

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2
890 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

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February 23, 1979

Honorable James Duncan
State Representative
Pouch V
Juneau, Alaska 99811

Dear Jim:

I would like to take this opportunity to express my opposition to your General Stock Ownership Plan (G.S.O.P.) bill.

*Does not
Replace
future
Perm Fund*
I feel the State's royalty and/or permanent fund income would be more equitably used as a vehicle to reduce income taxes and increase revenue sharing. This would result in a distribution which relates in some manner to the widely varying burdens carried by different people by present income and property tax schedules.

*Not pay
Plan
but find*
I likewise find the \$100/200/300 tax credit bill passed last year distasteful. The person who pays, say, \$10,000 a year in State income tax realizes no more benefit than the person who previously paid only \$300 and only an insignificant benefit in comparison to the person who draws welfare and pays no taxes.

G.S.P.
A program for an across the board percentage temporary tax credit or permanent tax reduction would be more equitable. A scaled credit with a smaller percentage applying to higher tax brackets would be less preferable than a flat credit but would still be preferable to last year's credit or the proposed G.S.O.P., which are both nothing more than thinly-veiled welfare programs.

Sincerely,

R. Shattuck

Roger R. Shattuck

RRS/ce

cc: Honorable Mike Miller
Honorable Bill Ray

File
Revenue
G.S.O.P.
w/ Mr
Bill

Looking at the proposal to buy BP's ownership in the TAPS Pipeline

There are a number of problems that come to mind when reviewing the numbers provided in the back of the GSOP proposal. These are some of them:

The acquisition price of the BP pipeline is listed at 1.3 billion dollars. BP, however, has reported a book value of its TAPS investment of 1.463 billion dollars in filings before the F.E.R.C. This is a difference of 163 million dollars in the purchase price.

The most serious problem is in the listed tariff of \$5.50. I guess that the \$5.50 tariff is simply the tariff that BP asked for less their allowance for federal income taxes. Otherwise I have no idea where \$5.50 came from since no company or regulator has used it before. BP filed a tariff with the F.E.R.C. of \$6.35. That is now in effect on a refundable basis. On June 19, 1977, the I.C.C. rejected the \$6.35 tariff and set the BP tariff at \$4.68. This lower tariff was \$1.67 lower than the one filed. It was lower because the I.C.C. used a different formula to compute rate of return than the oil companies used. The U.S. Supreme Court upheld the lower tariff.

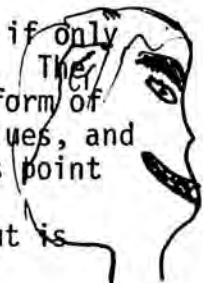
Now the higher tariff is in effect, but only for a while on a refundable basis. Everyone but everyone knows its coming down when the F.E.R.C. completes its hearings, expected by this summer. The first phase of the F.E.R.C. hearing only consider treatment of income taxes, rate of return, and rate base methodology. These items alone will lower the tariff to around \$4.50. Phase II of the F.E.R.C. hearings will consider new numbers for depreciation, operating costs, removal cost of the pipeline, and a number of other items including the cost overruns. This will lower the tariff much more. In fact, the State of Alaska has already spend more than 1 million dollars documenting a case for disallowing 1.5 billion dollars of cost overruns. If accepted this will lower the rate base by 16%, forcing rates even lower. If the cost overruns are disallowed, the pipeline will not be that profitable for BP, which is probably why they want to sell it.

Furthermore, the tariff will actually decrease as the rate base is depreciated. (Even without increased throughput) Since the pipeline is different from a telephone or electric utility, which is always adding on plant, the rates decrease dramatically as the bonds are paid off and the equity investment depreciated. Tariffs later on will be very low.

The operating costs of the pipeline will increase some but that will have little affect on the tariff, since the big costs are capital costs, such as debt servicing, ect. For example, current operating expenses are around 25¢ a barrel for the pipeline. Even if this doubled in ten years, it would only be an increase of another 25¢.

The primary advantage a GSOP has over another firm is the tax treatment. It pays no federal income taxes. This cost savings is substantial, but they will all be passed on to the ratepayer. There will be no bonanza for the State from the BP pipeline, in terms of income.

It may, however, be worthwhile for the State to own it, if only to lower the cost of bringing North Slope oil to market. The GSOP tax savings would be passed on to shippers in the form of a lower tariff, this in turn would increase wellhead values, and increase our royalty and severance tax income. From this point of view the investment might make good sense. But to look at those great dividends the GSOP report talks about is very misleading.



Jamie Love
AkPIRG
3/14/79

SECTION BY SECTION ANALYSIS OF VOLUNTARY BROADENED STOCK OWNERSHIP,
JOB PRESERVATION AND COMMUNITY STABILIZATION ACT.

SECTION 1. TITLE

SECTION 211. FINDINGS

(1) Unemployment is a serious problem that causes grave economic loss and social suffering to individuals, their families and the Nation;

(2) Unemployment insurance program is under financial and administrative pressure and greatly taxes the resources of the Nation;

(3) Unemployment should be prevented wherever possible by strengthening local responsibility and providing individuals with an ownership base in corporations,

(4) Federal initiatives to reduce unemployment should be multifaceted and should be designed to prevent the loss of jobs in the first place;

(5) Shutdowns, sales to unrelated outside interests and resulting outmigration of industrial, manufacturing, business and agricultural concerns causes grave social and economic harm to employees;

(6) Experience and research have shown that in some cases employee or employee-community purchase of such concerns can save jobs, maintain viable economic enterprises and strengthen the local economy;

(7) Current shortage of capital formation will hamper Nation's economic growth;

(8) Present concentration of capital ownership has created too great a disparity between the "haves" and the "have-nots";

(9) Current alarming decrease in productivity could be alleviated by employee ownership;

(10) It is necessary to provide a National program of federal financial assistance to avoid plant shutdowns, sales of companies to unrelated outside interests or the outmigration of such concerns and to promote broadened stock ownership by employees.

SECTION 212. STATEMENT OF PURPOSES

(a) Purpose is to save jobs and stabilize communities through a voluntary program that will facilitate employee or employee-community purchases through employee stock ownership plans or general stock ownership corporations of concerns that would be otherwise shut down, sold to unrelated outside interests or moved out of such communities. Federal Government shall provide:

(1) Information to employee or employee-community groups about the option offered under this Act;

(2) Technical Assistance to evaluate feasibility of option offered under this Act;

(3) Information to current owners of firm about the option offered under this Act;

(4) Technical Assistance to employee or employee-community groups on aspects of ownership transfer under this Act;

(5) Loans and loan guarantees to employee or employee-community groups to provide funds for technical assistance and startup and operating costs associated with purchase of concern.

(b) Further purpose is to support the local tax base by maintaining viable concerns through federal loans and loan guarantees and to test this program as an alternative to unemployment insurance (and other methods of dealing with unemployment).

SECTION 213. DEFINITIONS (Self-explanatory).

SECTION 214. FEDERAL ASSISTANCE.

(a) Existing EDA offices, working in cooperation with State and Local entities, will identify firms in danger of closing down or relocating and which have a potential for acquisition through a form of ownership described in this Act.

(b) In those cases where firms may be able to be kept in operation profitably, EDA will furnish information about this program to the employees and the community.

(c) (1) Loans for technical assistance and loan guarantees for startup and operating costs may be provided to employee and employee-community organizations that have had an application for funds approved under Section 215.

(2) In order to apply for assistance, an organization must meet the following requirements:

(A) Incorporate under the laws of the State in which the plant is located;

(B) Certify that a form of ownership has been adopted by the members of the organization after full consideration of their alternatives under State law, certify that the form of ownership insures continuous provision of information to individual stockholders and allows for inclusion of new employees and provides for acquisition of stock of those no longer associated with the firm.

(d) For the purpose of enabling employee or employee-community groups to purchase firms which would otherwise close, be sold to unrelated outside concerns or be relocated or in which more than 20 percent of the outstanding stock is available for purchase, EDA may guarantee loans in order to provide equity funding for purchase of concern. The rate of interest shall not exceed the prevailing rate for loans on similar accounts made for creditworthy purchasers in the community.

(e) Employee or employee-community groups may adopt any ownership form they choose, including employee stock ownership plans, provided they are qualified under the IRS code, provided that all employees are offered an opportunity to participate in the ownership plan, and that employees subject to collective bargaining agreements shall be included in such an offering, unless the union representing such employees waives, in writing, participation in the plan.

SECTION 215. APPLICATIONS

(a) EDA may provide loans and loan guarantees to any organization which applies for assistance, if the feasibility study conducted under subsection (b) provides reasonable grounds to expect that the proposed transfer of ownership will assure the likelihood of full repayment of any government loans or loan guarantees and will result in a viable business enterprise.

(b) EDA will conduct a feasibility study within 60 days after receiving an application to determine whether reasonable grounds exist to expect that the proposed transfer will be successful.

(c)(1) EDA may provide loans and loan guarantees to any organization whose application has been approved.

(2) The Secretary shall establish a reserve fund of 15 percent of the total amount of loan guarantees outstanding as authorized under the Act.

(d) Technical assistance may be provided to eligible organizations under this section.

(e) Not more than 10 percent of the amount of loans or loan guarantees may be used for consulting services in connection with this transfer of ownership.

SECTION 216. NONDISCRIMINATION

SECTION 217. WAIVER OF SECURITIES ACT OF 1933

(a) The section allows the Secretary of Commerce to exempt employee or employee-community organizations from select provisions of the Securities Act of 1933 to facilitate purchase of the plant.

SECTION 218. REPORT

(a) EDA will evaluate the success or failure of the program and report to Congress at the end of two years and again after six years.

SECTION 219. AUTHORIZATIONS.

(a)(1) Loan guarantees are authorized for six fiscal years.

(2) Total loan guarantees shall be the higher of (A) \$100,000,000 or (B) 1 percent of the amount expended for unemployment compensation during fiscal year 1978. For each of the succeeding six fiscal years, the amount of funds authorized shall be increased by 10 percent.

-4-

(b) Total authorizations for loans are not to exceed \$15,000,000 for each of the six fiscal years.

(c) Total appropriation to cover loan guarantees shall be 15 percent of the amount specified in subsection (a).

(d)(1) 10 percent of the appropriated funds may be used for feasibility studies, technical assistance and associated administrative costs.

(2) Funds appropriated under subsection (c) which are not used for purposes outlined in subsection (d) may be placed in the reserve fund and used to reduce appropriations in future years.

SECTION 2. AMENDMENTS TO THE INTERNAL REVENUE CODE

(a) Amends the ESOP provision of the IRS code to increase the employers' contribution to a leveraged ESOP from 25 percent to 50 percent.

(b) Technical amendment.

(c) Amends the General Stock Ownership Corporation provision of the IRS code to allow a class of stockholders who are smaller than all citizens of a State to be eligible to set up a GSOC.

FACT SHEET ON VOLUNTARY BROADENED STOCK OWNERSHIP, JOB PRESERVATION
AND COMMUNITY STABILIZATION ACT

Legislation would amend TITLE II of PWEDA so that EDA would be specifically authorized to make loans guarantees for loans made to employee or employee/community organizations seeking to purchase their firms when they would otherwise close, relocate, or have a substantial part of their stock purchased by an outside interest.

***Plant shutdowns are a major source of unemployment. According to United Auto Workers, Michigan lost more than 200,000 jobs to plant shutdowns between 1966 and 1976. Since 1960, New England lost 9 percent and the Midwest 13 percent of its manufacturing employment. In Watsonstown, Pennsylvania last year Zenith decided to phase out 1,000 jobs at the last U.S. color TV plant in a community of 5,000 people. Ohio, the scene of another massive shutdown of Youngstown Sheet and Tube affecting 5,000 people, lost over 10 percent of its manufacturing employment in the same period.

***Employee ownership provides a free enterprise, community based solution to the problem of unemployment and economic dislocation, while simultaneously providing an effective means to increase productivity and provide for capital growth.

***Employee ownership provides a workable solution to two major problems in the U.S. economy: decline in productivity and unemployment. In addition to preventing unemployment, employee-owned firms are 1.5 times more profitable and significantly more productive (30% in one major study) than comparable conventional firms. An EDA report has found increased job satisfaction, lower absenteeism, fewer job greivances and better communication among workers and managers in employee-owned firms.

***EDA has made loans for employee-ownership plans, but their legislative mandate is such that they must give priority to companies suffering the effects of disasters, defense realignments, or government regulations.

*** Legislation would amend TITLE II so that loan guarantees would be made to employee or employee-community organizations, including those using ESOP or GSOP plans. The decision to make a guarantee would be based on a feasibility study of the particular situation for which EDA could make such a loan. Employee or employee-community groups must show that they will use the money to purchase the company, that the company is viable or would become viable under employee ownership, and that the distribution of ownership shares will not discriminate against lower paid employees or against any individual on the grounds of race, sex, religion, etc.

***Bill authorizes Secretary of Commerce to make technical assistance available to company employees seeking to purchase their firms and requires her to conduct studies of the issue of employee ownership.

***Bill authorizes \$100 million in loan guarantees, with a 15% reserve fund to be appropriated to cover guarantees. Bill also authorizes \$15 million in loans for feasibility studies.

Jerry Gauche

Benefits of Employee Stock Ownership Plans affected markedly by the 1978 Revenue Act

by RONALD L. LUDWIG and JOHN E. CURTIS, JR.

The new law incorporates TRASOPs into the Code and places restrictions on employer securities, put options, and voting pass-through rules. In addition, changes made by other Code provisions make ESOPs and TRASOPs more advantageous. In this article, the authors analyze all of the changes made by the Act and indicate that further changes may be forthcoming which will add to advantages of such plans.

SIGNIFICANT CHANGES were made concerning ESOPs (Employee Stock Ownership Plan) and TRASOPs (ESOPs permitting additional investment credits) by the Revenue Act of 1978 (P.L. 95-600, 11-6-78). In addition, other proposals, most notably S. 3241, which would have given a tax credit based on covered payroll to an employer who adopted and funded a TRASOP, reflect a growing Congressional awareness of, and support for, the broadening of employee stock ownership. This will undoubtedly result in further legislation to expand and refine ESOPs and TRASOPs.

Changes in TRASOP operations

TRASOP part of the Code. Clearly, the most far-reaching change for ESOPs and TRASOPs which occurred in 1978 was the incorporation of the TRASOP provisions in new Section 409A.¹ Congress only extended the additional investment tax credits for TRASOP contributions through 1983,² and the TRASOP provisions were codified in substantially the same form as they previously existed; that is, an employer that makes the required contributions to a TRASOP may claim an additional investment tax credit equal to 1% of its qualified investment each year, with an additional credit equal to 1½% of its qualified investment, provided that employees match that 1½% portion of the employer's TRASOP contribution. Since TRASOPs are now a part of the Code, however, Senator Russell B. Long will work to make the provisions permanent next year. In addition, the Treasury Department and the White House are urging that the TRASOP tax credit should be based upon a percentage of wages rather than capital investment. This modification in the TRASOP concept will probably be made by the end of 1983.

While the Senate Committee on Fi-

nance was looking at the question of whether to make TRASOPs a part of the Code, it was recognized that there was really no significant distinction between a TRASOP which is "qualified" and one which is not. Accordingly, it was determined that a TRASOP should be required to comply with all applicable requirements of Section 401(a).³ In general, a plan must be established by the last day of the employer's taxable year in order to be qualified for that year. The use of the additional investment tax credit for determining TRASOP contributions causes a problem in that it may be many months after the close of the year before an employer can determine whether a TRASOP is feasible. Both the 1975 Tax Reduction Act and the 1976 Tax Reform Act provided that a TRASOP need be established only at the time the additional investment tax credit is claimed. The question of qualification under Section 401(a) for the initial TRASOP year was unclear. To resolve this problem, the Congress agreed that a TRASOP may satisfy the requirements of Section 401(a) even though it is not adopted by the last day of the first taxable year for which it is effective, provided that it is adopted by the due date for the filing of the employer's tax return for that year.⁴

Coverage of subsidiaries. Recognizing that more employers might wish to adopt a TRASOP as a result of its extension and improvement under the Act, the Congress attempted to alleviate certain potential problems which might impede full participation by all employers within a controlled group of corporations. For example, Section 414(b) applies the 80% test of Section 1563 in determining whether a subsidiary would be included within a controlled group for purposes of participation in a qualified plan. In addition, even if a parent corporation

and a subsidiary corporation met the requisite ownership test, there were problems in providing stock of the parent corporation for the benefit of employees of the subsidiary. If the parent corporation were to make a capital contribution of its stock to the subsidiary for purposes of the subsidiary's TRASOP contribution, the contribution by the subsidiary to the plan might have resulted in taxable gain to the subsidiary. Finally, securities law problems could possibly arise if the subsidiary was making cash contributions to the TRASOP for purchase of stock of the parent corporation, while an offering of the parent corporation's securities was in process.

