The Oxford Symposium on Employee Ownership'23

Solving Barriers to Employee Ownership

Background Materials
30-31 August 2023

The Organisers of the Oxford Symposium on Employee Ownership

The **Center on Business and Poverty** has offices in Franklin, Tennessee and Oxford, England. It supports businesses that embody the practice of participatory capitalism. The Center works with companies that create good jobs, and does so through partnerships with firms, as well as non-profits and individuals. The Center has worked in more than 37 U.S. States and has focused international efforts in India, China, Sri Lanka, Ghana and Mexico. The Center for Business and Poverty is a recognised 501(c)3 non-profit organisation.

Since its founding in 1991, the Washington, D.C. headquartered **Employee Ownership Foundation** has operated in pursuit of a single overarching goal: to help more individuals become employee owners. The Foundation has raised and donated millions of dollars to collect data used by academics, encourage objective research, and to facilitate dialogue about employee ownership between thought leaders. Going forward, the Foundation is placing a larger emphasis on raising awareness of the employee ownership model among business owners, identifying impediments or obstacles to employee ownership, and to funding more applied research that can further improve the market advantage held by well-run employee-owned businesses. Governed by a national 50-person board of trustees and an eight-person executive committee, the Foundation is recognized by the Internal Revenue Service as an independent 501(c)(3) non-profit organisation.

Fieldfisher is a dynamic European law firm headquartered in Riverbank House, overlooking the River Thames, in the City of London. It is a full-service firm with many market-leading practices including in technology, financial services, energy and natural resources, and life sciences. Fieldfisher has extensive expertise in advising on, creating, and sustaining employee ownership and employee share ownership solutions for a wide range of businesses and for decades has maintained a leading role in developing and advancing the U.K.'s employee share ownership and employee ownership regulatory and non-regulatory frameworks.

Contents

Annex A: Background to the review

The review's remit

Norman Lamb, Minister for Employment Relations, announced on 8 February 2012 that Graeme Nuttall a partner in the law firm Field Fisher Waterhouse LLP had been appointed the Government's independent adviser on employee ownership. This appointment followed the announcement by Nick Clegg, Deputy Prime Minster on 16 January 2012 at Mansion House of a Government drive to introduce the concept of employee ownership into the mainstream British economy. Norman Lamb is leading the cross-Whitehall work to investigate how Government can support this growing business model, and this review is submitted to him.

The review's remit has been to "work with Government to identify the barriers to employee ownership and help find the solutions to knock them down".

The Mansion House speech referred to what the Government is already doing in relation to employee ownership in the public sector. In particular, it referred to the work of the Cabinet Office on employee led mutuals, based upon advice from Mutuals Taskforce under Julian Le Grand. It also referred to the reform of Royal Mail and its transformation into an organisation in which staff have a meaningful stake. This review focuses on employee ownership in the private sector and not the transformation of public sector activities into private sector companies with employee ownership.

The 21 March 2012 Budget Report announced HM Treasury will conduct an internal review to examine the role of employee ownership in supporting growth and examine options to remove barriers, including tax barriers, to its wider take-up, and which will consider the findings of this review.

Glossary

Co-operatives – member-owned, member-controlled enterprises which operate for member benefit. On international definitions, many of the UK's companies which are majority owned by employees would be classified as co-operative. Compared to other countries, the UK has a relatively strong consumer-owned co-operative sector, as well as worker co-operatives. Worker co-operatives adhere to an additional code, beyond the core international principles, focused on democracy and participation in the workplace. All co-operatives are mutuals, but not all mutuals are co-operatives.

Employee benefit trust – typically, a discretionary trust for the benefit of employees of a company or group of companies. The beneficiaries may extend to former employees, charity and other beneficiaries as permitted under section 86 of the Inheritance Tax Act 1984.

Employee ownership – means a significant and meaningful stake in a business for all its employees. If this is achieved then a company has employee ownership: it has employee owners.

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What is 'meaningful' goes beyond financial participation. The employees' stake must underpin organisational structures that ensure employee engagement. In this way employee ownership can be seen as a business model in its own right.

This review has a particular emphasis on the employees' stake being a substantial or controlling stake. There is no set rule as to what percentage of issued share capital is a substantial stake. Over 25% is substantial from a company law perspective. This review heard evidence that the full benefits of employee ownership can be achieved at lower percentages.

