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# The ESOP Association

September 13, 2011

Senate Committee on Finance  
Attn. Editorial and Document Section  
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Set forth below is a statement from The ESOP Association for the Committee's hearing on "Tax Reform Options: Promoting Retirement Security." The official statement is in quotation marks.

"Chair Baucus, Ranking Member Hatch, and distinguished members of the Senate Committee on Finance:

This statement is for the official hearing of the Committee's September 15, 2011, hearing on "Tax Reform Options: Promoting Retirement Security."

This statement is submitted by:

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The author of this statement is J. Michael Keeling, President of The ESOP Association at the address and phone number above. Mr. Keeling's email address is [michael@esopassociation.org](mailto:michael@esopassociation.org).

The ESOP Association is a national trade association of approximately 2,400 members. Its primary, and majority, of members are U.S. corporations that sponsor employee stock ownership plans, or ESOPs, as the plans are most commonly known.

The mission of the Association is simple: To advocate for, and education about, employee ownership through the ESOP model.

ESOPs are imbedded in the Employee Retirement Income Security Act of 1974, or ERISA. Prior to 1974 they were recognized in the Internal Revenue Code, first in 1921, as stock bonus plans.

*Serving The Entire ESOP Community*

The fact is that it was the leadership of the Senate Finance Committee that pushed codification of ESOPs in ERISA, and in 1981, 1984, 1986, and 1998, the Committee added provisions to the Internal Revenue Code to encourage the creation and operation of ESOPs. The primary leader for ESOPs was the much loved, and revered, former Senator, and former Committee Chair for many years, Russell B. Long of Louisiana. To be noted in addition to this single champion for employee ownership, there is no public evidence that any member of this Committee ever opposed the creation and expansion of ESOP policy.

As it should, the Committee, the Senate, and the entire Congress, will work on tax reform examining all the evidence about each provision of the Tax Code of 1986. You will seek evidence that that the ESOP model of employee ownership is good for employees and their retirement income security. At the same time, when you examine the evidence about current ESOP policy, you will also review, 'Are ESOP companies good for employees, good for the companies, good for their communities, and good for America?'

You will ask these questions, for as the legislative history proves beyond doubt, be it in Committee reports, from statements on the Senate floor, or from votes on the Senate floor, ESOPs are 'ownership' plans as well as retirement savings plans.

In short, you will seek answers to the questions about ESOP tax law using two measures: One, are they good retirement savings plans, and two, are they good ownership plans?

Set forth below is a summary of the very credible evidence that ESOPs are both good retirement savings plans for employees with ESOP accounts, and are good for companies, communities, and the United States.

1. In the book, *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-Based Stock Options*, edited by Joseph R. Blasi, Douglas L. Kruse, of Rutgers University, and Richard B. Freeman of Harvard University, the editors set forth findings on shared capitalism. The book identifies ESOPs as a primary model of shared capitalism in the U.S. Below are the summarized findings.
  - Shared capitalism can increase wealth for workers at lower and middle income levels.
  - Shared capitalism improves the performance of firms. It is associated with greater attachment, loyalty, and willingness to work hard; lower chance of turnover; worker reports that co-workers work hard and are involved in company issues; and worker suggestions for innovations.
  - Shared capitalism improves worker well-being. It is associated with greater participation in decision-making; higher pay, benefits, and wealth; greater job security, satisfaction with influence at the workplace, trust in the firm, and assessment of management; and better labor management relations practices.
  - Shared capitalism complements other labor policies and practices. Firms with shared capitalism compensate more and are likely to have other worker-friendly labor policies and practices.