To resolve these problems, Section 409A(1)(4) provides that only a 50% stock ownership test must be met for a first tier subsidiary to participate in a TRASOP established by the parent corporation. For each tier of subsidiaries below that, the 80% test would be applied. However, the 80% standard would continue to be applied for all other purposes of determining qualified status or possible discrimination. Section 109A(m) provides that a subsidiary would not recognize income as a result of the transfer of the parent corporation stock to a TRASOP. Clearly, however, the subsidiary would be eligible for the investment tax credit allowable for its TRASOP contribution.

TRASOP allocations. A major administrative problem in the TRASOP area has been the requirement that each employee who participated in the TRASOP at any time during the year must share in the allocation of stock representing the employer's annual TRASOP contribution. This applied even if he was employed for only a short time during the year and had terminated service prior to the end of the year. This created a great recordkeeping problem in that each such employee would receive an allocation (and in most cases a distribution) of stock for the year in which he ceased to be employed by the employer. Since the Act requires all TRASOPs to satisfy the requirements of Section 401(a), no specific reference to allocations of contributions was needed in Section 409A, since as qualified plans TRASOPs can require that an individual must be an employee on the last day of the year to receive a TRASOP allocation. The \$100,000 limit on compensation and the requirement that TRASOPs allocate contributions in pro-

portion to compensation was continued under the Act.⁵

TRASOP contributions. Since the Tax Reform Act of 1976, many companies which have adopted a TRASOP have decided not to take advantage of the additional 1½% investment tax credit provided by that Act. The matching employee contribution provisions are unclear and difficult to administer. One of the major reasons for this has been the Revenue Service's failure to promulgate Regulations dealing with the required matching employee contributions. Congress attempted to alleviate this problem in the Revenue Act of 1978 but failed to do so. According to the Senate Finance Committee, the Act would have provided that an employer's additional contribution for the 1½% investment tax credit (and the claiming of that amount of credit on the employer's Federal income tax return) would have been based upon the times when the employees make their TRASOP contributions. In addition, it was to provide that the employee contributions (and consequently the employer contributions relative to the 1½% investment tax credit) could have been made at any time up to two years following the close of the taxable year for which the 1% additional investment tax credit is claimed. Either Regulations or "technical corrections" to the Act will be necessary to implement this new feature.

Since TRASOPs have been made a part of the Code and since the tax credit for TRASOP contributions has been extended through 1983, Congress felt the provisions relating to withdrawal of TRASOP contributions if the investment tax credit is recaptured should be stricken. It is inconsistent with the employee benefit nature of TRASOPs to permit amounts previously contributed to be withdrawn. However, the employer will still be able to reduce TRASOP contributions in future years, or claim a tax deduction, for any portion of the 1% (or 1½%) portion of any recaptured investment tax credit.⁶ When (and if) the TRASOP contribution tax credit

is made a permanent part of the Code in future years, there should be no further concern by employers.

Employer securities

Section 409A(1) makes certain revisions to the definition of employer securities for TRASOP purposes. In general, employer securities will be common stock (of any class) which is readily tradable on an established securities market. The rules of prior law which required the use of common stock with dividends and voting rights no less favorable than other common stock have been so modified: publicly-traded companies. Where there is no readily tradable common stock (for closely-held companies), the existing rule has been modified to permit the use of common stock having a combination of voting power and dividend rights equal to or in excess of common stock having the greatest voting power and the greatest dividend rights. In addition, preferred stock which is convertible at any time at a reasonable conversion price into common stock meeting the above requirements may be used in lieu of common stock. The use of other employer securities (such as convertible debentures) for TRASOP purposes is prohibited for years beginning after 1978.

The Committee Reports also imply that similar definition of employer securities will also apply to leveraged ESOPs under Section 4975(c)(7). The Act itself does not include such a requirement. However, the special increase on the dollar amount of annual additions under Section 415(c)(6), which is applicable to ESOPs and TRASOPs, has been amended to limit its application to such employer securities only.⁷

Put options and stock distributions. In 1976 the IRS proposed Regulations regarding ESOPs. These Regulations contained significant problems which, if allowed to go unchanged, would have seriously curtailed the adoption of ESOPs by employers and the broadening of stock ownership among employees. In the Conference Report on the Tax Reform Act of 1976, Congress specifically instructed the IRS and the Department of Labor regarding the ways in which the Proposed Regulations were unsatisfactory. The agencies published final ESOP Regulations in 1977 which generally alleviated the problems under the Proposed Regulations. However, in the area of "put options," the final ESOP

Regulations did not totally remove obstacles that acted as a deterrent to the adoption of ESOPs. The Department of Labor and the IRS felt that any participant who receives a distribution of stock of a closely-held corporation from an ESOP should have a market for the stock. The agencies felt that the best vehicle for guaranteeing such a market is to require that a closely-held employer grant a "put option" to the participant to resell his stock to the employer. However, the final Regulations applying to leveraged ESOPs contained overly restrictive requirements regarding the duration of the put option, the terms for resale of the stock by the participant and other related matters. Many employers were concerned that the effect of these onerous put option Regulations would be to make the leveraged ESOP unworkable for some closely-held corporations. It was expected that TRASOP Regulations would include similar put option provisions when distributed stock is not readily tradable.

At the same time, Congress realized that ESOPs (and TRASOPs) have been faced with a problem in that they have generally been required by the IRS to distribute a participant's interest in shares of employer stock. This has been the case even though Reg. 1.401-1(b)(1)(iii) only requires that benefits from a stock bonus plan be "distributable" in stock of the employer company. Many employees wish to convert their distributed stock interest to cash immediately, particularly if the stock is not publicly traded. Congress recognized that it was inappropriate to require the ESOP to incur the administrative burden of issuing shares of employer stock, with the employer repurchasing such stock immediately. At the same time, Congress felt that an employee who really wanted to receive a distribution of employer stock should be able to do so. Therefore, Congress decided that, subject to a participant's right to demand a distribution of employer stock, an ESOP or TRASOP may elect to distribute cash or employer stock.⁸ This right to demand stock must be communicated in writing when a distribution is due.

Any participant in a leveraged ESOP or TRASOP who receives a distribution of employer securities which are not readily tradable on an established market is required by Section 409A(h)(1)(B) to be given a put option on such stock, based on the following terms:

1. Upon receipt of the employer stock,

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the distributee must have up to six months to require that the employer repurchase this stock at its fair market value. Although the obligation to repurchase stock under the put option would apply to the employer, not to the ESOP or TRASOP, it is permissible for the ESOP or TRASOP to actually make the purchase in lieu of the employer. If the distributee does not exercise the put option within the six-month period, the option will temporarily lapse.

2. After the close of the employer's taxable year in which the temporary lapse of a distributee's put option occurs, and following a determination of the value of the employer stock (determined in accordance with Regulations) as of the end of that taxable year, the employer will notify each distributee (who did not exercise the initial put option in the preceding year) of the new value of the employer stock. Each such distributee will then have up to three months to require that the employer repurchase his employer stock. If the distributee does not exercise this second put option, then the employer stock will no longer be subject to a mandatory put option.

3. At the option of the party repurchasing employer stock under the put option, such stock may be repurchased on an installment basis over a period of five years. If the distributee agrees the repurchase period may be extended to a period of ten years. As security for the installment repurchase, the seller must at least be given a promissory note, the full payment of which could be required by the seller if the repurchaser defaults in the payments of a scheduled installment payment. In addition, if the term of the installment obligation exceeds five years, the employee must be given adequate security for the outstanding amount of the note.

4. Because a distributee might wish to contribute the ESOP or TRASOP distribution to an IRA in a "tax-free" rollover and because the contribution would have to be made before the expiration of the first six-month put option period, the IRA trustee must be able to exercise the same put option as the actual distributee.

The cash distribution and put option provisions of the Act are effective for years beginning after 1978. It is expected that Regulations on ESOPs and TRASOPs will be modified to reflect the Finance Committee's directions with regard to put options. These provisions

are applicable only to TRASOPs and leveraged ESOPs, but it would certainly be consistent with the intent of Congress for such provisions to be extended to all ESOPs and stock bonus plans.

Voting pass-through. The most controversial ESOP decision which the Congress made in the Act was to require "pass through" voting rights on certain employer stock acquired by qualified defined contribution plans.

For companies which are publicly-traded (generally, those registered under Section 12 of the 1934 Securities Exchange Act) the requirement for full pass-through of voting rights on employer securities to TRASOP participants is continued. For other employers, a "limited" voting pass-through requirement applies with respect to corporate matters which (by law or corporate charter) must be decided by more than a majority vote of outstanding common shares voted.⁹ The Finance Committee report indicated that this was intended to include major corporate issues such as mergers, acquisitions, etc. requiring shareholder approval. The Act extends these TRASOP voting requirements to leveraged ESOPs for years beginning after 1978, presumably only with respect to stock acquired after that date in a transaction contemplated by the ESOP loan exemption.¹⁰

Further, the Act, Section 143, adds new Section 401(a)(22), extending this limited voting pass-through requirement to any defined contribution plan maintained by an employer whose stock is not publicly-traded, if more than 10% of plan assets are represented by employer securities after 1979. It appears that this requirement applies only to stock acquired after that date.

These provisions in the Act are a bit unclear and appear to exempt many employers from having to comply with the limited voting pass-through requirement. On October 18, 1978, Senator Long issued a statement stating that it is his intent that ESOPs be treated the same as all other defined contribution plans investing in employer securities with respect to the voting pass-through provision. The statement mentions a study to be conducted by the Treasury Department on this matter and invites comments from affected businesses. It appears that, if Senator Long is convinced that companies will not adopt ESOPs or will terminate ESOPs because of the voting pass-through requirement,

he will work toward deleting these provisions from the law.

The Senate Finance Committee report states that the Treasury Department is to conduct a one-year study and to report to the Committee on the extent to which voting rights and financial disclosure should be given to participants under ESOPs and TRASOPs holding employer stock issued by closely-held corporations. The Treasury is to work with representatives of businesses, the Department of Labor and the Congressional staffs on this study. In addition, the study is to consider the resale rights (put options, etc.) which should be available to a participant receiving a distribution of employer stock from an ESOP, TRASOP or stock bonus plan.

The Act itself does not include a provision relating to this study. It is understood, however, that the Finance Committee expects such a study to be completed by Treasury during the first six months of 1979. The study may well result in a reconsideration of the voting rights and put option provisions included in the Act. In this regard, a 1976 staff report prepared for the Joint Economic Committee recommended that voting rights should be passed through to ESOP participants only when the employer is publicly-traded.

ESOP definition. The Act has also modified the definition of ESOP in Section 4975(c)(7) to limit its application to "leveraged ESOPs."¹¹ It is apparent that this definition was included in the Code (by ERISA) primarily for purposes of the ESOP loan exemption in Section 4975(d)(3). The definition of ESOP in ERISA Section 407(d)(6) has remained unchanged for purposes of the ERISA Section 408(c) "safe exemption" from the prohibited transaction rules and the definition of "eligible individual account plan" in ERISA Section 407(d)(3).

Under the Act, leveraged ESOPs will be subject to the new TRASOP rules

⁹ Act, Section 141(a).

¹⁰ Act, Section 141(c), amending Section 46(a)(2)(E).

¹¹ Section 409A(a)(1).

¹² Section 409A(f)(2).

¹³ Section 409A(b). Compare with Section 201(d)(1) of the Tax Reduction Act of 1975.

¹⁴ Sections 409A(g) and 48(n)(4).

¹⁵ Act, Section 141(f)(7).

¹⁶ Sections 409A(h)(1)(A) and (2).

¹⁷ Section 409A(e).

¹⁸ Act, Section 141(f)(5)(C), amending Section 4975(e)(7).

¹⁹ Act, Section 141(f)(5).

²⁰ Act, Section 141(f)(5)(C). See Section 409A(c) and (h).

²¹ Sections 2039(e), (f).

regarding voting rights on employer securities and the cash distribution/put option rule, effective for years beginning after 1978.¹²

Other changes affecting plans

Estate tax exclusion. The Act also contained changes which affect employee benefit plans in addition to ESOPs and TRASOPs. Under the Tax Reform Act of 1976, a lump-sum distribution from a qualified plan is no longer eligible for the estate tax exclusion under Section 2039(c). It has been unclear since that time whether the denial of the estate tax exclusion is applicable only to a distribution for which the special ten-year averaging provisions for income tax treatment is elected under Section 402(e) or whether it applies to any total distribution, even if no favorable income tax treatment is actually elected by the distributee.

In attempting to resolve this problem, Congress was concerned that the party claiming the estate tax exclusion (the administrator of the estate) and the party receiving a lump-sum distribution treatment (the designated beneficiary) could be different individuals with conflicting interests. Accordingly, it was agreed that the estate tax exclusion would be permitted for a lump-sum distribution only if the distributee agreed in writing not to elect lump-sum distribution treatment for income tax purposes.¹³

Minimum tax. Any reduction in income taxes which occurs as the result of a credit claimed under Section 38 may result in increased liability for the minimum tax on tax preferences. Since the TRASOP tax credit is claimed as a result of the investment tax credit provided by Section 46 of the Code, its actual basis for claim is Section 38. Therefore, even if an employer received no net benefit from the reduction of taxes by reason of the TRASOP contribution offsetting its tax saving, it might find itself paying an increased minimum tax. For this reason, Section 56(c) now provides that the tax credit for TRASOP contributions (the additional 1% and 1/2% investment tax credit) is added back to the regular tax for the purpose of computing liability for the minimum tax under Section 56, thus precluding any minimum tax resulting from the TRASOP contributions. This provision was specifically made retroactive to all years in which an employer claimed an additional invest-

ment tax credit for a TRASOP contribution.

Capital gains. One of the most beneficial aspects of the Act which affects ESOPs is the reduction of taxes on capital gains, through the increased capital gains exclusion and the elimination of capital gains from the add-on minimum tax provisions. This change may result in many participants having lower income tax payable upon receipt of lump sum distributions from ESOPs, inasmuch as unrealized appreciation in employer securities received in such distribution will be taxed as a long term capital gain upon subsequent sale. Further, the reduction in taxes on capital gains will be an added incentive to the sale of stock to an ESOP by a major shareholder. This should result in greater uses of ESOPs to transfer ownership from shareholders to employees.

IRA provisions. The Act makes a number of changes in the provisions relating to IRA rollovers which will affect ESOPs as well as other plans. The Act includes a provision allowing the rollover of the proceeds from the sale of any property received in kind in a lump-sum distribution. This change and the other changes in the Act relating to IRA rollovers will result in more beneficial treatment of ESOP participants in providing flexibility with respect to the planning of distributions.