A company in which a controlling stake is held by or on behalf of all employees is an employee owned company.

If a company has one or more employee share plans, which could include an employee benefit trust, that do not provide a substantial stake these can still be part of an employee ownership business model, if they go beyond just providing financial participation.

This definition also includes employee share ownership in listed companies. What is 'a substantial stake' in the context of listed companies is likely to be a lower percentage of issued share capital than in private companies, and to be linked more to the percentage of employees participating in the employee ownership arrangements.

References to share ownership by all employees assume such ownership is voluntary. Share ownership must be made available to all employees on the same or similar terms but this can be subject to a minimum period of employment or other reasonable qualifying conditions. Entitlements often vary on a fair basis according to length of service, remuneration or similar factors.

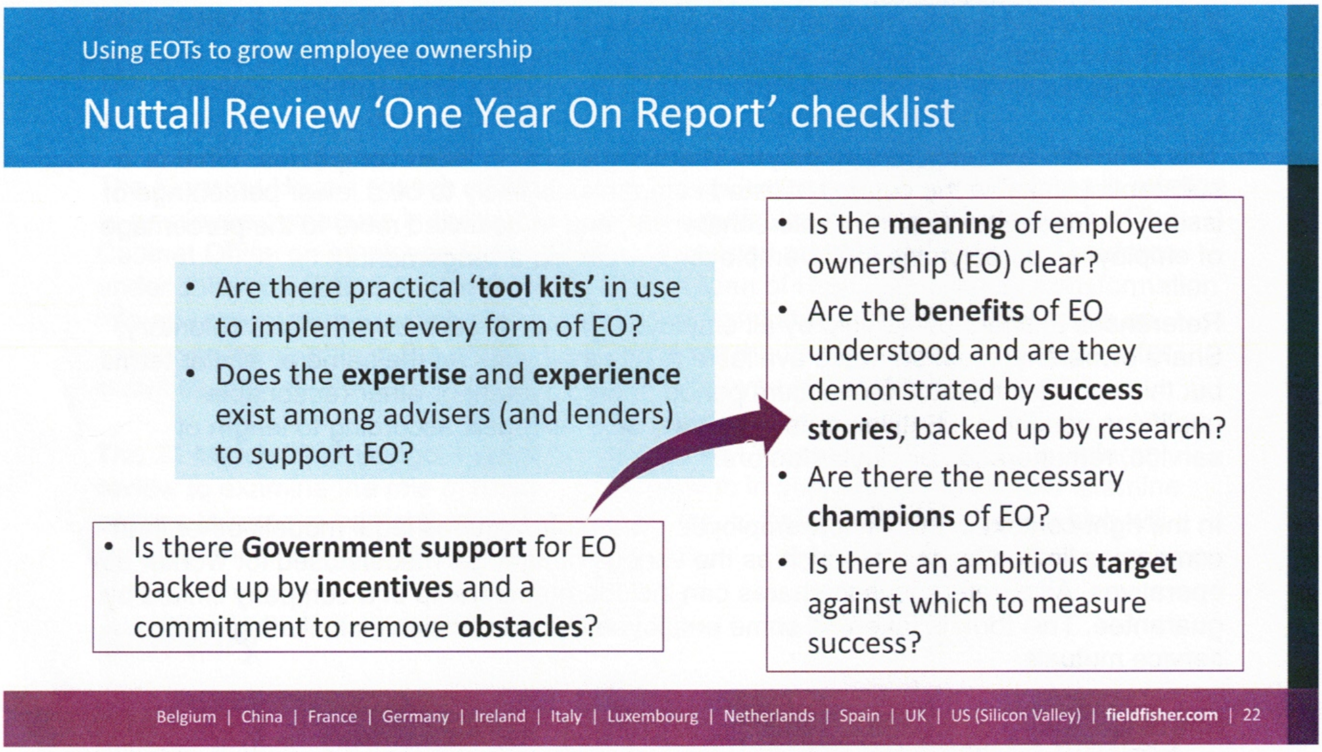
In the right context in this review employee ownership includes legal models other than companies limited by shares, such as the various other legal models used for worker co-operatives. Also, references to shares can include membership of a company limited by guarantee. This form is taken be some employee owned companies including public service mutuals.