- The risk of shared capitalism investments in one's employer is manageable. Portfolio theory suggests employee ownership can be part of an efficient portfolio. Most workers have modest amounts of employee ownership within the ranges suggested by portfolio theory. Less risky forms of shared capitalism such as cash profit sharing and stock options where workers are paid market wages, or company stock is not financed by worker savings, can be prudently combined with riskier forms where workers purchase stock.
2. In August 2010, The ESOP Association and the Employee Ownership Foundation released the results of a survey conducted among the Association's 1,400 corporate members which confirmed positive benchmarks for ESOPs. The eye-opening statistics of the 2010 survey are the increase in age of the ESOP and account balances. In 2010, the average age of the ESOP was reported to be 15 years, demonstrating ESOP companies are sustainable. In addition, the average account balance has risen dramatically to \$195,222.65; a high figure compared to most data tracking defined contribution plans which correlates with the age of ESOPs participating in this year's survey. And approximately 90% of members reported having retirement savings plans in addition to the ESOP including the use of 401(k) plans, pension plans, stock purchase plans, and stock options. In terms of motivation and productivity, 84% of respondents agree that the ESOP improved motivation and productivity. The Company Survey is conducted every five years and was last completed in 2005. Prior to 2005, the survey was completed in 2000.
  3. Also in September 2010, the Employee Ownership Foundation released the results of an extensive study it funded that evidenced that ESOPs provide more employee benefits than non-ESOP companies. The study, which reviewed data from the Department of Labor Form 5500 on defined contribution retirement plans, found: ESOP companies have at least one plan, the ESOP, but more than half (56%) have a second retirement savings/defined contribution plan, likely a 401(k) plan. In comparison, the Bureau of Labor statistics reports that only 47% of companies have some sort of defined contribution plan which shows that an ESOP company is more than likely to have two defined contribution plans than the average company is to have one plan.

The project was done by the National Center for Employee Ownership (NCEO).

4. Also, in the summer of 2011, the Employee Ownership Foundation released its 20<sup>th</sup> Annual Economic Performance Survey (EPS), that evidenced a very high percentage of companies, 92%, declared that creating employee ownership through an ESOP was "a good decision that has helped the company."
5. In June 2008, Brent Kramer, a doctoral candidate at the City University of New York, now Ph.D., submitted a study, *Employee Ownership and Participation Effects on Firm Outcomes*, that "provides strong evidence that majority employee-owned businesses have a significant advantage over comparable traditionally-owned businesses in sales per employee." The average advantage, \$44,500, means that a typical 200 person ESOP businesses could be expected to have an almost \$9 million annual sales advantage over its non-ESOP counterpart.

6. In January 2007, the co-operative relationship between the Employee Ownership Foundation and the University of Pennsylvania's Center for Organizational Dynamics led to an important new and "fresh" study of the effectiveness of ESOPs and employee ownership as uncovered in 30 years of scholarly research on the issue. The study, "Effects of ESOP Adoption and Employee Ownership: Thirty Years of Research and Experience," authored by Dr. Steven F. Freeman, Affiliated Faculty and Visiting Scholar School of Arts and Sciences, University of Pennsylvania, confirms that employee-owned companies experience increased productivity, profitability, and longevity.
7. The most comprehensive and significant study to date of ESOP performance in closely held companies was conducted by Dr. Joseph R. Blasi and Dr. Douglas L. Kruse, professors at the School of Management and Labor Relations at Rutgers University, and funded in part by the Employee Ownership Foundation. The study, which paired *1,100 ESOP companies* with *1,100 comparable closely-held non-ESOP companies* and followed the closely-held businesses for *over a decade*, reported overwhelmingly positive and remarkable results indicating that ESOPs appear to increase sales, employment, and sales/employee by about 2.3% to 2.4% over what would have been anticipated, absent an ESOP. In addition, Drs. Blasi and Kruse examined whether ESOP companies stayed in business longer than non-ESOP companies and found that 77.9% of the ESOP companies followed as part of the survey survived as compared to 62.3% of the comparable non-ESOP companies. According to Drs. Blasi and Kruse, ESOP companies are also more likely to continue operating as independent companies over the course of several years.
8. In 1995, the U.S. Department of Labor released a study entitled "The Financial and Non-Financial Returns to Innovative Workplace Practices: A Critical Review." This study found that companies that seek employee participation, give employees company stock, and train employees, can positively affect American corporations' bottom lines.

So, based on the research cited, and there are many more studies, by the way, the Committee may agree, even agree strongly, that ESOP companies are good for our economy while providing in the vast majority of ESOP companies excellent retirement savings for the employee participants.

At the same time, however, it is legitimate for each Senator to ask as s/he thinks of our national tax system: 'Is the Federal tax revenue foregone because of tax law preferences for ESOP creation and operation worth it?' Or to ask differently, 'Is our nation benefitting from ESOPs as we, the Congress, and in particular, the Finance Committee, intended?'