Possible future ESOP changes

During the period between the date S. 3211 was introduced and the date which Congress passed H.R. 13511, it became clear that a TRASOP tax credit based upon payroll will eventually be enacted into law, either as an alternative to, or substitute for the TRASOP investment tax credit. In introducing S. 3211, Senator Long specifically stated that "At the same time, the bill will make ESOPs attractive to labor-intensive employers which . . . make their investment in salaries and wages . . ." On October 3, 1978, the Treasury Department sent to each Senator an analysis of each provision of the Revenue Act of 1978. In analyzing the provisions on ESOPs, the Treasury Department stated that "we do believe that the investment credit base for TRASOPs should be converted to a partial credit based on wages." In addition, on September 22, 1978, Mr. Stuart Eizenstat, Assistant to the President for Domestic Affairs and

Policy, wrote to Senator Long on ESOPs. In that letter, Mr. Eizenstat stated that "the challenge is to move toward broadened stock ownership in a way which is . . . fair both as between different industries and firms and employees within a given business enterprise." Clearly, this is directed toward a payroll based TRASOP credit, which would provide an equal benefit to each employee-participant. Finally, at the conclusion of the Senate debate on H.R. 13511 (October 10, 1978), Senator Jacob Javits (R.-N.Y.), who has been critical of ESOPs and TRASOPs in the past, made the following statement regarding employee stock ownership: "If a tax credit is to be provided for TRASOPs, I would prefer using a wage base for such a credit rather than an investment base." These statements all reflect a common feeling about the wage-based TRASOP credit. ★

Normal retirement age not *per se* actuarially reasonable

THE SERVICE has stated in *Rev. Rul.* 78-331, *IRB* 1978-37, 8, that actuarial assumptions which are required to be "reasonable" must be tested in light of anticipated experience. There is nothing in the Code or Regulations relating to qualified pension plan requirements which makes the assumption that employees will retire at the normal retirement age specified in the plan reasonable *per se*.

Thus, if the most reasonable expectation is that employees will not retire at the normal age specified in the plan, the choice of the retirement age assumption must, in combination with all other assumptions, be reasonable in light of anticipated experience, i.e., the frequency of early or late retirements.

Section 412(c)(3) mandates that all actuarial assumptions and methods must be, in the aggregate, reasonable, taking into account the experience of the plan and reasonable expectations. This applies to the minimum funding requirements of Section 412 as well as to the deductibility of an employer's contributions to the plan under Section 404(a)(1)(A). Therefore, if the use of the normal retirement age is not a reasonable assumption, the actuarial assumptions in the aggregate could be found not to be reasonable.

If the effect of a plan's subsidized early retirement benefit is ignored, the plan could fail to satisfy the minimum funding requirements of Section 412 be-

Employee Stock Ownership Council of America

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December 8, 1978

MEMORANDUM TO MEMBERS OF THE ESOP COUNCIL OF AMERICA

FROM: Ronald L. Ludwig, General Counsel

RE: Recent ESOP Developments

FINAL ESOP REGULATIONS

On November 17, 1978, the Internal Revenue Service published final regulations relating to certain ESOP requirements under Section 4975(e)(7) of the Internal Revenue Code. This publication finalized those items of the ESOP regulations which had been presented in temporary and proposed form on September 2, 1977. The final regulations are in substantially the same form as proposed last year and cover the following matters:

Continuing Loan Provisions

The terms of an ESOP must specifically provide for protections and rights attributable to stock acquired with the proceeds of an ESOP loan. These rights primarily relate to the "put option" requirements of the ESOP loan regulations, as well as prohibitions against certain other restrictions on "leveraged" stock. These provisions must continue to apply to "leveraged" stock, even after the ESOP loan is repaid and even if the plan ceases to be a "leveraged" ESOP in the future.

Integration with Social Security

The final regulations make it clear that an ESOP established after November 1, 1977, may not be "integrated" with Social Security. A plan must have been designated as an "ESOP" on that date in order to be integrated. An existing integrated ESOP may not increase the extent of its integration with Social Security, but may continue to increase the level of integration (as the taxable wage base increases) if the ESOP so provided on that date.

Dividend Pass-Through

An ESOP will not fail to satisfy the requirements of Code Section 401(a) merely because it provides for the current distribution of cash dividends to participants. Under a stock bonus plan which is an ESOP, such current distributions must be made within two years' after received by the ESOP.

Multiple Plans

In general, an ESOP which was not in existence on November 1, 1977, may not be considered together with another qualified plan for purposes of satisfying the non-discrimination requirements of the Code. There is an exception whereby two or more ESOPs established after that date may be considered together for this purpose, provided that each ESOP holds substantially the same proportions of various classes of employer securities.

Effect of 1978 Revenue Act

These final regulations do not take into account the changes in ESOP requirements enacted in the Revenue Act of 1978. ESOP Council members have previously been supplied with our summary of these changes. It is expected that the ESOP regulations will be modified in the future to reflect such changes. It is also expected that there will be a "Technical Corrections" bill introduced in Congress early in 1979. Various clarifications of the ESOP provisions in the Act are necessary. Any ESOP Council member with suggestions for changes on this should contact Ron Ludwig as soon as possible.

TREASURY DEPARTMENT STUDY ON VOTING PASS-THROUGH

The Revenue Act of 1978 included provisions requiring certain pass-through of voting rights to participants under ESOPs, TRASOPs, stock bonus plans and other plans investing in employer securities. The Senate Finance Committee report on the Act mandated the Treasury Department to study the question of voting rights, financial disclosure, and resale rights to be available under ESOPs of closely-held corporations.

The Treasury Department has informed Senator Long that "... every effort will be made to report to Congress by July, 1979." The study will be expanded to consider voting

rights applicable under plans maintained by publicly-traded corporations, as well as closely-held corporations.

The ESOP Council is presently developing a questionnaire to be sent to all members, soliciting their views on the items to be considered in the Treasury Department study. The results of the responses will be compiled and presented to the Treasury Department, Senator Long and other key members of Congress. In this way we will be in a position to accurately reflect the feelings and concerns of our members in connection with the study. We expect that the questionnaire will be forwarded to you early in 1979. At the same time, we will encourage all ESOP Council members to comment directly on this issue to their representatives in Congress. Any member having suggestions for items to be covered in our questionnaire should contact Ron Ludwig at your earliest convenience.

ELIMINATION OF FORM EBS-1

On November 21, 1978, the Department of Labor proposed regulations which would eliminate the ERISA requirement for filing Form EBS-1, Plan Description. If finalized, the requirement would be satisfied by the filing of the Summary Plan Description with DOL. This change will become effective on the date of adoption of final regulations. The elimination of Form EBS-1 will reduce the paperwork and administrative burdens for all plans covered by ERISA.

PLAN AMENDMENTS TO COMPLY WITH FINAL REGULATIONS

On November 20, 1978, the Internal Revenue Service issued Announcement 78-175, to specify the time periods for amending all plans to comply with final ERISA regulations. Generally, any necessary amendments must be made by the end of the first plan year that begins after a new regulation is adopted and must be effective as of the first day of that year.

If a new regulation specifically provides for a different effective date, the date specified in the regulation will be controlling. In addition, where a plan satisfied prior ERISA guidelines, no amendment need be made earlier than June 30, 1979. Finally, if the plan met the conditions of the IRS Special Reliance Procedure, the amendment need not be made effective prior to the first plan year beginning after December 31, 1977.

TRASOP REGULATIONS

It is expected that final TRASOP regulations covering the 1½ additional investment tax credit will be published by IRS very soon. This will not include provisions relating to the 1/2% credit requiring matching employee contributions. ESOP Council members will be advised when these regulations are issued.

ESOP DETERMINATION LETTERS

On October 1, 1978, the IRS issued Commissioner Delegation Order No. 112 (Rev. 5), concerning authority to issue determination letters relating to employee plans matters. Included was a delegation to the District Directors of key districts to issue determination letters with respect to whether a plan constitutes an ESOP under Code Section 4975(e)(7). The ESOP regulations issued on September 2, 1977, had indicated that such determinations could be secured from IRS.

It is our understanding that the National Office of IRS is working on specific procedures for ESOP determination letters. Under existing procedures for Form 5301 (Application for Determination), determination letters generally relate only to "qualified" status under Code Section 401(a), and not to "ESOP status" under the regulations. We will advise ESOP Council members when we obtain more definitive information on this matter.

WAGE-PRICE GUIDELINES

It appears that ESOP and TRASOP contributions are included as fringe benefits for purposes of the seven percent limit on pay increases under the President's voluntary anti-inflation program. The Council on Wage and Price Stability is presently considering possible changes in the wage guidelines applicable to fringe benefits. It is expected that regulations will be published by CWPS in the near future and that there will be some liberalization in the standards applying to costs needed to maintain current fringe benefit levels.

MARSHALL v. PENN

On November 21, 1978, the U.S. Court of Appeals for the Tenth Circuit issued its opinion affirming the 1976 decision of the U.S. District Court which had ordered the rescission of a transaction involving the "conversion" of a profit sharing plan into an ESOP and the use of existing plan assets to purchase Company stock. The Court of Appeals held

"THE EXPANDED EMPLOYEE STOCK OWNERSHIP ACT OF 1978—A SUMMARY AND ANALYSIS"

(By John E. Curtis, Jr., Counsel, Senate Finance Committee and Ronald L. Ludwig, Attorney at Law, San Francisco, and Counsel to Employee Stock Ownership Council of America)

I. TRASOP LEGISLATION

A. Commentary

On June 23, 1978, Senator Russell B. Long, Chairman of the Senate Committee on Finance, introduced the "Expanded Employee Stock Ownership Act of 1978" (S. 3241). This bill marks the latest major congressional effort towards broadening the access of employees to stock and capital ownership in their employers. In the Regional Rail Reorganization Act of 1973,¹ Congress provided that the Consolidated Rail Corporation (CONRAIL) could use an employee stock ownership plan (ESOP) as part of its financing program, thereby enabling CONRAIL employees to share in ownership of the new railroad system. In the Employee Retirement Income Security Act of 1974,² Congress for the first time formally recognized ESOPs as an employee benefit plan and established criteria for its adoption and operations. In the Trade Act of 1974,³ as part of the relief package being established for companies which are members of foreign trade impacted industries, Congress provided that some preference would be given for assistance to such companies which use an ESOP in conjunction with federal loan guarantees. In the Tax Reduction Act of 1975,⁴ Congress established the "TRASOP," an ESOP funded through an additional investment tax credit allowed for corporate employees. The Tax Reform Act of 1976⁵ expanded the provisions for TRASOPs and provided guidance to the federal agencies for developing final ESOP regulations.

The purposes of the Expanded Employee Stock Ownership Act of 1978 are to further the steps already taken by prior ESOP legislation and to make the ESOP a better instrument for providing stock ownership to employees. The bill accomplishes these goals primarily by expanding the use of the TRASOP, the special form of ESOP presently tied to the additional investment tax credit available under the Tax Reduction Act of 1975, as amended by the Tax Reform Act of 1976. For purposes of this article, the term "TRASOP" will be used to refer to a "tax credit ESOP," while the term "ESOP" will apply to any ESOP (including a TRASOP). The purpose of this analysis is to explain each provision contained in the bill and to analyze the background problem or underlying reason for its inclusion.

Changes for TRASOP

The major changes made by S. 3241 are in the TRASOP area. As part of the overall increase in the investment tax credit from 7 percent to 10 percent, the Tax Reduction Act of 1975 provided for an additional 1 percent investment tax credit. This credit could be claimed by an employer that adopted a TRASOP (satisfying the requirements established by that Act) and contributed to the TRASOP an amount of employer stock (or cash to buy stock) equal in value to the amount of the additional tax credit claimed. The Tax Reform Act of 1976 expanded this concept, providing that an employer could claim an additional $\frac{1}{2}$ percent investment tax credit for TRASOP contributions (thereby increasing its total available investment tax credit to $11\frac{1}{2}$ percent provided that participating employees made matching contributions to the TRASOP equal to the additional $\frac{1}{2}$ percent investment tax credit). Such employee contributions were a mandatory prerequisite for the claiming of the additional $\frac{1}{2}$ percent investment tax credit by the employer. It is important to note that the additional investment tax credit for TRASOP contributions would largely be available only to capital-intensive corporations, and would have little applicability to labor-intensive corporations. In addition, the Tax Reform Act of 1976 extended the additional investment tax credit for TRASOP contributions only through 1980. This was because the TRASOP was tied to the investment tax credit increase from 7 percent to 10 percent which is due to expire on December 31, 1980.

¹ Pub. L. 93-238.

² Pub. L. 93-406.

³ Pub. L. 93-618.

⁴ Pub. L. 94-12.

⁵ Pub. L. 94-453.

TRASOP REGULATIONS

It is expected that final TRASOP regulations covering the 1% additional investment tax credit will be published by IRS very soon. This will not include provisions relating to the 1/2% credit requiring matching employee contributions. ESOP Council members will be advised when these regulations are issued.

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On October 1, 1978, the IRS issued Commissioner Delegation Order No. 112 (Rev. 5), concerning authority to issue determination letters relating to employee plans matters. Included was a delegation to the District Directors of key districts to issue determination letters with respect to whether a plan constitutes an ESOP under Code Section 4975(e)(7). The ESOP regulations issued on September 2, 1977, had indicated that such determinations could be secured from IRS.

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that Mr. Penn's actions as an ESOP fiduciary were subject to the "solely in the interest of participants" and "prudence" tests of ERISA Sections 404(a)(1)(A) and (B) and affirmed the lower court's finding that these requirements had been violated in connection with the "conversion."

The District Court had found that the primary purpose of the profit sharing plan had been to provide retirement income to participants and that the "conversion" to an ESOP had resulted in a situation in which participants' legitimate expectations of benefits were severely jeopardized. The Court of Appeals held that rescission of the "conversion" was a proper remedy to protect the participants' interests and to effectuate the purposes of the original profit sharing plan.

It is clear that the Penn case involved a situation of extreme abuse under ERISA. The District Court had specifically stated that it was not ruling that a "conversion" of a profit sharing plan into an ESOP would always be a violation of the ERISA fiduciary rules. It is also clear that any situation involving the "conversion" of an existing plan into an ESOP must be approached with extreme caution in the event that existing plan assets are to be used to purchase Company stock.

We do not regard the Penn case as a precedent which jeopardizes the proper establishment and operation of an ESOP under ERISA. It appears that it is a decision relating to the use of profit sharing plan assets to invest in Company stock, where the profit sharing plan had previously operated as a "retirement plan." The case does point out, however, that all ESOP transactions will be judged in the context of compliance with ERISA's fiduciary rules.

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The purposes of the Expanded Employee Stock Ownership Act of 1978 are to further the steps already taken by prior ESOP legislation and to make the ESOP a better instrument for providing stock ownership to employees. The bill accomplishes these goals primarily by expanding the use of the TRASOP, the special form of ESOP presently tied to the additional investment tax credit available under the Tax Reduction Act of 1975, as amended by the Tax Reform Act of 1976. For purposes of this article, the term "TRASOP" will be used to refer to a "tax credit ESOP," while the term "ESOP" will apply to any ESOP (including a TRASOP). The purpose of this analysis is to explain each provision contained in the bill and to analyze the background problem or underlying reason for its inclusion.

Changes for TRASOP

The major changes made by S. 3241 are in the TRASOP area. As part of the overall increase in the investment tax credit from 7 percent to 10 percent, the Tax Reduction Act of 1975 provided for an additional 1 percent investment tax credit. This credit could be claimed by an employer that adopted a TRASOP (satisfying the requirements established by that Act) and contributed to the TRASOP an amount of employer stock (or cash to buy stock) equal in value to the amount of the additional tax credit claimed. The Tax Reform Act of 1976 expanded this concept, providing that an employer could claim an additional $\frac{1}{2}$ percent investment tax credit for TRASOP contributions (thereby increasing its total available investment tax credit to $11\frac{1}{2}$ percent provided that participating employees made matching contributions to the TRASOP equal to the additional $\frac{1}{2}$ percent investment tax credit). Such employee contributions were a mandatory prerequisite for the claiming of the additional $\frac{1}{2}$ percent investment tax credit by the employer. It is important to note that the additional investment tax credit for TRASOP contributions would largely be available only to capital-intensive corporations, and would have little applicability to labor-intensive corporations. In addition, the Tax Reform Act of 1976 extended the additional investment tax credit for TRASOP contributions only through 1980. This was because the TRASOP was tied to the investment tax credit increase from 7 percent to 10 percent which is due to expire on December 31, 1980.