Employee share ownership – employees own shares in the company for which they work. The aggregate employee shareholding may be an insignificant proportion of the total equity or provided only as a tax effective bonus arrangement, and therefore not count as 'employee ownership'. In this review the expression employee share ownership can be taken as referring to either or both employee ownership and employee financial participation arrangements depending on the context.

Mutual – an organisation that is owned by its customers or its employees or some combination of the two.

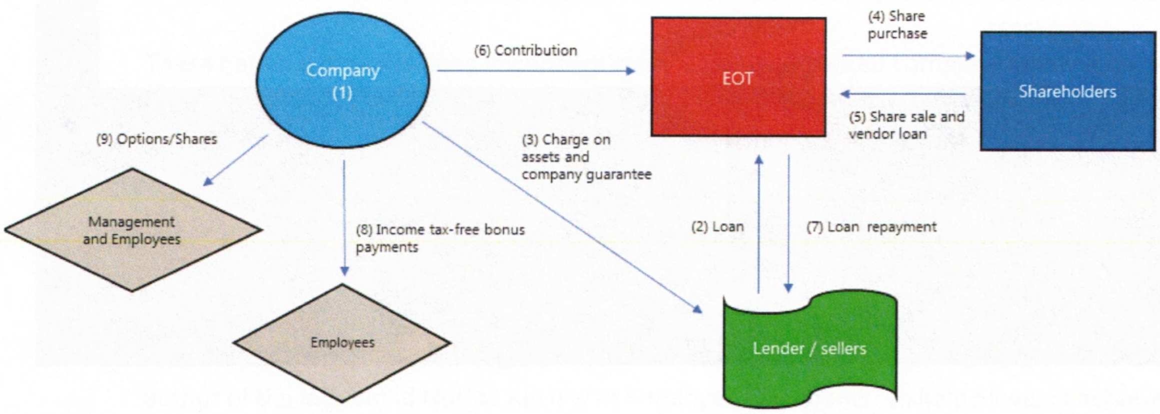
Shared capitalism/employee financial participation – company profits are shared with employees. This may be achieved through employee share ownership. Not all forms of shared capitalism or employee financial participation necessitate any direct or indirect form of employee ownership. A large number of businesses remunerate senior managers in proportion to profits (often with equity-based remuneration packages) but without extending this to all employees.

Nuttall Review, ‘One Year On Report’ Checklist



Typical U.K. EOT Transaction Diagram

Typical EOT transaction



1. The company is valued for the purposes of the EOT transaction.
2. The EOT borrows money from sellers (vendor loan) with a company guarantee.
3. The lenders take a charge over the company's assets.
4. The shareholders sell 100% of the shares to the EOT for cash and a vendor loan note and pay no capital gains tax on the shares sold.
5. The EOT pays for the shares with cash and vendor loans.
6. The company makes contributions to the EOT out of post tax profit.
7. The loan due to the sellers from the EOT is repaid over time using contributions made to the trust by the company.
8. Employees are eligible to receive income tax-free bonus payments up to £3,600 per employee per annum; bonuses not mandatory.
9. As an incentive to align interests, the company may issue shares or options to key managers and employees; EOT must always hold majority of shares

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Share

PRESS RELEASE

Slovenia joins international employee ownership ESG initiative spearheaded by Fieldfisher partner Graeme Nuttall

28/03/2023

LOCATIONS

United Kingdom

Slovenia's Institute for Economic Democracy has added its backing to the growing movement to raise corporate environmental, social and governance standards through the medium of employee-owned businesses.

Fieldfisher is delighted to announce that the Slovenian Institute for Economic Democracy (IED) has formally added its support to an international initiative to raise environmental, social and governance (ESG) standards by promoting employee ownership (EO).

The EO ESG initiative was established in 2020 by Fieldfisher tax and structuring partner Graeme Nuttall OBE, who leads the initiative and advocates for greater understanding and adoption of EO in the UK and internationally.

Slovenia's IED joins the initiative's existing members, the UK Employee Ownership Association, Scotland for Employee Ownership, Employee Ownership Wales, Employee Ownership Australia, Irish ProShare Association, Japan Employee Ownership Association and

Southern Africa Employee Ownership Association who have all pledged their support for campaign.

These national organisations encourage every employee-owned company to make an overall positive contribution to society and the environment, as part of promoting the success of its business.

