall of Fame.

Mid-Atlantic Chapter Officers

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My company just went 100% ESOP and is converting from C Corp. to an S Corp. What is this alphabet soup all about and what does it mean to me?

Converting from “C” to “S” Corp. brings tremendous tax advantages, but also opens the door to a potential trap for the unwary set up by our friends at the IRS.

First, the good news. Generally, S Corp earnings are taxable to the S Corp. shareholders and the S Corp. makes a distribution to help shareholders pay their share of taxes on those earnings. However, due to an exemption in the tax code, an ESOP that is an S Corp. shareholder does not pay tax on its share of S Corp. earnings. This means that an S Corp. that is 100% owned by an ESOP has no tax liability associated with its corporate earnings.

As with any ESOP, participants are taxed on the value of their shares when they take a distribution years in the future. In the case of the 100% S Corp. ESOP, these tax savings can allow the employer to pay down debt and expand business operations. Earnings of ESOP-owned C Corps. are not similarly protected from corporate income tax.

Now, the not-so-good news. Due to the tremendous tax benefits discussed above, the S Corp. ESOP arrangement could be used improperly to shield personal income. To crack down on perceived abuses, Congress enacted Code Section 409(p), a wide-reaching anti-abuse provision that triggers catastrophic tax consequences for noncomplying S Corp. ESOPs. While the new anti-abuse rules primarily target small employers, testing to ensure compliance with Section 409(p) is complex and involves a review of all forms of stock ownership of the employer, not just shares held in the ESOP. You should consult your friendly tax attorney, CPA and/or TPA for more information.

The effective date of Section 409(p) is Jan. 1, 2005, for most ESOPs. Speak with an exciting ESOP professional to ensure that your S Corp. ESOP will satisfy 409(p) by year-end. If your ESOP does not pass, certain strategies are available to avoid adverse tax consequences, but time is running short.

Dr. ESOP seeks questions at rcmapp@kaufcan.com.



Test Your ESOP Knowledge

- A. For a selling shareholder to qualify for a section 1042 rollover, the ESOP must own at least this percentage of company stock after the sale?
- B. The acronym ERISA, which is the legislation governing retirement plans for U.S. workers, stands for what?
- C. What is the maximum number of years that can be used for a graded or step vesting schedule?
- D. What is a “put option”?

(See ANSWERS below.)



Mike Nesselrodt, Jeff McCartney and Brandi Garrett get ready to tell their company ESOP stories.

ANSWERS

- A. 30%
- B. Employee Retirement Income Security Act of 1974.
- C. 7 years.
- D. Requirement that the company buy back stock distributed from the ESOP to the participant.

MEMBER PROFILE



Logistics Management Resources, Inc. provides information technology services with a focus on logistics functional expertise in the areas of research and analysis, system design and development, implementation and training, and sustainment support and management of both government and commercial logistics information systems.

2003 was a banner year for LMR when it established its ESOP. The process of becoming an ESOP company started in 1999, when the Company's founders began exploring ways to pull back from the day-to-day management of the Company and share the success of LMR with the employees who helped build it into a nationally recognized Company. They wanted to make this transition in such a way as to maintain the corporate culture and 'family' atmosphere that had been built during its 10-year history and were critical to its success.

Since its founding in 1994, LMR has grown to over 230 employees with locations in 23 states including the corporate headquarters in Prince George, Virginia, and regional offices in Atlanta and Washington, DC. We have been repeatedly recognized as one of Virginia's most successful small businesses, having been selected for the last four years to the *Fantastic 50*, an annual list of the fastest growing small businesses in the state.

In January 2004, the owners agreed to sell, over a set period of time, 100% of the stock to the ESOP. At that time we completed the first step with bank financing by purchasing 30% of the stock. The loan will be repaid in 2005, at which time a second purchase of stock will be made.

LMR has been built on a foundation of commitment, experience, innovation, support, and quality. No doubt employee ownership will only enhance these well-established attributes in the years ahead.



Gettysburg Teaches Management Lessons

By Paul Horn

ESOP Chapter Officers from around the country gathered in Gettysburg, PA on September 10 to tour the battleground and listen to Michael Keeling relate how the events of July 1-3, 1863 can teach us valuable management lessons.

Gen. Lee's forces of 70,000 soldiers, after their dramatic victory at Chancellorsville, VA, headed north where they basically bumped into the Union forces (93,000) under Gen. Meade at Gettysburg. The personalities and management skills of the various generals, as well as some luck, were critical in fashioning the events of the three-day battle that culminated with the ill-fated 12,000-man assault known as Pickett's charge. Lee could not continue the battle after sustaining heavy losses and retreated across the Potomac River back into Virginia.

The weather was glorious and our view from Little Roundtop (the southern end of the Union flank) was spectacular. The numerous monuments and statues that inhabit the battlefield enhanced the learning experience.

On Saturday, the Chapter Officers reconvened in Baltimore, MD to discuss session topics for the May annual meeting. It was great seeing all who attended this event.



ComSonics employees Mike Nesselrodt, Keith Robertson, and Donn Meyerhoeffer enjoy a moment with Rep. Bob Goodlatte (VA-6th) at the May Congressional Reception.

Welcome New MAC Members 2004*

CORPORATE MEMBERS

Clinical Trials & Surveys Corporation, Baltimore, MD
FMS, Inc., Pasadena, MD
Hengler Computer Consultants, Inc., Elliott City, MD
John H. Frischkorn, Jr., Inc., Richmond, VA
Med Response, Inc., Bluefield, WV
Sonny Merryman, Inc., Rustburg, VA
Sun Automation Group, Sparks, MD

PROFESSIONAL MEMBERS

Mr. Aaron Bartley, Houlihan, Lokey, Howard & Zukin, McLean, VA
Ms. Ellyn Bess, McPhillips, Roberts & Dean, PLC, Norfolk, VA
Mr. Lawrence J. Eisenberg, Silver, Freedman & Taff LLP, Washington, D.C.
Mr. Tom Roback, Blue Ridge ESOP Associates, Inc., Charlottesville, VA
Mr. Randall R. Shrake, Blue Ridge ESOP Associates, Inc., Charlottesville, VA
Mr. Gregory S. Washburn, Blue Ridge ESOP Associates, Inc., Charlottesville, VA
Ms. Beverly J. White, Luse, Lehman, Gorman, Pomerenk & Schick, Washington, D.C.

AFFILIATE MEMBERS

Educational Services, Inc., Washington, D.C.
Leonard Resource Group, Inc., Alexandria, VA
Professional and Scientific Associates, Reston, VA
WEB Equipment, Inc., Fredericksburg, VA

EDUCATIONAL MEMBERS

U.S. Department of Labor, Mr. Scott C. Albert, Chief, Baltimore, MD

** Since the last newsletter, please let us know if we missed you.*

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