¹ Pub. L. 93-236.

² Pub. L. 93-406.

³ Pub. L. 93-613.

⁴ Pub. L. 94-12.

⁵ Pub. L. 94-453.

S. 3241 makes significant changes in TRASOPs. In the first place, it increases the investment tax credit which an employer can claim for its TRASOP contribution from one percent to two percent. In addition, it removes the provisions for matching employee contributions to the TRASOP; rather, any employee contributions are to be purely voluntary and subject to a decision by the employer at the time that the TRASOP is adopted or amended. More significantly, the TRASOP provisions are to be permanently incorporated within the Internal Revenue Code in new §§440⁴ and 410. This means that TRASOPs would not expire with the tax cuts under the Tax Reduction Act of 1975. Finally, in an effort to broaden this type of ESOP, the bill provides an alternative tax credit based on payroll for labor-intensive companies which adopt a TRASOP and contribute stock to it. This provides a tax credit equal to 1 percent of the compensation of all participating employees under the TRASOP, provided that the employer contributes to the TRASOP an amount of stock (or cash used to purchase stock) equal in value to the tax credit claimed.

In introducing S. 3241, Senator Long noted that this country faces a serious shortage of capital formation. The Chase Manhattan Bank has predicted that over the next decade our economy will require 1.5 trillion dollars of new capital formation. S. 3241 attempts to partially resolve that capital shortage by requiring that the employers who adopt and fund a TRASOP will be doing so in a manner that will generate additional capital formation. The bill requires that at least one-half of the tax credit claimed for TRASOP contributions (whether based on the additional investment tax credit or the payroll credit) would have to be represented by the transfer of newly-issued securities to the TRASOP.

A major problem which exists in the TRASOP area is the requirement⁵ that each employee who participated in the TRASOP at any time during the year must share in the allocation of stock representing the employer's annual TRASOP contribution, even if he was no longer employed at the end of the year. This creates a great recordkeeping problem in that a record had to be maintained as to the location of each terminated participant so that he can receive an allocation (and in most cases a distribution) of stock for the year in which he ceased to be employed by the employer and ceased to be a TRASOP participant. The bill provides that an employer need allocate stock from its current TRASOP contribution only to participants who are employed on the last day of the TRASOP plan year. This is an optional provision and does not preclude an employer, if it so chooses, from making allocations of employer securities to the TRASOP account of a participant who terminated employment during the year.

The Tax Reduction Act of 1975, in establishing the TRASOP, required that each participant must be entitled to direct voting rights on all stock allocated to him under the TRASOP.⁶ Generally, TRASOPs have been established only by large capital-intensive corporations, most of which are publicly-traded. For these companies, the expense and burden of providing participants with the proxy solicitation materials regarding the voting of such shares is relatively minor. However, the requirement for the pass-through of voting rights has acted as a deterrent for closely-held corporations which desired to adopt a TRASOP. With the creation of the labor-intensive tax credit for TRASOP contributions, this problem would be magnified. Many of the companies which would take advantage of these provisions are closely-held and would be deterred from establishing a TRASOP (and thereby broadening its ownership base) because of a requirement that TRASOP stock be voted by participants. Therefore, the bill requires the pass-through of voting rights to participants only when the employer is a publicly-traded company (generally, a company which is reporting to the Securities and Exchange Commission under the Securities Exchange Act of 1934). This approach was first suggested in the staff report of the Joint Economic Committee on ESOPs which was issued in 1976.

In establishing the requirements which a TRASOP must satisfy in order to obtain the additional investment tax credit, the Tax Reduction Act of 1975 provided that a TRASOP, whether or not "qualified" under §401(a) of the Internal Revenue Code, would have to meet the minimum participation standards for qualified plans under Code §410.⁷ Under §410(b)(2)(A), employees covered by a collective bargaining agreement could be excluded provided that retirement benefits were the subject of good-faith bargaining between the employer and the

⁴ Section 301(d)(3), Tax Reduction Act of 1975.

⁵ Section 301(b)(5).

⁶ Section 301(d)(7)(c).

bargaining representatives. Since many TRASOPs were adopted during the term of existing collective bargaining agreements, some employers which adopted TRASOPs elected not to include union members as participants. In order to alleviate this apparent unfairness, the bill provides that all employees who are covered by a collective bargaining agreement will become participants in the TRASOP (subject to minimum age and service requirements) unless their bargaining representatives waive their right to participate in the TRASOP. The Committee Report on the bill is expected to expand upon this and point out that bargaining on the TRASOP issue will in no way reopen an existing collective bargaining agreement for bargaining on other issues.

Cash distribution option

In 1976, the IRS promulgated proposed regulations regarding ESOPs. These regulations contained significant problems which, if allowed to go unchanged, would have seriously curtailed the adoption of ESOPs by employers and the broadening of stock ownership among employees. In the Conference Report on the Tax Reform Act of 1976, Congress specifically instructed the IRS and the Department of Labor regarding the ways in which the proposed regulations were unsatisfactory. The agencies published final ESOP regulations in 1977 which generally alleviated the problems under the proposed regulations. However, in one critical area, the final ESOP regulations did not totally remove obstacles that acted as a deterrent to the adoption of ESOPs. These were the regulations regarding the granting of "put options" to employees who receive a distribution of ESOP stock acquired under ERISA's "ESOP loan exemption." The Department of Labor and the IRS felt, and justifiably so, that any participant who receives a distribution of stock of a closely-held corporation from an ESOP should have a market for the stock. This is an extremely critical point when an employee might well find himself holding employer stock for which there is no market at the time he is subject to income tax liability on his ESOP distribution. The agencies felt that the best solution for such a problem is to require that a closely-held employer grant a "put option" to the participant to resell his stock to the employer. In establishing this right, the final regulations contained very specific requirements regarding the duration of the put option, the terms for resale of the stock by the participant and other related matters. Many employers were concerned that the effect of these onerous put option regulations would be to make the leveraged ESOP unworkable for closely-held corporations. Accordingly, the bill provides that if the terms of the ESOP give each employee the option (prior to the distribution of benefits) of receiving cash in lieu of employer stock as his ESOP benefit, there would be no requirement that an employee who elected to receive stock be granted a put option. In this way, each employee is given the option to receive cash in lieu of stock and, therefore, is not faced with the problem of lack of marketability. This change would allow an ESOP to avoid the requirements for put options under the regulations and would simplify the administration of the ESOP, while at the same time offering employees the ability to "cash out" their ESOP shares. The bill provides such an employee election would not constitute the offering of a security under federal or state securities laws.

Charitable deduction

S. 3241 provides that an individual (or an estate or trust) will be eligible to claim a charitable deduction (for income, estate and gift tax purposes) for any "donation" to an ESOP. This would include an outright "gift" to an ESOP and a "bargain sale" to an ESOP. However, to assure that such deduction will not be providing a tax benefit for a transaction designed to benefit the donor (directly or indirectly), the bill establishes criteria which must be met in order for the deduction to be available. The donation to the ESOP must be allocated among participants in a nondiscriminatory manner, pursuant to Code § 401(a)(4). In addition, no part of the donation may be allocated to the donor or persons related to the donor under Code § 267(b). Finally, no portion of the donation may be allocated to any other persons owning (directly or indirectly) more than 25 percent of any class of employer securities. This provision would create an alternative to traditional contributions to charity (or private foundations) for major shareholders and would be an incentive to provide stock ownership for employees.

Dividend deduction

S. 3241 would allow a tax deduction for dividends paid on employer stock held by an ESOP, provided that such dividends were "passed-through" to participants within sixty days after the close of the year in which paid. This provision would be limited to dividends on voting common stock. The purpose of this provision is to encourage ESOPs to provide participants with an immediate tangible benefit of stock ownership. Section 803(h) of the Tax Reform Act of 1976 has made it clear that an ESOP could currently pay out such dividends to participants in cash. This provision of the bill would serve as an incentive to pay out dividends by providing a tax deduction to the employer.

Other tax changes

The bill also contains certain changes which affect employee benefit plans other than ESOPs and TRASOPs. Under the Tax Reform Act of 1976, a lump-sum distribution from a qualified plan is no longer eligible for the estate tax exclusion under Code §2039(e). It is unclear whether the denial of the estate tax exclusion is applicable to any total distribution or whether it applies only to a distribution for which the special ten-year averaging provisions for income tax treatment is elected under §402(e).

In order to clarify this matter, the bill provides that the estate tax exclusion would be denied only when lump-sum distribution income tax treatment is elected under Code §402(e). In addition, the estate tax exclusion would be extended to a TRASOP not qualified under §401(a) to the extent applicable to qualified plans.

In order to defer taxation on a lump-sum distribution through a "rollover" to an individual retirement account (IRA), any property (such as employer stock) received in the distribution must be "rolled over" in the same form as it is received. This requirement has created a problem with respect to distributions of employer stock from an ESOP. It is often difficult to find an IRA trustee willing to receive a rollover of employer stock, particularly if the stock is not publicly traded. In addition, an ESOP distributee frequently elects to resell stock received in a lump-sum distribution back to the employer (or the ESOP) immediately, often pursuant to the put option granted at the time of distribution. However, under existing law if the participant were to resell his shares of employer stock he is not permitted to roll over the cash proceeds from the sale to an IRA and thereby defer tax on the distribution. Therefore, the bill provides that an employee may resell employer stock to the employer or to the ESOP (or other plan) and still defer taxation on the distribution by rolling over the cash proceeds of the sale to an IRA. In addition, the bill provides that an employee who elects to receive cash in lieu of employer stock from an ESOP will also be able to transfer the cash distribution as a rollover contribution to an IRA.

S. 3241 also provides that participation in a TRASOP (whether or not "qualified") would not preclude deductible IRA contributions by the participant under Code §§219 and 220. If the participant did not participate in any other plan qualified under §401(a), he would still be entitled to contribute to an IRA. This provision would remedy the problem of participation in a TRASOP (possibly representing a small percentage of pay) denying the opportunity for retirement savings by an individual through an IRA.

Under existing Code §402(e), a participant who receives a distribution from a qualified plan which constitutes a "lump-sum distribution" may elect to take advantage of the ten-year forward averaging provision available for such a distribution. However, if the distribution to the participant includes employer securities which have appreciated in value during the time that they were held by the plan, the participant is taxed only on the plan's cost basis for such securities. The appreciation will be taxed as long-term capital gain upon subsequent disposition. In the event of an immediate resale of the securities, total tax liability will be a combination of ten-year averaging and capital gain treatment. In many cases, this results in greater tax liability than if the entire value of the distribution were subject to ten-year averaging. In order to alleviate this increased tax burden and to provide greater simplicity in calculating the tax liability on a lump-sum distribution including employer securities, the bill would allow an election to the recipient to treat the entire distribution (including appreciation in value of employer securities) as ordinary income for purposes of §402(e) and the ten-year

* Code §402(a)(5).

averaging provisions. This is similar to the election added in Code § 402(e)(4)(L) in 1976 to allow ten-year averaging with respect to pre-1974 participation.

Under the Tax Reform Act of 1976, an employer which makes a TRASOP contribution and which later recaptures a portion of this investment tax credit, may, if the TRASOP has allocated contributions to separate segregated accounts, recapture a portion of the stock from the TRASOP.¹¹ It is also worth noting that the employer would have the option of leaving the stock in the TRASOP and simply taking a deduction for that portion of the contribution which is reflected by the recapture. However, assuming that the employer wished to actually recapture any stock from the TRASOP, a problem is presented for participants. This is because the participant must receive his entire distribution within a single year in order to be eligible for the beneficial tax treatment on lump-sum distributions.¹² Any amount held in the segregated account would probably not be distributed to him at that time, resulting in the loss of lump-sum distribution treatment for a significant number of employees. Therefore, the bill provides that if such a situation exists and the TRASOP is holding stock for its participants in segregated accounts subject to recapture, an employee who receives a distribution of the remaining portion of his benefit under the TRASOP will still be eligible to elect lump-sum distribution treatment on that portion. Any amount later distributed to him from a segregated account will simply be treated as ordinary income. However, the beneficial tax treatment which attaches to a lump-sum distribution will be eligible for the initial distribution.

Under present law,¹³ any reduction in taxes which occurs as the result of a credit claimed under Code § 38 may result in increased liability for the minimum tax on tax preferences. Since the TRASOP tax credit is claimed as a result of the investment tax credit provided by § 46 of the Code, its actual basis for claim is § 38. Therefore, if an employer received no net benefit from the reduction of taxes by reason of the TRASOP contribution offsetting its tax savings, it might find itself paying an increased minimum tax. For this reason, the bill adds back the credit for a TRASOP contribution (the additional investment tax credit or the tax credit based on payroll) to the regular tax computation for purposes of determining liability for the minimum tax under § 56.

With the exception of the minimum tax relief provided by the bill, all sections of the bill will generally be effective for taxable years beginning after December 31, 1977. Because the problems created by the minimum tax on tax preferences would have dated back to the effective date of the Tax Reduction Act of 1975, the effective date of that section is for all plan years beginning after December 31, 1974.

Increase in ESOP contribution limits

On July 14, 1978, Senator Mike Gravel introduced S. 3291 to propose an additional incentive for ESOPs. Under S. 3291, the deduction limits under Code § 204(a) and the allocation limits under Section 415(c) for ESOP contributions would be increased from 25 percent of covered payroll to 50 percent of covered payroll. These increased limits would be subject to the restrictions on allocations to officers, shareholders and highly-compensated employees included in existing Code § 415(c)(6).

Conclusion

S. 3241 and S. 3291 demonstrate the interest of the Senate Finance Committee in providing increased incentives for the adoption of ESOPs to allow for greater "ownership-sharing" opportunities for employees. On July 19-20th, the Finance Committee held ESOP hearings to consider these bills and other matters relating to ESOPs. It may be expected that action on these bills will occur sometime this year and that ESOPs will continue to be encouraged by Congress.

¹¹ Code § 402(e)(4)(A).

¹² Section 301(d)(5)(B)(iii).

¹³ Code § 56.

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GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

March 17, 1978

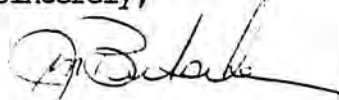
The Hon. Mike Gravel
United States Senator
4107 Dirksen Senate Office Building
Washington, D.C. 20510

Attention: Mr. Jerry Gauche
Legislative Aide

Dear Senator Gravel:

In Mr. Kelso's absence from the city, he asked that I forward to you the enclosures which he thought you may find of interest.

Sincerely,



Jan Bertsche for
Louis O. Kelso

Enclosures

THE FOLLOWING DOCUMENT(S) MAY NOT FILM
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17815 1-10-79

FILE:0096: TITLE/LINE--SET 1

1. H.R.15: SPON=Rep Rodino; INDX=State taxation; STLI=Interstate Taxation Act
2. H.R.159: SPON=Rep Brockhead; INDX=Foreign Investment; STLI=Foreign Investment Disclosure Act
3. H.R.261: SPON=Rep Dellums; INDX=Intelligence services; STLI=Intelligence Community Reorganization and Reform Act of 1979
4. H.R.395: SPON=Rep Guyer, et al.; INDX=Old age, survivors and disability insurance
5. H.R.1509: SPON=Rep Frenzel; INDX=(NOT PRESENT); STLI=Expanded Employee Stock Ownership Act of 1979
6. H.R.2222: SPON=Rep Kostmayer, et al.; INDX=(NOT PRESENT)
7. S.7: SPON=Sen Cranston; INDX=veterans; STLI=veterans Health Care Amendments of 1979
8. S.399: SPON=Sen Stewart, D., et al.; INDX=(NOT PRESENT)

READY FOR NE. 0100400:

S.399
Sen Stewart, D., et al.
SENATOR: 02/05/79
Senate Small Business

A bill to promote the *OWNERSHIP* of small businesses by their *EMPLOYEES* and to provide a means whereby *EMPLOYEES* can purchase their companies where the companies would otherwise be closed, liquidated, or relocated, and to assure that firms owned wholly or partly by their *EMPLOYEES* are eligible for all forms of assistance from the Small Business Administration.