Their support is based on the foundational principle that EO is integral to stronger, more resilient, productive and fair economies.

Graeme Nuttall OBE is a leading expert on the employee ownership business model and author of the influential Nuttall Review of Employee Ownership. To help Slovenia achieve its ESG aims through EO, and to develop Slovenian EO laws, Graeme has been made a member of the IED's Experts' Board.

Commenting on Slovenia's backing for the initiative, Graeme Nuttall OBE, said:

"Adding another national organisation's voice to this movement is a great achievement and further evidence of the growing understanding of the positive impact EO can have on ESG.

"We welcome Slovenia's IED to this initiative and look forward to their contributions, which thrives on sharing best practice and the many success stories generated by the EO community."

Slovenia's IED (Inštitut za ekonomsko demokracijo) said:

"We recognise the social responsibility that the employee-owned companies have by the virtue of their legal structure. Employee ownership tackles wealth inequality at its root cause, leads to better working conditions, and improves well-being of the workers. In employee-owned businesses, the business interests are generally aligned with the interests of the local communities, which internalizes the externalities and improves the environmental impact of the firms."

U.S. DEPARTMENT OF THE TREASURY

SSBCI State Small Business Credit Initiative

State Small Business Credit Initiative (SSBCI) Fact Sheet

Transactions to Support Broad-Based Employee Ownership in a Business: Employee Stock Ownership Plans (ESOPs), Worker Cooperatives, Employee Ownership Trusts, and Related Vehicles

What is the State Small Business Credit Initiative?

Reauthorized and expanded by the American Rescue Plan Act of 2021, the State Small Business Credit Initiative (SSBCI) is a $10 billion program to support small businesses and entrepreneurship in communities across the United States by providing capital and technical assistance to promote small business stability, growth, and success. SSBCI will provide funding to states, the District of Columbia, territories, and Tribal governments (collectively, participating jurisdictions) for programs that catalyze lending and investing in small businesses, build ecosystems of opportunity and entrepreneurship, and create high-quality jobs.

How does SSBCI work?

SSBCI includes two programs: the Capital Program and the Technical Assistance (TA) Grant Program. Under the Capital Program, participating jurisdictions implement credit and equity/venture capital programs to provide capital to small businesses. Under the TA Grant Program, Treasury supports programs that provide legal, accounting, or financial advisory services to qualifying small businesses.

Jurisdictions design their SSBCI Capital Programs to support one or more credit or investment programs:

- Capital access programs provide portfolio insurance in the form of a loan loss reserve fund into which the lender and borrower contribute.
- Collateral support programs enable financing that might otherwise be unavailable due to a collateral shortfall, generally through pledged cash collateral accounts.
- Loan guarantee programs enable small businesses to obtain loans or lines of credit by providing lenders with necessary support in the form of a partial guarantee.
- Loan participation programs provide credit support through the purchase of a portion of a loan made by a lender or through a direct loan alongside a private lender.
- Equity/venture capital programs provide capital in the form of equity investments to small businesses.

The SSBCI Capital Program Policy Guidelines (Guidelines) specify the requirements applicable to SSBCI-supported transactions.

How can SSBCI programs support financing of ESOPs, Worker Cooperatives, & Employee Ownership Trusts?

Buyouts

While the Guidelines (Sections VII.f, VIII.f) generally prohibit the use of SSBCI support to purchase business ownership interests, there is an exception for the purchase of an interest in an ESOP qualifying under section 401 of the Internal Revenue Code,

State Small Business Credit Initiative:
ESOP Factsheet
4/27/2023

worker cooperative, employee ownership trust, or related vehicle so long as the transaction results in broad-based employee ownership for employees in the business and the ESOP or other employee-owned entity holds a majority interest (on a fully diluted basis) in the business.[1]

Loans to businesses owned by ESOPs and worker cooperatives

Businesses owned by ESOPs, worker cooperatives, employee ownership trusts, and related vehicles may be eligible borrowers under an SSBCI-supported Capital Program. Subject to SSBCI rules, eligible borrowers can use SSBCI-supported funding for an eligible business purpose, including:

- Start-up costs, franchise fees, and working capital;
- The acquisition of equipment, inventory, or services used in the production, manufacturing, or delivery of a business's goods or services; and
- The purchase, construction, renovation, or tenant improvements of an eligible place of business that is not for passive real estate investment purposes.[2]

How can a business find an SSBCI lender?