Of course the ESOP community, as do advocates of all of our tax deferred retirement plans, reminds each and everyone that tax deferred ERISA plans do not, over a period of say 15 to 20 years, lower Federal tax revenues. It is only because the budget/tax expenditure estimating process looks at 5/10 year fiscal windows that ERISA plans seem to be revenue losers. Over time, as more and more Americans take money from their retirement savings plans, tax revenue is increased, and due to growth of the value of the plans, taxes paid on the distributions are more than the taxes foregone years earlier.

Let the record show that The ESOP Association endorses this view of the employer community that sponsors a variety of ERISA plans. The negative image of the tax preferential treatment of ERISA plans as revenue losers is a false image when these plans are viewed and analyzed beyond 5 to 10 years.

The ESOP community, however, has some special tax laws, primarily added as noted earlier by this Committee, that requires you to review these special rules for ESOPs beyond the general discussion of ERISA basic tax law preferences.

The special rules are consistently estimated by the Joint Committee on Taxation (JCT) and the Office of Management and Budget (OMB) for the past 10 to 15 years to lower Federal income tax revenue at approximately \$2 billion to \$2.5 billion per fiscal year. (A precise revenue score would have to be made in the context of the current law, and any proposals for change that might emerge. The numbers above come from the tax expenditure tables prepared by the JCT, and the OMB, both of which clearly explain that a tax expenditure estimate is not a revenue estimate, though everyone agrees that the tax expenditure number is nearly always in the ball park with a revenue estimate.)

To further explain, the special ESOP tax benefits number is divided about 75% to the corporation sponsoring an ESOP, and about 25% to individuals selling to an ESOP, and/or potential taxes paid by a potential shareholder of an S corporation sponsoring an ESOP. (It is murky how the S ESOP tax liability deferred until the ESOP participant receives a distribution is viewed by the estimators. An assumption may be that estimators view the ESOP trust, for estimating purposes, to be an individual S shareholder. Clearly as the Committee considers tax reform, clarity could be determined on these estimates about ESOP tax preferences.)

The \$2 to \$2.5 billion has to be put into context. The Federal government is estimated to collect \$1.154 trillion in income tax revenue in Fiscal Year 2011. The Federal government will collect \$2.174 trillion in total tax revenue. The Federal government will spend \$3.819 trillion in Fiscal Year 2011. The Federal deficit will be \$1.645 trillion in Fiscal Year 2011. The total GDP of the United States in Fiscal Year 2011 will be approximately \$15.080 trillion.

Thus, the ESOP tax expenditures represent .0017% of total income tax revenue, .0009% of total revenue, .00052% of total Federal spending, .0012% of the Federal deficit, and .00013% of the annual GDP.

Thus, the Congress, with the agreement of the President, could repeal all of the ESOP tax preferences, and each taxpayer would have her/his \$1 paid in tax reduced to approximately 2/10<sup>th</sup>s of a penny or by such a miniscule amount it would not be noticeable. In lowering the taxes on a dollar by these minuscule amounts Congress would have abandoned a policy, for which there is ample evidence in the vast majority of instances provide very good retirement income security, creates more productive, more sustainable, more profitable, and better places to work, while ensuring the jobs are locally controlled.

In fact, given these facts of what ESOP companies provide to employees, do for communities, by keeping jobs locally controlled, and making these companies more competitive in the global market place as a result, the Congress should be passing new laws to encourage the creation of more ESOP companies.

But at the least, the Congress should not, based on the evidence, and based on the fact getting rid of special laws encouraging ESOP creation and operation will not provide any significant tax rate reduction, or Federal deficit reduction, restrict, or eliminate, current laws benefiting ESOP creation and operation.

As the Committee moves forward reviewing and modernizing our current Federal Internal Revenue Code of 1986, The ESOP Association, and we know the wonderful ESOP companies of America, will work with you, and your staffs, both Committee staff, and personal staff, to openly examine the reasons for our current national policy that modestly encourages creation of more employee ownership in our nation through the ESOP model.

We thank you for accepting our statement and placing it in the hearing record of your September 15<sup>th</sup> hearing, 'Tax Reform Options: Promoting Retirement Security'."