CHRONOLOGY OF ACTIONS:
***** OPEN DATE *****
PAGE 1 OF 1. READY FOR NE. COMMAND OR NE. OPTION:

H.R.2203
Rep Kostmayer, et al.
HOUSE: 02/15/79
House Banking, Finance and Urban Affairs

COSPONSOR: Rep Lyndine
COSPONSORED BY: 02/15/79
Rep McHugh
WITHDRAWN BY: 02/15/79

PAGE 1 OF 1. READY FOR NE. COMMAND OR NE. OPTION:

S.399
Sen Stewart, D., et al.
SENATOR: 02/05/79
Senate Small Business

COSPONSOR: Sen Nelson, G.
COSPONSORED BY: 02/05/79
Sen Weicker
WITHDRAWN BY: 02/05/79
Sen Hatch
02/05/79
Sen Braceler
02/05/79

PAGE 1 OF 1. READY FOR NE. COMMAND OR NE. OPTION:

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February 14, 1979

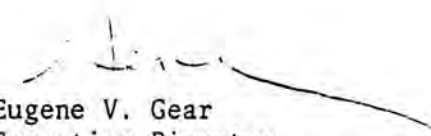
*Print
2-22-79*

Mr. Jerry N. Gauche
Legislative Aide
U. S. Senator Mike Gravel
3121 Senate Office Building
Washington, D. C. 20510

This is to confirm that expense arrangements have been worked out for your trip to San Francisco and your valued participation on the Legislative & Legal Update Workshop panel.

We will send you a check in advance to cover one round-trip air fare. We have made a double room reservation for you and Mrs. Gauche at the Hotel St. Francis for the nights of March 8 and 9. Please pay your own expenses, including hotel, and submit an expense account for reimbursement.

I'm enclosing another copy of the brochure. Note the reception the evening of March 8. Look forward to meeting you then.


Eugene V. Gear
Executive Director

EVG:pdm
Enclosure

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GEORGE W. FRITTS, JR., MINORITY COUNSEL

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

March 13, 1978

MEMORANDUM

TO: Senator Russell B. Long
Jim Guirard

FROM: Jack Curtis

RE: ESOP Legislation for 1978

There are several aspects of the investment tax credit ESOP which we should try to correct. In addition, the continuation of the coal strike will provide a vehicle upon which Senator Long can base his concept of an ESOP tied to covered payroll in the same way an investment tax credit ESOP is tied to the investment tax credit.

Briefly, I suggest the inclusion of the following items in a separate bill on ESOP:

1. Increase the investment tax credit available to ESOP to 2%, but require that the new 1% credit be made up of new stock. (This promotes the capital formation aspect of ESOP. Also, we would delete the entire matching $\frac{1}{2}$ percent provision.)

2. Provide a tax credit for an ESOP continuation for labor-intensive companies, using the coal strike as the keynote for this provision, and possibly for the entire bill. In this, we would require that $\frac{1}{2}$ the credit taken be made up of new stock.

3. Provide that this tax credit not be treated like an item of tax preference. (This was an oversight which has been brought to our attention several times this spring. For example, Weyerhouser, Armco Steel, and Wilbur Mills have raised it.)

4. Provide that unions will not be automatically excluded from participation in the ESOP. (This was brought to our attention by Senator Robert Byrd and the IBEW.)

5. Provide that employees will still receive lump-sum distribution (10-year averaging) on stock distributed from an ESOP even if a portion of the stock is held in a separate subject to recapture by the employer pursuant to the Tax Reform Act of 1976.
6. Clarify section 2039(c) of the Code to allow an estate tax exclusion for amounts distributed from an ESOP if lump-sum distribution treatment (10-year averaging) is not elected on the distribution.
7. Amend Code section 219 to exclude an investment tax credit ESOP from the list of plans, the adoption of which precludes contributions to an IRA.
8. Amend Code section 402(a)(5) to permit a "rollover" to an IRA of cash proceeds from the sale of stock received in lump-sum distribution from an ESOP. (Present law requires the rollover of the stock itself--this creates a problem for the remaining employees and the employer which would wish to reacquire the stock for the ESOP.)
9. Extend "new jobs" tax credit under Code Sections 551-553 beyond 1978, conditioned upon stock contributions to an ESOP like the investment tax credit ESOP.
10. Possibly provide an energy tax credit provision if stock is put into an ESOP.

96TH CONGRESS
1ST SESSION

H. R. 1589

To amend the Internal Revenue Code of 1954, and the Tax Reduction Act of 1975, with respect to employee stock ownership plans.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 29, 1979

Mr. FRENZEL introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954, and the Tax Reduction Act of 1975, with respect to employee stock ownership plans.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Expanded Employee
4 Stock Ownership Act of 1979".

5 SEC. 2. CREDIT FOR ESTABLISHING EMPLOYEE STOCK OWN-
6 ERSHIP PLAN.

7 (a) IN GENERAL.—Subpart A of part IV of subchapter
8 A of chapter 1 of the Internal Revenue Code of 1954 (relat-

1 ing to credits allowed) is amended by inserting after section
2 44B the following new section:

3 "SEC. 44C. EMPLOYEE STOCK OWNERSHIP PLAN CONTRIBU-
4 TIONS.

5 "(a) GENERAL RULE.—In the case of a corporation
6 which meets the requirements of section 416, there is al-
7 lowed as a credit against the tax imposed by this chapter for
8 the taxable year, an amount equal to the greater of—

9 "(1) not more than 2 percent of the qualified in-
10 vestment (as determined under subsections (c) and (d)
11 of section 46) of the taxpayer for the taxable year, or

12 "(2) not more than 1 percent of the aggregate
13 participants' compensation (as defined in section
14 415(c)(3)) paid by the corporation during the taxable
15 year.

16 "(b) TRANSFER OF NEW EMPLOYER SECURITIES RE-
17 QUIRED.—The credit allowable under subsection (a) for any
18 taxable year shall not be allowed unless, in meeting the re-
19 quirements of such section for such taxable year, employer
20 securities equal in value to the credit claimed are transferred
21 to the trust and at least the total amount of the credit
22 claimed under subsection (a)(1) in excess of 1 percent of the
23 qualified investment, or at least one-half of the credit claimed
24 under subsection (a)(2) is represented by new employer secu-
25 rities transferred to the trust. For purposes of this subsection,

1 the term 'new employer securities' means employer securities
2 (as defined in section 416(a)(9)) not previously issued.

3 "(c) LIMITATION BASED ON TAX LIABILITY; CAR-
4 RYOVER OF EXCESS CREDIT.—

5 "(1) LIMITATION.—The amount of the credit al-
6 lowed under subsection (a) for the taxable year shall
7 not exceed so much of the liability for tax for the tax-
8 able year as does not exceed \$50,000, plus 95 percent
9 of as much of the liability of the taxpayer for tax under
10 this chapter for the taxable year as exceeds \$50,000.

11 "(2) CARRYOVER OF EXCESS CREDIT.—If the
12 amount of the credit determined under subsection (a)
13 for the taxable year exceeds the amount of the limita-
14 tion imposed by paragraph (1) for such taxable year
15 (hereinafter in this paragraph referred to as the
16 'unused credit year'), such excess shall be—

17 "(A) an ESOP credit carryback to each of
18 the 3 taxable years preceding the unused credit
19 year, and

20 "(B) an ESOP credit carryover to each of
21 the 7 taxable years following the unused credit
22 year, and

23 subject to the limitations imposed by paragraph (1),
24 shall be taken into account under the provisions of sub-
25 section (a) in the manner provided in that subsection.

1 The entire amount of the unused credit for an unused
 2 credit year shall be carried to the earliest of the 10
 3 taxable years to which (by reason of subparagraphs (A)
 4 and (B)) such credit may be carried and then to each of
 5 the other 9 taxable years to which it may be carried.

6 "(d) LIMITATION WITH RESPECT TO CERTAIN COM-
 7 PANIES.—In the case of a regulated public utility, no credit
 8 shall be allowed by subsection (a) if the taxpayer's cost of
 9 service for ratemaking purposes is reduced by reason of any
 10 portion of the credit allowable by subsection (a) (determined
 11 without regard to this subsection), or if the base to which the
 12 taxpayer's rate of return for ratemaking purposes is applied is
 13 reduced by any reason of any portion of the credit allowed by
 14 subsection (a) (determined without regard to this subsec-
 15 tion).".

16 (b) Subpart B of part I of subchapter D of chapter 1 of
 17 such Code is amended by adding at the end thereof the fol-
 18 lowing new section:

19 "SEC. 416. SPECIAL EMPLOYEE STOCK OWNERSHIP PLANS.

20 "(a) PLAN REQUIREMENTS FOR TAXPAYERS CLAIM-
 21 ING SECTION 44C CREDIT.—In order to meet the require-
 22 ments of this subsection—

23 "(1) Except as expressly provided in subsections
 24 (b) and (c), a corporation (hereinafter in this subsection
 25 referred to as the 'employer') shall establish an em-

1 employee stock ownership plan (described in paragraph
2 (2)) which is funded by transfers of employers securi-
3 ties in accordance with the provisions of paragraph (6)
4 and which meets all other requirements of this subsec-
5 tion.

6 “(2) The plan referred to in paragraph (1) shall be
7 a defined contribution plan established in writing
8 which—

9 “(A) is a stock bonus plan, a stock bonus
10 and a money purchase pension plan, or a profit-
11 sharing plan,

12 “(B) is designed to investment primarily in
13 employer securities, and

14 “(C) meets such other requirements (similar
15 to requirements applicable to employee stock
16 ownership plans as defined in section 4975(e)(7))
17 as the Secretary may prescribe.

18 “(3) The plan shall provide for the allocation of
19 all employer securities transferred to it or purchased by
20 it (because of the requirements of section 44C) to the
21 account of each participant (who is an employee of the
22 employer at the close of the plan year or, if applicable,
23 the date as of which the allocation is made) as of the
24 close of each plan year in an amount which bears sub-
25 stantially the same proportion to the amount of all

1 such securities allocable to all participants in the plan
2 for that plan year as the amount of compensation paid
3 to such participant (disregarding any compensation in
4 excess of the first \$100,000 per year) bears to the
5 compensation paid to all such participants during that
6 year (disregarding any compensation in excess of the
7 first \$100,000 with respect to any participant). Not-
8 withstanding the preceding sentence, the allocation to
9 participants' accounts may be extended over whatever
10 period may be necessary to comply with the require-
11 ments of section 415. For purposes of this paragraph,
12 the amount of compensation paid to a participant for a
13 year is the amount of such participant's compensation
14 within the meaning of section 415(c)(3) for such year.

15 "(4) The plan must provide that each participant
16 has a nonforfeitable right to any stock allocated to his
17 account under paragraph (3), and that no stock allo-
18 cated to a participant's account may be distributed
19 from that account before the end of the 84th month be-
20 ginning after the month in which the stock is allocated
21 to the account except in the case of separation from
22 the service, death, or disability.

23 "(5) The plan must provide that, in the case of
24 securities issued by an employer which has a class of
25 securities registered under section 12 of the Securities

1 Exchange Act of 1934, or which would be required to
2 be so registered except for the exemption from regis-
3 tration provided in subsection (g)(2)(8) or (g)(2)(9) of
4 that section, each participant is entitled to direct the
5 plan as to the manner in which any employer securities
6 which are allocated to the account of the participant
7 are to be voted.

8 “(6) On making a claim for credit under section
9 44C, the employer shall state in such claim that it
10 agrees, as a condition of receiving any such credit—

11 “(A) to transfer employer securities to the
12 plan having a value at the time of the claim equal
13 to the amount of the credit claimed under section
14 44C for the taxable year, a portion of which, as
15 required in section 44C(b), shall consist of new
16 employer securities (as defined in section 44C(b)),

17 “(B) except as provided in subparagraph (C),
18 to effect the transfer not later than 30 days after
19 the time (including extensions) for filing its income
20 tax return for a taxable year, and

21 “(C) in the case of an employer whose credit
22 (as determined under section 44C(a)) for a taxable
23 year, exceeds the limitations of subsection (c) of
24 such section to effect that portion of the transfer
25 allocable to credit carryovers of such excess credit

1 at the time required under subparagraph (B) for
2 the taxable year to which such portion is carried
3 over.

4 For purposes of meeting the requirements of this para-
5 graph, a transfer of cash shall be treated as a transfer
6 of employer securities if the cash is, under the plan,
7 used to purchase employer securities.

8 “(7) Notwithstanding any other provision of law
9 to the contrary, if the plan does not meet the require-
10 ments of section 401—

11 “(A) stock transferred under paragraph (6)
12 and allocated to the account of any participant
13 under paragraph (3) and dividends thereon shall
14 not be considered income of the participant or his
15 beneficiary under this chapter until actually dis-
16 tributed or made available to the participant or
17 his beneficiary and, at such time, shall be taxable
18 under section 72 (treating the participant or his
19 beneficiary as having a basis of zero in the con-
20 tract),

21 “(B) no amount shall be allocated to any
22 participant in excess of the amount which might
23 be allocated if the plan met the requirements of
24 section 401, and

1 “(C) the plan must meet the requirements of
2 sections 410 and 415.

3 “(8)(A) Except as provided in subparagraph
4 (B)(iii), if the amount of the credit determined under
5 section 46 is recaptured or redetermined in accordance
6 with the provisions of section 47 and the amount of the
7 credit claimed under section 44C for the taxable year
8 to which such recapture or redetermination relates was
9 computed under paragraph (1) of section 44C(a), the
10 amounts transferred to the plan under this subsection
11 and allocated under the plan shall remain in the plan
12 or in participant accounts, as the case may be, and
13 continue to be allocated in accordance with the plan.

14 “(B) If the amount of the credit determined under
15 section 46 for a taxable year is recaptured in accord-
16 ance with the provisions of section 47 and the amount
17 of the credit claimed under section 44C for the taxable
18 year to which such recapture relates was computed
19 under paragraph (1) of section 44C(a)—

20 “(i) the employer may reduce the amount re-
21 quired to be transferred to the plan under para-
22 graph (6) of this subsection, for the current tax-
23 able year or any succeeding taxable years by the
24 portion of the amount so recaptured which is at-
25 tributable to reduction in the qualified investment

1 (as determined under section 46 (c) and (d) of the
2 employer),

3 "(ii) notwithstanding the provisions of para-
4 graph (12), the employer may deduct such por-
5 tion, subject to the limitations of section 404 (re-
6 lating to deductions for contributions to an em-
7 ployees' trust or plan), or

8 "(iii) if the requirements of subsection (c)(1)
9 are met, the employer may withdraw from the
10 plan an amount not in excess of such portion.

11 "(C) If the amount of the credit claimed by an
12 employer for a prior taxable year under section 38 is
13 reduced because of a redetermination of the qualified
14 investment for such prior taxable year which becomes
15 final during the taxable year, and the employer trans-
16 ferred amounts to a plan which were taken into ac-
17 count for purposes of this subsection for that prior tax-
18 able year, then—

19 "(i) the employer may reduce the amount it
20 is required to transfer to the plan under paragraph
21 (6) of this subsection for the taxable year or any
22 succeeding taxable year by the portion of the
23 amount of such reduction in the credit or increase
24 in tax which is attributable to the contribution to
25 such plan, or

1 “(ii) notwithstanding the provisions of para-
2 graph (12), the employer may deduct such portion
3 subject to the limitations of section 404.

4 “(9) For purposes of this subsection—

5 “(A) EMPLOYER SECURITIES.—The term
6 ‘employer securities’ means common stock issued
7 by the employer or a corporation which is a
8 member of a controlled group of corporations
9 which includes the employer with voting power
10 and dividend rights no less favorable than the
11 voting power and dividend rights of other common
12 stock issued by the employer or such controlling
13 corporation, or securities issued by the employer
14 or such controlling corporation, convertible into
15 such stock. For purposes of this subparagraph, the
16 term ‘controlled group of corporations’ has the
17 meaning given to such term by section 1563(a),
18 except that—

19 “(i) ‘more than 50 percent’ shall be sub-
20 stituted for ‘at least 80 percent’ each place it
21 appears in section 1563(a)(1), and

22 “(ii) the determination shall be made
23 without regard to subsections (a)(4) and
24 (e)(3)(C) of section 1563.