Businesses may learn about participating lenders on each jurisdiction's website or by contacting the jurisdiction's program managers. Jurisdiction program managers are the first point of contact to discuss a potential use of SSBCI funds for a particular transaction.

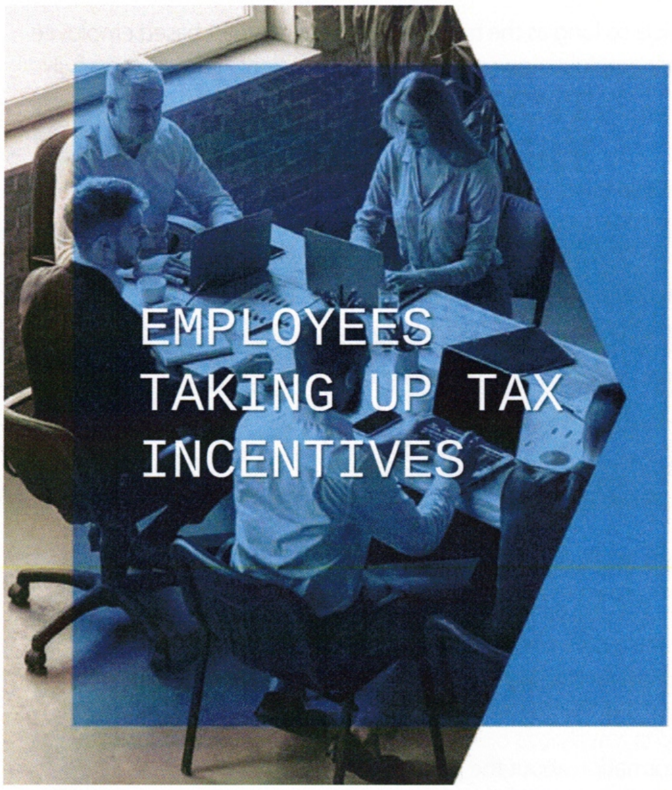
Information about each participating jurisdiction's capital programs, including websites and contacts, may be found here: List of SSBCI Capital Programs and Contacts | U.S. Department of the Treasury

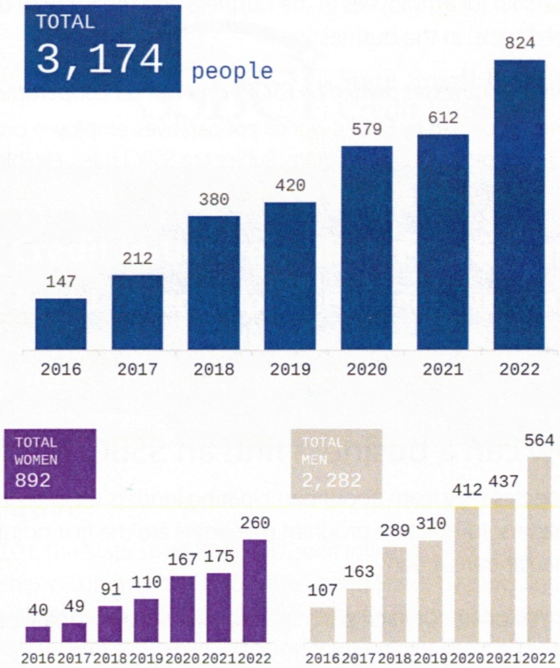
In addition, Treasury issues regular press releases and other information about the program on the SSBCI website: State Small Business Credit Initiative (SSBCI) | U.S. Department of the Treasury

Submit a request to join the SSBCI Bulletin email distribution list or request additional information by emailing SSBCI at ssbci_information@treasury.gov.

1 *See* sections VII.f. and VIII.f of the Guidelines.

