

ESOP's and Opportunity Zones

Opportunity Zone Testimony-February 14, 2019

My name is Christopher Mackin. I serve as an adviser to companies that are substantially employee-owned primarily through the use of Employee Stock Ownership Plans or ESOPs. ESOPs are a form of defined contribution benefit plan that makes use of a legal trust structure that holds employer stock on behalf of employees. ESOPs have been part of Federal law since 1974 and have grown to over 6,500 companies nationwide collectively employing nearly 11 million workers. A second form of employee ownership, worker cooperatives, are also part of the employee ownership family that is interested in the ideas being discussed today.

ESOPs are primarily used by healthy, privately held firms of scale whose founders have reached retirement age and are looking to exit ownership and control of their companies. Federal tax incentives passed over several Congressional cycles reaching back to 1974 make it attractive for business owners to sell internally to their employees. The largest such company that makes use of an ESOP is the Publix Supermarket chain of Florida and Georgia with 190,000 employees and \$34 billion in annual sale. W.L. Gore,

manufacturer of Gore-Tex fabric in Newark, Delaware, employing nearly 10,000 employees is another well-known brand with majority employee ownership through an ESOP. Harpoon Brewing in my native Boston, MA is one more fairly well-known example employing over 300 people in Boston and nearby Vermont.

Senator Russell Long Democrat of Louisiana, who served in Congress between 1948 and 1987 and who passed away in 2003 is the widely recognized father of the ESOP idea. He was successful in recruiting bi-partisan support for the ESOP idea initially with Senator Robert Dole of Kansas and including President Ronald Reagan. Bi-partisan support for these ideas continue through today. On August 20, 2018, S.2786 The Main Street Employee Ownership Act passed as part of the FY 2019 National Defense Authorization Act with leadership from Democratic Senators Kirstin Gillibrand of New York and Ben Cardin of Maryland as well as Republican Senators Todd Young of Indiana and James Risch of Idaho among others. The employee ownership idea has a healthy and growing constituency. In addition to the evidence accumulated over the years for the outstanding economic performance characteristics of these ideas in terms of productivity and profitability, this idea is increasingly being looked at as a

practical and bi-partisan tool to help overcome economic inequality.

Employee ownership introduces a welcome "pre-distributive" - 'before the fact' - design to an economic conversation that has relied almost exclusively and contentiously on re-distributive 'after the fact' methods for taxing accumulated wealth. Employee ownership shares wealth 'as it is being earned' by the workers and managers in our workplaces.

In testimony submitted in December of 2018, representatives of the City of Newark, and Cook County Illinois joined me and others in expressing a hope that Opportunity Zone legislation will provide an opportunity for economic advancement for workers and managers of operating companies, located within Opportunity Zones, that share ownership with their employees. We believe this is an entirely complementary policy idea that extends the promise of Opportunity Zones beyond real estate. In order for this goal to be achieved, flexibility and clarification in the regulations on Qualified Opportunity Zones issued on October 19, 2018 will be necessary to make it possible for workers and managers around our country to benefit from equity participation in addition to wages. In particular, the proposed revision to the regulations would make it easier to create ESOPs in Qualified Opportunity

Zones by allowing the ESOP to be designed making use of what is called “structured equity.”

Suggested change to proposed regulations under Code section 1400Z-2:

Add to the definition of “qualified opportunity zone stock” in §1.1400Z-2(d)-1(c)(2) a provision that the term “qualified opportunity zone stock” includes any interest constituting “synthetic equity” within the meaning of section 409(p)(6)(C) and the regulations thereunder, in the case of an S corporation the stock of which is owned by an employee stock ownership plan (ESOP), as defined in section 4975(e)(7).

Explanation. The full tax benefits of an ESOP are available only if all of the stock of an S corporation is held by the ESOP. Accordingly, outside investors in ESOP-owned S corporations typically acquire their equity by investing in hybrid securities of the S corporation which do not fall within the meaning of “stock” under section 1361. Such securities include convertible debt and subordinated debt with warrants attached, among others. This issue was confronted by Congress in enacting the ESOP anti-abuse provision of section 409(p), which creates the concept of “synthetic

equity” to describe the hybrid securities representing this kind of non-stock equity. The concept is equally applicable here, to ensure that the purpose of the opportunity zone tax provisions is carried out by enabling the use of ESOPs in appropriate situations.

Thank you for your attention.

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