1 “(B) VALUE.—The term ‘value’ means the
2 average of closing prices of the employer’s securi-
3 ties, as reported by a national exchange on which
4 securities are listed, for the 20 consecutive trad-
5 ing days immediately preceding the date of trans-
6 fer or allocation of such securities or, in the case
7 of securities not listed on a national exchange, the
8 fair market value as determined in good faith and
9 in accordance with the regulations issued by the
10 Secretary.

11 “(10) The Secretary shall prescribe such regula-
12 tions and require such reports as may be necessary to
13 carry out the provisions of this section.

14 “(11) If the employer fails to meet any require-
15 ment imposed under this section or under any obliga-
16 tion undertaken to comply with a requirement of this
17 section, he is liable to the United States for a civil
18 penalty of an amount equal to the amount involved in
19 such failure. The preceding sentence shall not apply if
20 the taxpayer corrects such failure (as determined by
21 the Secretary) within 90 days after notice thereof. For
22 purposes of this paragraph, the term ‘amount involved’
23 means an amount determined by the Secretary, but not
24 in excess of the amount of the credit claimed by the
25 taxpayer for the taxable year under section 44C(a) and

1 not less than the product of one-half of 1 percent of
2 such amount multiplied by the number of months (or
3 parts thereof) during which such failure continues. The
4 amount of such penalty may be collected by the Secre-
5 tary in the same manner in which a deficiency in the
6 payment of Federal income tax may be collected.

7 “(12) Notwithstanding any provision of this title
8 to the contrary, no deduction shall be allowed under
9 section 162, 212, or 404 for amounts transferred to an
10 employee stock ownership plan and taken into account
11 under this subsection.

12 “(13) (A) As reimbursement for the expense of es-
13 tablishing the plan, the employer may withhold from
14 amounts due the plan for the taxable year for which
15 the plan is established, or the plan may pay, so much
16 of the amounts paid or incurred in connection with the
17 establishment of the plan as does not exceed the sum
18 of 10 percent of the first \$100,000 that the employer
19 is required to transfer to the plan for that taxable year
20 under paragraph (6) and 5 percent of any amount in
21 excess of the first \$100,000 of such amount.

22 “(B) As reimbursement for the expense of admin-
23 istering the plan, the employer may withhold from
24 amounts due the plan, or the plan may pay, so much of
25 the amounts paid or incurred during the taxable year

1 as expenses of administering the plan as does not
2 exceed the smaller of—

3 “(i) the sum of 10 percent of the first
4 \$100,000 and 5 percent of any amount in excess
5 of \$100,000 of the income from dividends paid to
6 the plan with respect to stock of the employer
7 during the plan year ending with or within the
8 employer's taxable year, or

9 “(ii) \$100,000.

10 “(14) The return of a contribution made by an
11 employer to an employee stock ownership plan de-
12 signed to satisfy the requirements of this subsection or
13 subsection (b) (or a provision for such a return) does
14 not fail to satisfy the requirements of this subsection,
15 subsection (b), section 401(a), or section 403(c)(1) of
16 the Employee Retirement Income Security Act of
17 1974 if—

18 “(A) the contribution is conditioned under
19 the plan upon determination by the Secretary that
20 such plan meets the applicable requirements of
21 this subsection, subsection (b), or section 401(a),

22 “(B) the application for such a determination
23 is filed with the Secretary not later than 90 days
24 after the date on which the credit under section
25 44C is allowed, and

1 “(C) the contribution is returned within one
2 year after the date on which the Secretary issues
3 notice to the employer that such plan does not
4 satisfy the requirements of this subsection, subsec-
5 tion (b), or section 401(a).

6 “(15) Notwithstanding any provision of this title
7 to the contrary, employees who are included in a unit
8 of employees covered by a collective-bargaining agree-
9 ment between an employee representative and one or
10 more employers and who satisfy the minimum age and
11 service requirements, if any, established by the plan
12 shall not be excluded from eligibility under the plan,
13 unless the employee representative declines coverage
14 for employees in the unit. Where the employee repre-
15 sentative declines coverage, section 410(b)(2)(A) shall
16 apply.

17 “(b) ADDITIONAL PLAN REQUIREMENTS.—

18 “(1) The employer may not make participation in
19 the plan a condition of employment and the plan may
20 not require employee contributions as a condition of
21 participation in the plan. However, the plan may
22 permit employee contributions to be made.

23 “(2) Employee contributions (if any) under the
24 plan must meet the requirements of section 401(a)(4)
25 (relating to contributions).

1 “(c) RECAPTURE.—

2 “(1) GENERAL RULE.—Amounts transferred to a
3 plan under subsection (a)(6) may be withdrawn from
4 the plan by the employer if the plan provides that
5 while subject to recapture—

6 “(A) amounts so transferred with respect to
7 a taxable year are segregated from other plan
8 assets, and

9 “(B) separate accounts are maintained for
10 participants on whose behalf amounts so trans-
11 ferred have been allocated for a taxable year.

12 “(2) COORDINATION WITH OTHER LAW.—Not-
13 withstanding any other law or rule of law, an amount
14 withdrawn by the employer will neither fail to be con-
15 sidered to be nonforfeitable nor fail to be for the exclu-
16 sive benefit of participants or their beneficiaries merely
17 because of the withdrawal from the plan of amounts
18 described in paragraph (1), nor will the withdrawal of
19 any such amount be considered to violate the provi-
20 sions of section 403(c)(1) of the Employee Retirement
21 Income Security Act of 1974.

22 “(d) EFFECT OF RECAPTURE PROVISIONS ON DISTRI-
23 BUTION TO A PARTICIPANT (OR HIS BENEFICIARY).—A
24 distribution to a participant (or his beneficiary) which other-
25 wise satisfies the requirements of subsection (e)(4)(A) of sec-

1 tion 402 shall be treated as a lump sum distribution for pur-
 2 poses of section 402, notwithstanding the fact that a portion
 3 of the amount allocated to the participant's account under the
 4 plan as provided in this section is retained in the plan follow-
 5 ing the distribution to him in order to permit an amount pre-
 6 viously transferred to the plan to be withdrawn by his em-
 7 ployer under subsection (a)(8)(B) of this section. Any portion
 8 of this amount retained in the plan which is not withdrawn by
 9 the employer and which is subsequently distributed to the
 10 participant (or his beneficiary) shall not be treated as a lump
 11 sum distribution."

12 (c) CONFORMING CHANGES.—

13 (1) Paragraph (2) of section 46(a) of such Code
 14 (relating to amount of credit for current taxable year)
 15 is amended—

16 (A) by striking out "Except as otherwise
 17 provided in subparagraph (B), in the case of prop-
 18 erty described in subparagraph (D)," and inserting
 19 in lieu thereof the following: "In the case of prop-
 20 erty described in subparagraph (C),",

21 (B) by striking out subparagraph (B) and re-
 22 designating subparagraphs (C) and (D) as (B) and
 23 (C), respectively,

1 (C) by striking out "subparagraph (D)," in
2 subparagraph (B) (as so redesignated) and insert-
3 ing in lieu thereof "subparagraph (C)",

4 (D) by striking out "subparagraphs (A) and
5 (B)" in subparagraph (C) (as so redesignated) and
6 inserting in lieu thereof "subparagraph (A)", and

7 (E) by striking out the last sentence of sub-
8 paragraph (C) (as so redesignated).

9 (2) Subparagraph (A) of section 46(c)(3) of such
10 Code (relating to public utility property) is amended by
11 striking out "subsection (a)(2)(C)" and inserting in lieu
12 thereof "subsection (a)(2)(B)".

13 (3) Paragraph (9) of section 46(f) of such Code
14 (relating to limitation in case of certain regulated com-
15 panies) is amended—

16 (A) by striking out "makes an election under
17 subparagraph (B) of subsection (a)(2)," and insert-
18 ing in lieu thereof "claims the credit allowed by
19 section 44C",

20 (B) by striking out "then, notwithstanding
21 the prior paragraphs of this subsection, no credit
22 shall be allowed by section 38 in excess of the
23 amount which would be allowed without regard to
24 the provisions of subparagraph (B) of subsection

1 (a)(2)" and inserting in lieu thereof "then no
2 credit shall be allowed by such section".

3 (d) CLERICAL AMENDMENTS.—

4 (1) The table of sections for subpart A of part IV
5 of subchapter A of chapter 1 of such Code is amended
6 by inserting immediately after the item relating to sec-
7 tion 44B the following new item:

"Sec. 44C. Employee Stock Ownership Plan Contributions."

8 (2) The table of sections for subpart B of part I of
9 subchapter D of chapter 1 of such Code is amended by
10 adding at the end thereof the following new item:

"Sec. 416. Special employee stock ownership plans."

11 SEC. 3. TREATMENT OF ANNUITIES FOR ESTATE PURPOSES.

12 Subsection (c) of section 2039 of such Code (relating to
13 exemption of annuities under certain trusts and plans) is
14 amended—

15 (1) by striking out "(other than a lump sum distri-
16 bution described in section 402(e)(4), determined with-
17 out regard to the next to the last sentence of section
18 402(e)(4)(A))" and inserting in lieu thereof "(other than
19 an amount which the taxpayer elected, under section
20 402(e)(4)(B), to treat as a lump sum distribution)", and

21 (2) by inserting after "section 401(a)" in para-
22 graph (1) the following: ", or under an employee stock
23 ownership plan".

1 SEC. 4. RETIREMENT SAVINGS BY ESOP PARTICIPANTS.

2 (a) AMENDMENT OF SECTION 219.—Paragraph (4) of
3 section 219(c) of such Code (relating to participation in gov-
4 ernmental plans by certain individuals) is amended—

5 (1) by inserting “; PARTICIPATION IN CERTAIN
6 EMPLOYEE STOCK OWNERSHIP PLANS” after “INDI-
7 VIDUALS” in the caption of such paragraph, and

8 (2) by adding at the end thereof the following new
9 subparagraph:

10 “(C) CERTAIN EMPLOYEE STOCK OWNER-
11 SHIP PLANS.—A participant in an employee stock
12 ownership plan described in section 416 is not
13 considered to be an active participant in a plan
14 described in subsection (b)(2) solely because of his
15 participation in the employee stock ownership
16 plan.”.

17 (b) AMENDMENT OF SECTION 220.—Paragraph (5) of
18 section 220(c) of such Code (relating to participation in gov-
19 ernmental plans by certain individuals) is amended—

20 (1) by inserting “; PARTICIPATION IN CERTAIN
21 EMPLOYEE STOCK OWNERSHIP PLANS” after “INDI-
22 VIDUALS” in the caption of such paragraph, and

23 (2) by adding at the end thereof the following new
24 sentence: “A participant in an employee stock owner-
25 ship plan which meets the requirements of section 416
26 is not considered to be an active participant in a plan

1 described in subsection (b)(3) solely because of his par-
2 ticipation in the employee stock ownership plan."

3 **SEC. 5. ROLLOVER OF ESOP INTO IRA.**

4 Paragraph (6) of section 402(a) of the Internal Revenue
5 Code of 1954 (relating to special rollover rules) is amended
6 by adding at the end thereof the following new subparagraph:

7 "(C) CASH IN LIEU OF EMPLOYER SECURI-
8 TIES.—For purposes of paragraph (5), the transfer of
9 all money received in lieu of a distribution of employer
10 securities (as defined in section 416(a)(9)(A)) or of the
11 proceeds from the sale of a distribution of employer se-
12 curities to the employer or to the trust or plan main-
13 tained by the employer, shall be treated as a transfer
14 of a distribution of such securities."

15 **SEC. 6. PUT-OPTION REQUIREMENT FOR CERTAIN ESOP CON-**
16 **TRIBUTIONS.**

17 Notwithstanding any other provision of law, an em-
18 ployee stock ownership plan (as defined in section 416 or
19 4975(e)(7) of the Internal Revenue Code of 1954) which per-
20 mits a participant to elect to receive cash in lieu of a distribu-
21 tion of employer securities shall not be required to provide a
22 put option for any securities distributed from the plan, nor
23 shall the provision of such an election be deemed to be an
24 offering of a security to the participant for purposes of Feder-
25 al securities laws.

1 SEC. 7. ELECTION WITH RESPECT TO UNREALIZED APPRECIATION
2 TION OF EMPLOYER SECURITIES.

3 Subparagraph (J) of section 402(e)(4) of such Code (relating to unrealized appreciation of employer securities) is
4 amended by inserting after "there shall be excluded" the following: "
5 at the election of the taxpayer (made at such time
6 and in such manner as the Secretary may prescribe by regulation),".

9 SEC. 8. DEDUCTIBILITY OF CERTAIN ESOP CONTRIBUTIONS.
10 BEQUESTS, ETC.

11 (a) DIVIDENDS PAID DEDUCTION.—In addition to the
12 deductions provided under section 404(a) of the Internal Revenue Code of 1954, there shall be allowed as a deduction to
13 an employer the amount of any dividend paid by that employer during the taxable year with respect to employer securities
14 (as defined in section 416(a)(9) of such Code) if—

17 (1) the employer securities were held on the
18 record date for the dividend by an employee stock ownership plan, and

20 (2) the dividend received by the plan is distributed, not later than 60 days after the close of the plan
21 year in which it is received, to the employees participating in the plan, in accordance with the plan provisions.
24

25 (b) BEQUESTS; CHARITABLE CONTRIBUTIONS, ETC.—
26 For purposes of sections 170(b)(1), 642(c), 2055(a), and 2522

1 of the Internal Revenue Code of 1954, a contribution, be-
2 quest, or similar transfer of employer securities or other
3 property to an employee stock ownership plan shall be
4 deemed a charitable contribution to an organization described
5 in section 170(b)(A)(vi) of such Code, if—

6 (A) such contribution, bequest, or transfer is allo-
7 cated, pursuant to the terms of such plan, to the em-
8 ployees participating under the plan in a manner con-
9 sistent with section 401(a)(4) of such Code;

10 (B) no part of such contribution, bequest or trans-
11 fer is allocated under the plan for the benefit of the
12 taxpayer (or decedent), or any person related to the
13 taxpayer (or decedent) under the provisions of section
14 267(b) of such Code, or any other person who, in the
15 year of contribution or any of the five preceding tax-
16 able years, has owned, directly or indirectly, more than
17 25 percent in value of any class of outstanding employ-
18 er securities (as defined in section 416(a)(9) of such
19 Code) under the provisions of section 318(a) of such
20 Code; and

21 (C) such contribution, bequest, or transfer is made
22 only with the express approval of such employee stock
23 ownership plan.

1 SEC. 9. ELIMINATION OF MINIMUM TAX ON EMPLOYEE STOCK
2 OWNERSHIP PLAN CONTRIBUTIONS.

3 In determining the regular tax deductions under section
4 56(c) of the Internal Revenue Code of 1954, the taxes im-
5 posed by chapter 1 of such Code shall not be reduced—

6 (1) in the case of a taxable year ending after De-
7 cember 31, 1974, and beginning before January 1,
8 1978, by the excess, if any, of the credit determined
9 pursuant to section 46(a)(2)(B) of such Code over the
10 credit which would have been determined pursuant to
11 section 46(a)(2)(A) of such Code, or

12 (2) in the case of a taxable year beginning after
13 December 31, 1977, by the amount of credit deter-
14 mined pursuant to section 44C of such Code.

15 SEC. 10. EFFECTIVE DATE.

16 Except as provided in section 9, the amendments made
17 by this Act shall apply with respect to taxable years begin-
18 ning after December 31, 1977.