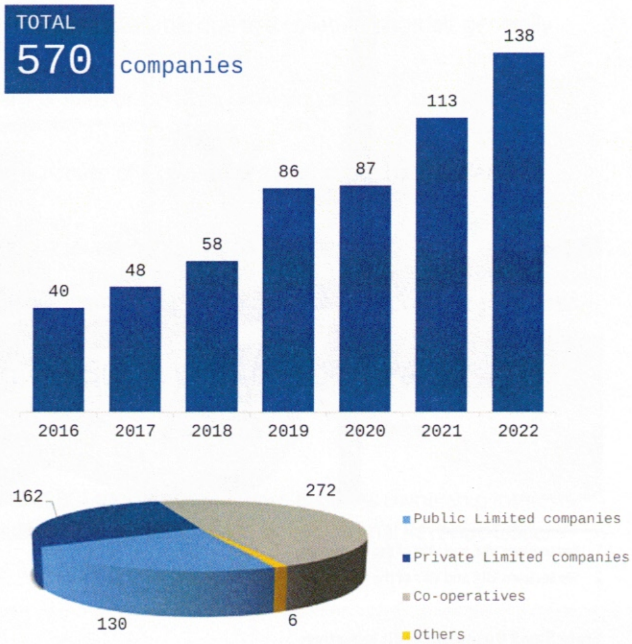
2 *See* sections VII.f. and VIII.f of the Guidelines.


EMPLOYEES TAKING UP TAX INCENTIVES


TOTAL
3,174 people
147 212 380 420 579 612 824
2016 2017 2018 2019 2020 2021 2022
TOTAL WOMEN 892
40 49 91 110 167 175 260
2016 2017 2018 2019 2020 2021 2022
TOTAL MEN 2,282
107 163 289 310 412 437 564
2016 2017 2018 2019 2020 2021 2022

30


INVESTEE COMPANIES THANKS TO TAX INCENTIVES


TOTAL
570 companies
40 48 58 86 87 113 138
2016 2017 2018 2019 2020 2021 2022
162
272
130
6
Public Limited companies
Private Limited companies
Co-operatives
Others

31

U.S. Department of Labor Launches Initiative to Promote Worker-Owned Businesses

U.S. DEPARTMENT OF LABOR

News Release

DEPARTMENT OF LABOR LAUNCHES INITIATIVE TO PROMOTE WORKER-OWNED BUSINESSES, INCREASE WORKPLACE DEMOCRACY, IMPROVE BOTTOM LINE FOR MANY AMERICANS

WASHINGTON – To help create and promote business ownership by America's workers, the U.S. Department of Labor today announced the launch of a new Employee Ownership Initiative within its Employee Benefits Security Administration.

As part of the Worker Ownership, Readiness, and Knowledge Act in the SECURE 2.0 Act of 2022 and aligned with President Biden's promise to lead the most pro-worker administration in history, EBSA will implement a new program to empower workers through ownership arrangements and educate those workers on possible pathways to greater rewards in return for their labor.

"Worker ownership arrangements help create pathways for employees to earn a fair share of the profits that their labor makes possible and will play a critical role in the Biden-Harris administration's fight to give workers a voice on the job and a seat at the table," said Acting Secretary of Labor Julie A. Su. "This new Department of Labor initiative is an important step in implementing President Biden's economic plan to empower workers and grow the economy from the middle out and the bottom up — not the top down."

EBSA's new initiative includes creation of the Division of Employee Ownership in EBSA's Office of Outreach, Education and Assistance. The division will support the creation and expansion of worker-owned businesses by:

- Supporting existing programs designed to promote employee ownership and facilitating the formation of new programs.
- Developing a clearinghouse of techniques applied by new and existing state programs and sharing information about these techniques with states.
- Providing education, outreach, and training to inform employees and employers about the possibilities and benefits of worker ownership and business ownership succession planning.
- Providing technical assistance for employee's efforts to become business owners and helping employers and employees explore the feasibility of transferring full or partial ownership to employees.

"By launching this initiative, the Employee Benefits Security Administration is working to help balance the distribution of power in America's workplaces and empower the workers who fuel their employers' ability to be successful day in, day out, while educating employers about how worker ownership can be good for business," explained Assistant Secretary for Employee Benefits Security Lisa M. Gomez.

In the coming months, EBSA will hold stakeholder meetings to gain important feedback on how to best achieve the initiative's goals and carry out the division's activities. Separately, EBSA will also issue formal guidance on valuation of employer stock in employee stock ownership plans, as required by the WORK Act.

Employers and workers can reach EBSA's Division of Employee Ownership at 202-693-8602 or ownership@dol.gov.

Agency: Employee Benefits Security Administration
Date: July 10, 2023
Release Number: 23-1508-NAT

Media Contact: Grant Vaught
Phone Number: 202-693-4672
Email: vaught.grant.e@dol.gov

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Impacts	Comment
other public sector delivery organisations	applications. The EBT proposals are expected overall to have no impact on business and individual experience of dealing with the government as the proposed reforms do not change any processes or tax administration obligations.
Other impacts	No other impacts have been identified.

9. Summary of consultation questions

Question 1: Do you have any comments on the proposal to prohibit former owners and connected persons from retaining control of an EOT-owned company post-sale by appointing themselves in control of the EOT trustee board?

Question 2: Should the government go further and require that the EOT trustee board includes persons drawn from specific groups, such as employees or independent persons? If so, how should these groups be defined?

Question 3: Do you have any comments on the proposal to require that the trustees of an EOT are UK resident as a single body of persons?

Question 4: Do you have any comments on the proposal to confirm in legislation the distributions treatment for contributions made by a company to an EOT to repay the former owners for their shares?

Question 5: Do you have any comments on the proposal that HMRC stops giving clearances on the application of section 464A of the Corporation Tax Act 2010 to the establishment of EOTs?

Question 6: Should the EOT bonus rules be eased so that tax-free bonuses can be awarded to employees without directors necessarily also having to be included, and would this undermine protections which ensure that bonus payments are not abused or weighted towards some employees?

Question 7: Do the EOT bonus rules create any other unintended consequences or challenges in administering the tax-free bonus payments?

Question 8: In addition to the reforms proposed at Chapters 4 to 6, do you have any views on ways the Employee Ownership Trust tax regimes could be reformed to better support employee ownership?

Question 9: Do you have comments on the proposal to confirm the government's position by making it explicit in legislation that the restrictions on connected persons benefiting from EBT must apply for the lifetime of the trust?

Question 10: Do you have any comments on the proposal to only allow the IHT exemption where the shares have been held for two years prior to settlement into an EBT?

Question 11: Do you have any comments on the proposal that no more than 25% of employees who are able to receive income payments should be connected to the participator in order for the EBT to benefit from favourable tax treatment?

Question 12: In addition to the reforms proposed at Chapter 7, do you have any views on ways the tax treatment of EBTs could be enhanced?

10. The consultation process

The consultation process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1: Setting out objectives and identifying options.

Stage 2: Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3: Drafting legislation to effect the proposed change.

Stage 4: Implementing and monitoring the change.

Stage 5: Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of specific proposals.

How to respond

A summary of the questions in this consultation is included at Chapter 9.

Responses should be sent by 25 September 2023, by email to asres.consult@hmrc.gov.uk or by post to:

Assets and Residence Team
HM Revenue and Customs
Area 3C/03
100 Parliament Street
London
SW1A 2BQ

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address.

Consultation: Daniel Hama Email to Graeme Nuttall About Growing Employee Ownership in Uganda

Graeme Nuttall OBE

From:	Daniel Hama <hama.m.daniel@gmail.com>
Sent:	01 August 2023 07:06
To:	Graeme Nuttall OBE
Subject:	Re: Introducing Daniel Hama (Steward Ownership) & Graeme Nuttall (Employee Ownership) - Uganda [FFW-DOCS.FID7293508]
Attachments:	image323644.png; image096957.png

Good day Graeme,

Hope all is proceeding well with the organizing of the symposium.

I understand that you must be busy, but just after reading through quite a bit of the documentation that you sent, I am very thrilled and humbled and wanted to follow up as soon as possible with my thoughts -to which you can always respond later when you are less busy.

There are a few of organizations that come to mind that could be approached, but I must say I am not certain about the details of their mandates and how easily and quickly they would be willing to extend them to include EO. But having read what you have accomplished, I am feeling quite positive. The question of the willingness of the organizations to come on board is something that will likely require some inquiry and introduction and perhaps a bit of elaboration to them -some sort of fact finding on our part I guess, about their level of interest.

Please advise (when you can) on how you would like to proceed. I would gladly be your local representative on this side of things if the need should arise as this aligns quite well with my passion and work.

The organizations might include:
1. Uganda Cooperative Alliance (UCA)
https://www.uca.coop/

2. Uganda Workers' Cooperative Union (UWCU) - I seem currently unable to find their contact details.

3. Uganda Chamber of Commerce
https://www.chamberuganda.go.ug/

4. Private Sector Foundation Uganda (PSFU)
https://www.psfuganda.org/

5. Uganda Investment Authority (UIA)
https://www.ugandainvest.go.ug/

6. Sustainable Business for Uganda (SB4U)
https://sb4uplatform.com

7. ActionAid
https://uganda.actionaid.org/

Let's chat pegaps after your symposium.