○

96TH CONGRESS
1ST SESSION

S. 388

To promote the ownership of small businesses by their employees and to provide a means whereby employees can purchase their companies where the companies would otherwise be closed, liquidated, or relocated, and to assure that firms owned wholly or partly by their employees are eligible for all forms of assistance from the Small Business Administration.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 8 (legislative day, JANUARY 15), 1979

Mr. STEWART (for himself, Mr. NELSON, Mr. WEICKER, Mr. HATCH, and Mr. PRESSLER) introduced the following bill; which was read twice and referred to the Select Committee on Small Business

A BILL

To promote the ownership of small businesses by their employees and to provide a means whereby employees can purchase their companies where the companies would otherwise be closed, liquidated, or relocated, and to assure that firms owned wholly or partly by their employees are eligible for all forms of assistance from the Small Business Administration.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

1 That this Act may be cited as the "Small Business Employee
2 Ownership Act".

3 SEC. 2. The Congress finds and declares that—

4 (1) employee ownership of firms has been shown
5 to be a successful means of organizing an enterprise
6 and that employee-owned firms are likely to have
7 greater productivity rates, better long-range prospects,
8 greater employee and management job satisfaction, and
9 broader distribution of the company's profits and equity
10 than similar nonemployee-owned firms;

11 (2) employee ownership of firms provides a means
12 for preserving jobs and business activity where they
13 would otherwise be lost due to company closings, liqui-
14 dations, or relocations;

15 (3) employee ownership of firms provides a means
16 of keeping a small business small when it might other-
17 wise be sold to a conglomerate or other large enter-
18 prise;

19 (4) employee ownership provides a means for cre-
20 ating a new small business from the sale of a subsidi-
21 ary of a large business, when such a subsidiary would
22 otherwise be closed, liquidated, relocated, or sold to
23 another large business;

24 (5) unemployment insurance programs, welfare
25 payments, and job creation programs are less desirable

1 and more costly for both the Government and program
2 beneficiaries than loan programs to maintain employ-
3 ment in firms that would otherwise close, be liquidated,
4 or relocate;

5 (6) the continued closing of small businesses or
6 the sale of small businesses to conglomerates repre-
7 sents an undesirable and anticompetitive trend towards
8 economic concentration;

9 (7) the slow growth in productivity in the United
10 States contributes to inflation and balance-of-payments
11 deficits;

12 (8) the present concentration of capital ownership
13 has created too great a disparity between the very
14 wealthy few and the low- and moderate-income
15 majority;

16 (9) by making and guaranteeing loans to employee
17 stock ownership trusts or other employee organiza-
18 tions, the Small Business Administration could provide
19 feasible and desirable methods for the transfer of all or
20 part of a company's ownership to employees, by aiding
21 employee organizations in purchasing small business
22 concerns that would otherwise close, be liquidated, or
23 relocate, or in purchasing subsidiaries of companies
24 which would close, be liquidated, or relocate, and
25 would, if independently owned, be small businesses.

1 SEC. 3. (a) It is the purpose of this Act to include as
2 small business concerns any employee-owned company which
3 would otherwise be defined as small, or any employee organi-
4 zation, or employee stock ownership plan, established for the
5 purpose of purchasing a business which, when purchased,
6 would otherwise be defined as a small business, and to make
7 such employee-owned firms or employee organizations eligi-
8 ble for all assistance available to small business concerns as
9 provided in the Small Business Act.

10 (b) It is the further purpose of this Act to assure that a
11 small business using an employee stock ownership plan
12 which qualifies under the specifications as set forth in this
13 Act can obtain assistance from the Small Business Adminis-
14 tration through an employee stock ownership trust.

15 (c) It is the final purpose of this Act to assure that the
16 Small Business Administration shall give a high priority to
17 guaranteeing loans to employee-owned firms, to employee or-
18 ganizations or employee stock ownership plans seeking to
19 buy their firms, and that such assistance shall be made avail-
20 able by the Small Business Administration on the basis of a
21 firm's future prospects rather than past performance or indi-
22 vidual employee-owner assets.

23 SEC. 4. Section 7 of the Small Business Act is amended
24 by adding at the end thereof the following:

25 "(m)(1) As used in this subsection, the term—

1 “(A) ‘employee organization’ means any organiza-
2 tion representing employees of a company which is a
3 small business concern as presently constituted or, if
4 the company is a subsidiary of a large business, would
5 be a small business concern if independently owned;

6 “(B) ‘employee’ means any full-time employee of
7 a small business concern;

8 “(C) ‘employee stock ownership plan’ or ‘ESOP’
9 means a plan described in section 4975(e)(7) of the In-
10 ternal Revenue Code of 1954;

11 “(D) ‘Administrator’ means the Administrator of
12 the Small Business Administration;

13 “(E) ‘employee stock ownership trust’ or ‘ESOT’
14 means a trust created by a small business concern or
15 an employee organization as part of an employee stock
16 ownership plan and which, among other functions, can
17 (i) borrow funds for the purpose of investment in com-
18 pany stock and (ii) can receive contributions of stock
19 from the small business concern or employee organiza-
20 tion;

21 “(F) ‘startup and operating costs’ means the funds
22 required to acquire ownership of a small business con-
23 cern and operate it.

24 “(2)(A) The Administrator is directed to make all assist-
25 ance available under this section available to employee orga-

1 nizations, employee-owned small business concerns, and em-
2 ployee stock ownership trusts which meet the qualifications
3 specified in this subsection.

4 “(B) Assistance to employee-owned business concerns
5 shall be made on the same basis as assistance to nonem-
6 ployee-owned firms, except as specifically provided in this
7 Act.

8 “(C) Assistance to small business concerns using an em-
9 ployee stock ownership plan shall be made to the employee
10 stock ownership trust on the same basis as assistance is made
11 to companies not using an employee stock ownership plan,
12 if—

13 “(i) the company seeking the assistance through
14 an ESOT guarantees to the Administrator that it will
15 be responsible for providing such funds as shall be nec-
16 essary to the ESOT for the repayment of the obliga-
17 tion incurred by the ESOT;

18 “(ii) the trustee of the ESOT warrants in writing
19 that funds acquired by the ESOT with the assistance
20 of the Small Business Administration will be used
21 solely for the purpose of purchasing stock in the small
22 business concern adopting the ESOP: *Provided, That*
23 nothing in this section shall limit the activities of
24 ESOT's with regard to funds acquired from other
25 sources except as may otherwise be specified by law;

1 “(iii) all stock issued to the ESOT pursuant to the
2 assistance made available through this subsection fully
3 vests with employees of the small business concern no
4 later than the expiration date of the assistance;

5 “(iv) a plan certified by legal counsel for the busi-
6 ness concern adopting the ESOP is presented to the
7 Administrator which assured that notwithstanding any
8 other provisions of law, allocations of stock to partici-
9 pants in the ESOP will ignore all compensation of par-
10 ticipants in excess of \$50,000 when annual compensa-
11 tion is used as a guide for such allocation: *Provided,*
12 That any allocation formula adopted under the ESOP
13 must be one which satisfies the requirements of the In-
14 ternal Revenue Code.

15 “(3) Loans to employee organizations, including em-
16 ployee organizations establishing an ESOP and using an
17 ESOT, shall be guaranteed as provided in this section for the
18 purpose of acquiring a small business concern in which the
19 employees work, or for acquiring a subsidiary which, if inde-
20 pendently owned, would be a small business concern, and in
21 which the employees work: *Provided, That—*

22 “(A) the small business concern or subsidiary
23 would otherwise close, be liquidated, or relocated, or
24 be purchased by a large business, or the owner and

1 employees agree to a transfer of ownership to the
2 employees;

3 "(B) an employee organization has completed a
4 feasibility report showing the management capability
5 planned for the new firm, a marketing analysis, and
6 such other features as the Administrator may require;

7 "(C) at the time the employee organization sub-
8 mits an application for a guarantee or a loan as pro-
9 vided in this subparagraph (B), whichever comes first,
10 the organization provides a plan certified by legal
11 counsel to the Administrator demonstrating that—

12 "(i) all employees will be offered an opportu-
13 nity to participate in the ownership plan, and that
14 employees subject to a collective bargaining
15 agreement will be included in such an offering,
16 unless the union representing the employees in
17 the bargaining specifically requests, in writing,
18 exclusion from the plan;

19 "(ii) at least 50 per centum of the total stock
20 or other asset value of the firm will be owned by
21 at least 50 per centum of the employees by the
22 time the assistance made available from the Ad-
23 ministration expires, or any other Government as-
24 sistance made at the same time expires, which-
25 ever occurs later;

1 “(D) in the case of subsidiaries, a plan is provided
2 demonstrating that once the transfer of the subsidiary
3 to the employees is completed, the subsidiary will be
4 an independent business which qualifies as a small
5 business concern; and

6 “(E) in addition to the requirement in subpara-
7 graph (C), the organization, at the same time, must
8 provide a plan which is certified by its legal counsel
9 and which would—

10 “(i) provide that where stock is distributed, it
11 will carry full voting rights and be vested by the
12 expiration of the last Government assistance made
13 available at the time the Small Business Adminis-
14 tration assistance is made available;

15 “(ii) enable the concern to retire stock being
16 sold by employees leaving the firm or make the
17 stock available to new employees;

18 “(iii) provide for a periodic review of the
19 mode of company organization and the role em-
20 ployee owners will play in the management of the
21 concern;

22 “(iv) except in the case of an ESOP, provide
23 a method whereby the loan to the employee orga-
24 nization can be repaid by employee members
25 through a system of payroll deductions should

1 other methods or repayment as may be specified
2 in the loan application be unable to provide the
3 necessary cash; and

4 "(v) provide adequate management contracts
5 to assure management expertise and continuity.

6 "(4) Assistance under this paragraph shall be provided
7 on a high-priority basis and shall be made when the feasibil-
8 ity study required shows that the future prospects of the firm
9 show a likelihood of an ability to repay any loans guaranteed,
10 and when the Administrator determines that the company
11 will generate sufficient revenues to provide a reasonable as-
12 surance of repayment. The individual business experience or
13 personal assets of individual employee-owners shall not be
14 used as loan guarantee criteria, except inasmuch as certain
15 employee-owners may assume managerial responsibilities, in
16 which case business experience or ability may be considered.

17 "(5) The principal amount of any loan guaranteed under
18 this section may not exceed \$1,000,000.

19 "(6) For the purpose of the feasibility study specified in
20 3(B), the Administrator is authorized to loan not more than
21 \$10,000 to the employee organization, at the same rate as
22 the current cost of money to the Government and which shall
23 be repayable within three years: *Provided*, That if the feasi-
24 bility report does not result in a Small Business Administra-
25 tion guarantee, the loan shall be considered a grant.

1 “(7) Nothing in this section affects the status of any
2 ESOP under section 401 of the Internal Revenue Code of
3 1954.

4 “(8) The Administrator shall compile a separate list of
5 applications for assistance under this provision, indicating
6 which applications were accepted and which were denied,
7 and shall report periodically to Congress on the status of
8 employee-owned firms assisted by the Small Business Ad-
9 ministration.

10 “(9) The Administrator is authorized to make the guar-
11 antees under this subsection directly to the seller of a small
12 business concern or a subsidiary of a large business that
13 would become a small business upon independently owned as
14 specified in section 4(M)(3)(D): *Provided*, That the guaran-
15 tees under this subsection must be made in accordance with
16 the provisions of this subsection for employee ownership.
17 *And provided further*, That—

18 “(A) In guaranteeing assistance under this subsec-
19 tion, the Administrator will guarantee payments on in-
20 stallment sale contracts by the buyer to the seller: *Pro-*
21 *vided*, That no more than 90 per centum of the total
22 remaining obligation at the time of default shall be
23 paid;

24 “(B) In the case of default, the seller will have
25 the option of (1) paying the Small Business Adminis-

1 tration 90 per centum of the total amount paid on the
2 contract at the point of default and exercising his
3 option to reassume title to the business, in which case
4 the Small Business Administration will be relieved of
5 any further obligations to the seller, including the obli-
6 gation to pay 90 per centum of the remaining pay-
7 ments on the contract, or (2) assigning to the Small
8 Business Administration the option of assuming title to
9 the business and receiving, in a lump sum, 90 per
10 centum of the remaining payments due on the contract;

11 “(C) If the seller should take option (2), the Small
12 Business Administration may resell the business or its
13 assets, or may seek another individual to reassume the
14 contract and make the remaining payments to the
15 Small Business Administration.

16 SEC. 5 DEFINITIONS OF MINORITY-OWNED FIRMS
17 WITH ESOP'S.—After the words in section 8(a)(4)(A)
18 “* * * at least 51 per centum of the stock is owned by one
19 or more socially and economically disadvantaged individuals;
20 add the phrase, “or in the case of a company with an em-
21 ployee stock ownership plan, in which 51 per centum of the
22 stock in the company is allocated through an ESOT to one or
23 more socially and economically disadvantaged individuals;”.

H.R. 462 WITH REVISIONS PROPOSED BY
KELSO BANGERT & CO. INCORPORATED TO
THE JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION, JANUARY 20, 1976

H.R. —

94th CONGRESS

2nd Session

AN ACT

To provide for accelerated capital formation.

*Be it enacted by the Senate and House of Representatives
of the United States of America in Congress assembled,*

Section 1. Title - This Act may be cited as the "Accelerated
Capital Formation Act of 1976."

Section 2. Purpose - The purpose of this Act is to provide
incentives for accelerated financing of the formation of U.S.
corporate capital and to encourage voluntary means for broadly
diffusing equity ownership among employees of U.S. enterprises
both (a) with respect to existing capital, by means consistent
with the protection of private property, and (b) with respect
to newly formed capital, by means which extend the logic of
conventional business finance to corporate employees.

January 16, 1976

Section 3. Amendment of Internal Revenue Code - The Internal Revenue Code of 1954 is amended by adding the following new Section 416 at the end of Subpart B of Part I of Subchapter D of Chapter 1:

Section 416 - EMPLOYEE STOCK OWNERSHIP PLAN FINANCING

(a) Definitions.

(1) Employee Stock Ownership Plan - The term "employee stock ownership plan" means a technique of corporate finance that utilizes a defined contribution plan which satisfies the requirements of Section 401(a) and is designed -

- (A) to invest primarily in employer stock;
- (B) to meet general capital financing requirements of a corporation, including capital growth and transfers in the ownership of employer stock;
- (C) to build into employees beneficial ownership of employer stock, substantially in proportion to their relative compensation;
- (D) to receive loans or other extensions of credit to acquire employer stock, with such loans or credit secured primarily by a commitment by the employer to make future payments to the plan (which may include dividends on employee stock) in amounts sufficient to enable such loans (and interest thereon) to be repaid; and

(E) to limit the liability of the plan (and its participants) for repayment of any such loan (including interest) to payments received from the employer (which may include dividends on employer stock) and to that portion of the employer stock acquired with the proceeds of such loan which represents that portion of the loan remaining unpaid.

(2) Regulations - The Secretary or his delegate may prescribe regulations further defining "employee stock ownership plan" consistent with the provisions of this Section. An employee stock ownership plan which satisfies the requirements of this Section shall also satisfy the definition in Section 4975(e)(7) and the definitions under Section 301(d)(2) of the Tax Reduction Act of 1975 and Section 407(d)(6) of the Employee Retirement Income Security Act of 1974.

(3) Employer Securities and Employer Stock - For purposes of this Section, the term "employer securities" means securities issued by the employer corporation or by an affiliate of such employer, and the term "employer stock" means employer securities which constitute common stock or preferred stock convertible (at a reasonable conversion ratio) into common stock.

(4) Diversification - The term "invest primarily in employer stock," in subparagraph (1)(A) of this subsection, shall not preclude an employee stock ownership plan from diversifying its investments in order to provide participating employees

(or their beneficiaries) with the optional benefits described in paragraph (c) (2), or from providing a reasonable reserve for the repurchase of employer securities from former participants or beneficiaries.

(b) Special Deductions.

(1) Dividends on Employer Securities - In the case of an employer maintaining an employee stock ownership plan, there shall be allowed as a deduction the amount of any dividend paid by such employer (or its affiliate) during the taxable year with respect to employer securities, provided -

(A) such employer securities were held on the record date for such dividend by the employee stock ownership plan, by an individual stock ownership plan described in paragraph (c) (5) of this Section, or by an individual holding employer securities distributed to him from the employee stock ownership plan; and

(B) any dividend received by such employee stock ownership plan or individual stock ownership plan is distributed, not later than sixty (60) days after the close of the plan year in which it is received, to the employees, former employees and their beneficiaries having accounts under the employee stock ownership plan, or for whose benefit the individual stock ownership plan is maintained, in accordance with provisions of such plan; or

(C) any dividend received by the employee stock ownership plan is applied, not later than sixty (60) days after the close of the plan year, to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of employer stock.

(2) Employer Contributions - Notwithstanding the limitations under Section 404(a), there shall be allowed as a deduction to an employer the amount of any contributions paid on account of a taxable year [as described in Section 404(a)(6)] to an employee stock ownership plan, provided such contributions are applied to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of employer stock.

(3) Certain Donative Transfers - For purposes of Sections 170(a)(1) and (b)(1), 642(c)(1), 2055(a) and 2522, a contribution, bequest or similar transfer of employer securities or other property to an employee stock ownership plan shall be deemed a charitable contribution to an organization described in Section 170(b)(1)(A)(vi), provided -

(A) such contribution, bequest or transfer is allocated, pursuant to the terms of such plan, to the employees (or former employees or their beneficiaries) participating under the plan, in a manner consistent with Section 401(a)(4);

(B) no part of such contribution, bequest or transfer is allocated under the plan for the benefit of the tax-

payer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of Section 267(b), or any other person who owns more than 25% of any class of outstanding employer stock, under the provisions of Section 318(a);

(C) such contribution, bequest or transfer is made only in accordance with the express provisions of the employee stock ownership plan; and

(D) such contribution, bequest or transfer is treated as an employer contribution to the plan for purposes of Sections 402 and 411.

(c) Treatment of Participants.

(1) Allocation of Employer Stock -

(A) Employer stock acquired by an employee stock ownership plan through acquisition indebtedness incurred by the plan, in connection with the financing of capital requirements of the employer corporation (or its affiliates), shall be allocated annually among the accounts of the participants to the extent that contributions by the employer (and dividends received by the plan on employer stock) are applied to the repayment of such acquisition indebtedness (including interest), in accordance with the terms of the plan and substantially in proportion to their relative compensation.

(B) The allocation for each plan year shall represent that portion of employer stock acquired with proceeds of any loan the cost of which bears substantially the same ratio to the cost of all employer stock acquired with proceeds of that loan as the amount of loan principal and interest repaid by the plan for that plan year bears to the total amount of principal and interest payable by the plan during the term of such loan.

(2) Distribution of Benefits - Upon retirement or death, or following separation from service, an employee participating under an employee stock ownership plan (or his beneficiary, in the event of death) is entitled to a distribution of his nonforfeitable interest under the plan in the employer securities or other investments allocated to his accounts, in accordance with the provisions of the plan. If the plan so provides, the participant (or beneficiary) may elect (prior to or following separation from service) to receive all or a portion of his distribution from the plan in -

- (A) other employer securities;
- (B) cash;
- (C) a diversified portfolio of income producing assets;
- (D) a nontransferable annuity contract; or
- (E) any combination of the above.

(3) Mandatory Repurchase of Employer Securities Under Certain Circumstances - An employee stock ownership plan may

provide for the mandatory repurchase of employer securities from an individual receiving a distribution thereof if all other outstanding employer securities of the same class, whether or not acquired under the plan, are subject to mandatory repurchase from nonemployee shareholders under similar circumstances.

(4) Taxability on Distributions -

(A) Upon receipt of a lump sum distribution [as described in Section 402(e)(4)(A)] from an employee stock ownership plan, or in the event of termination of an employee stock ownership plan, an individual may exclude from gross income that portion of his distribution from the plan which is held by him in the form of employer securities or is transferred to, and held or reinvested within sixty (60) days in, an individual stock ownership plan described in paragraph (5) of this subsection, as a rollover contribution described in Section 402(a)(5), for the purpose of providing that individual with dividends on such employer securities or other forms of realized current income from income producing assets held in such individual stock ownership plan.

(B) Upon subsequent sale or disposition of any such employer securities (except upon death), or distribution of any such assets from the individual stock ownership plan, to the extent that proceeds realized from such sale, disposition or distribution are not exchanged for other employer securities, or reinvested within sixty (60) days in income producing assets under an individual stock ownership plan, the total amount of such proceeds (or the fair

market value of any property transferred without adequate consideration) shall be treated as ordinary income to that individual.

(5) Individual Stock Ownership Plans - An individual stock ownership plan which is established to receive proceeds distributed from an employee stock ownership plan, as described in paragraph (4) of this subsection, shall be an individual retirement account, under Section 408(a), in all respects, except that -

(A) the requirements of paragraphs (6) and (7) of Section 408(a) shall not be applicable;

(B) the taxes provided in Sections 408(f) and 4974 shall not be applicable;

(C) the total realized current income (excluding gains on the sale of assets) of the plan must be distributed, not later than sixty (60) days following the close of the taxable year in which such income is received by the plan, to that individual for whose benefit the plan is maintained; and

(D) the plan may only hold amounts which are attributable to distributions from an employee stock ownership plan.

(6) Taxability of Dividends - An individual receiving a distribution under paragraphs (b)(1) or (c)(5)(C) of this Section shall be subject to taxation under Section 402(a)(1), and the provisions of Section 116(a) shall not apply to such distribution.

(7) Limitation on Accumulation -

(A) A contribution by an employer which is deductible under paragraph (b) (2) of this Section, or a transfer described in paragraph (b) (3) of this Section, and any forfeitures attributable thereto, shall not be included in the meaning of annual addition under Section 415(c) (2).

(B) No contribution to (or forfeitures under) an employee stock ownership plan may be allocated to the accounts of any individual if the total value (as of the close of the plan year) of the employer securities and other investments accumulated under the plan for the benefit of that individual equals or exceeds \$500,000, less the amount of any such accumulation for that individual under any other employee stock ownership plan (including amounts held in any individual stock ownership plan established under this Section).

(d) Special Provisions.

(1) Fiduciary Responsibility - The acquisition or holding of employer stock, or the incurring of acquisition indebtedness for the purchase thereof, by an employee stock ownership plan shall satisfy the exclusive benefit requirement of Section 401(a) and the fiduciary duties under Section 404(a) (1) of the Employee Retirement Income Security Act of 1974, provided -

(A) the conditions of Section 4975(d)(3) and (13) are satisfied with respect to any transaction between the plan and a disqualified person; and

(B) the same standards of prudence and fiduciary responsibility that corporate management must exercise with respect to its shareholders are satisfied.

(2) Procedure for Advance Opinions - Upon application by an employee stock ownership plan, the Secretary of the Treasury or his delegate shall, within sixty (60) days, issue an advance opinion as to whether a proposed transaction involving that employee stock ownership plan will satisfy all the requirements described in paragraph (1) of this subsection, and any such opinion shall be binding upon the Secretary. Such opinion of the Secretary or his delegate shall be a determination with respect to qualification for purposes of Section 7476(a), relating to certain declaratory judgments of the Tax Court, except that administrative remedies shall be deemed to have been exhausted after sixty (60) days following application by the plan. The Secretary or his delegate shall, within ninety (90) days following the enactment of this Section, promulgate regulations and guidelines for the implementation of the procedure described in this paragraph.

Section 4. Amendment of Employee Retirement Income Security Act -
Part 4 of Title I of the Employee Retirement Income Security Act
of 1974 (P.L. 93-406) is amended by adding the following sub-
section (d) to Section 404:

(d) In the case of an employee stock ownership plan
[as defined in Section 416(a)(1) of the Internal Revenue
Code of 1954], the acquisition or holding of qualifying
employer securities, or the incurring of acquisition
indebtedness for the purchase thereof, shall satisfy the
requirements of paragraph (a)(1), provided -

- (1) the requirements of Section 408(b)(3) and (e)
are satisfied with respect to any transaction
between the plan and a party in interest; and
- (2) the same standards of prudence and fiduciary
responsibility that corporate management must
exercise with respect to its shareholders are
satisfied.

Section 5. Effect of Economic Stabilization - Payments
by an employer to an employee stock ownership plan, as defined
in Section 416(a)(1) of the Internal Revenue Code of 1954,
for the purpose of enabling such plan to repay acquisition in-
debtedness incurred for the purchase of employer stock, or
other contributions to such plan, shall not be treated
as compensation, fringe benefits or deferred compensation
payments for the purposes of any laws, executive orders or
regulations designed to control, establish guidelines or
otherwise stabilize employee compensation or benefits, but
shall be treated as the equivalent of debt service payments
made in the normal course of financing the capital require-
ments of that employer.

PROPOSED AMENDMENTS TO
INTERNAL REVENUE CODE
RELATING TO DEDUCTIONS FOR
ESOP CONTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (10) to subsection (a) of Section 404 of Subpart A of Part I of Subchapter D of Chapter I:

(10) Employee stock ownership plans - In the case of an employee stock ownership plan described in Section 4975(e)(7), notwithstanding the provisions of paragraphs (1), (3) and (7), there shall be allowed as a deduction the amount of any contributions paid to the plan on account of a taxable year, as described in paragraph (6), provided such contributions are applied by the plan to the repayment of acquisition indebtedness (including interest) incurred for the purchase of qualifying employer securities.

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (5) to subsection (c) of Section 415 of Subpart A of Part I of Subchapter D of Chapter I:

(5) Employee stock ownership plans - Employer contributions described in Section 404(a)(10), and any forfeitures attributable thereto, shall not be included in the meaning of annual addition under paragraph (2), so long as the employee stock ownership plan provides that no contribution (or forfeitures) may be allocated to the accounts of any participant if the total value (as of the close of the plan year) of the qualifying employer securities and other investments accumulated under the plan for his benefit equals or exceeds \$500,000, less the amount of any such accumulation for that participant under any other employee stock ownership plan described in Section 4975(e)(7).

PROPOSED AMENDMENT TO
INTERNAL REVENUE CODE
RELATING TO DONATIVE TRANSFERS
TO AN ESOP

The Internal Revenue Code of 1954 is hereby amended by adding the following new subparagraph (G) at the end of paragraph (l) of Section 170(b) of Part VI of Subchapter B of Chapter 1:

(G) Certain transfers to an employee stock ownership plan - For purposes of paragraph (a)(l) and of this paragraph, and for purposes of Sections 642(c)(l), 2055(a) and 2522, a contribution, bequest or similar transfer of qualifying employer securities or other property to an employee stock ownership plan, as described in Section 4975(e)(7), shall be deemed a charitable contribution to an organization described in subparagraph (A)(vi), provided -

(i) such contribution, bequest or transfer is allocated, pursuant to the terms of such plan, to the employees (or former employees or their beneficiaries) participating under the plan, in a manner consistent with Section 401(a)(4);

(ii) no part of such contribution, bequest or transfer is allocated under the plan for the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of Section 267(b), or any other person who owns more than 25% of any class of outstanding qualifying employer securities, under the provisions of Section 318(a);

(iii) such contribution, bequest or transfer is made only in accordance with the express provisions of the employee stock ownership plan; and

(iv) such contribution, bequest or transfer is treated as an employer contribution to the plan for purposes of Sections 402 and 411, but not for purposes of Sections 404 and 415.

PROPOSED AMENDMENT TO
INTERNAL REVENUE CODE
TO PERMIT CORPORATE TAX DEDUCTION
FOR DIVIDENDS PAID ON EMPLOYER STOCK
IN CONNECTION WITH AN ESOP

The Internal Revenue Code of 1954 is hereby amended by adding the following new Section 251 at the end of Part VIII of Subchapter B of Chapter I:

Sec. 251 - DIVIDENDS PAID IN CONNECTION WITH
 AN EMPLOYEE STOCK OWNERSHIP PLAN.

(a) Deduction Allowed - In the case of a corporation maintaining an employee stock ownership plan, as defined in Section 4975(e)(7), there shall be allowed as a deduction the amount of any dividends paid during the taxable year with respect to qualifying employer securities, as defined in Section 4975(e)(8), provided -

(1) such qualifying employer securities were held on the record date for such dividend by the employee stock ownership plan or by an individual holding qualifying employer securities distributed to him from the employee stock ownership plan; and

(2) any dividend received by such employee stock ownership plan is distributed, not later than sixty (60) days after the close of the plan year in which it is received, to the employees, former employees and their beneficiaries having accounts under the employee stock ownership plan, in accordance with the provisions of such plan; or

(3) any dividend received by the employee stock ownership plan is applied, not later than sixty (60) days after the close of the plan year, to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of qualifying employer securities.

PROPOSED AMENDMENT TO
INTERNAL REVENUE CODE
RELATING TO ESOP ALLOCATIONS
AND DISTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (20) to subsection (a) of Section 401 of Subpart A of Part I of Subchapter D of Chapter 1:

(20) A trust forming part of an employee stock ownership plan, as defined in Section 4975(e)(7), shall not constitute a qualified trust under this Section unless the provisions of the plan satisfy the requirements of this paragraph.

(A) Qualifying employer securities acquired by the plan through acquisition indebtedness incurred by the plan, in connection with the financing of capital requirements of the employer corporation (or its affiliates), shall be allocated annually among the accounts of the participants to the extent that contributions by the employer (and dividends received by the plan on qualifying employer securities) are applied to the repayment of such acquisition indebtedness (including interest), in accordance with the provisions of the plan and substantially in proportion to their relative compensation. The allocation for each plan year shall represent that portion of qualifying employer securities acquired with the proceeds of any loan the cost of which bears substantially the same ratio to the cost of all qualifying employer securities acquired with the proceeds of that loan as the amount of loan principal and interest repaid by the plan for that plan year bears to the total amount of principal and interest payable by the plan during the term of such loan.

(B) Upon retirement or death, or following separation from service, an

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employee participating under the plan (or his beneficiary, in the event of his death) is entitled to a distribution of his nonforfeitable interest under the plan in the employer securities or other investments allocated to his accounts, in accordance with the provisions of the plan. If the plan so provides, the participant (or beneficiary) may elect (prior to or following separation from service) to receive all or a portion of his distribution from the plan in -

- (i) other employer securities;
- (ii) cash;
- (iii) a diversified portfolio of income producing assets;
- (iv) a nontransferable annuity contract; or
- (v) any combination of the above.

(C) An employee stock ownership plan may provide for the mandatory repurchase of employer securities from an individual receiving a distribution thereof if all other outstanding employer securities of the same class, whether or not acquired under the plan, are subject to mandatory repurchase from nonemployee shareholders under similar circumstances.

PROPOSED AMENDMENT TO
INTERNAL REVENUE CODE
RELATING TO DEFERRAL OF TAXATION
ON ESOP DISTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (5) to subsection (e) of Section 402 of Subpart A of Part I of Subchapter D of Chapter 1:

(5) Employee stock ownership plans -

(A) Upon the receipt of a lump sum distribution from an employee stock ownership plan, as defined in Section 4975(e)(7), an individual may exclude from gross income that portion of the distribution which is held by him in the form of employer securities or is transferred to, and held or reinvested within sixty (60) days in, an individual stock ownership plan described in subparagraph (C) of this paragraph, as a rollover contribution described in subsection (a)(5), for the purpose of providing that individual with dividends on such employer securities or other forms of realized current income from income producing assets held in such individual stock ownership plan.

(B) Upon subsequent sale or disposition of any such employer securities (except upon death), or distribution of any such assets from the individual stock ownership plan, to the extent that the proceeds realized from such sale, disposition or distribution are not exchanged for other employer securities, or reinvested within sixty (60) days in income producing assets under an individual stock ownership plan, the total amount of such proceeds (or the fair market value of any property transferred without adequate consideration) shall be treated as ordinary income to that individual.

(C) Individual Stock Ownership Plans - An individual stock ownership plan which is established to receive proceeds distributed from an employee stock ownership

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