Kind regards.

Institute for the Future of Work, Good Work Charter

The Good Work Charter

1 **Access**
Everyone should have access to good work

2 **Fair pay**
Everyone should be fairly paid

3 **Fair conditions**
Everyone should work on fair conditions set out on fair terms

4 **Equality**
Everyone should be treated equally and without discrimination

5 **Dignity**
Work should promote dignity

6 **Autonomy**
Work should promote autonomy

7 **Wellbeing**
Work should promote physical and mental wellbeing

8 **Support**
Everyone should have access to institutions and people who can represent their interests

9 **Participation**
Everyone should be able to take part in determining and improving working conditions

10 **Learning**
Everyone should have access to lifelong learning and career guidance

John Lewis Partnership Bonus Rates History 1919 - 2020

John Lewis Partnership Bonus Rates

In the form of **share promises**:

1919/20	15%	1920/21	none	1922/23	none
1923/24	none	1924/25	15%	1925/26	20%
1926/27	20%	1927/28	20%	1928/29	23.3%

In the form of **shares** (@7.5%)

1929/30 15% (distribution only possible by the gift of 15,000 from JSL)

1930/31	15%	1931/32	10%	1932/33	10%
1933/34	10%	1934/35	9% (only to Partners on £400 pa or less)		
1935/36	7%	1936/37	8%		

In the form of shares (@7.5%)

1937/38	6%	1938/46	none

In the form of stocks (@5%)

1946/47	6%	1947/48	6%	1948/53	none
1953/54	4%	1954/55	8%	1955/56	8%
1956/57	9%	1957/8	9%	1958/59	7%
1959/60	13%	1960/61	14%	1961/62	12%
1962/63	11%	1963/64	12%	1964/65	13%

In the form of stocks and cash

1965/66	15%	1966/67	12%	1967/68	18%	1968/69	18%

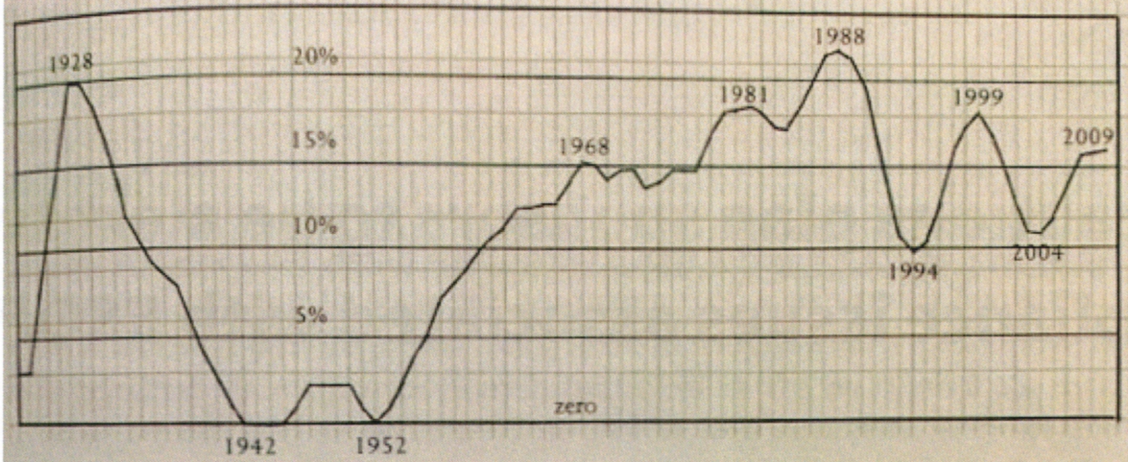
As soon as he felt able, John Spedan Lewis (JSL) put his ideas of profit sharing into operation. In 1920 … he gave the staff at Peter Jones certificates known as Share Promises. These were given out on the understanding that, when he was able, he would replace these Promises with shares in his business. This was not to happen until … 1929. Although the shares and share promises should not be sold on the open market they could be exchanged for cash. However, it was intended that as many as could should hold on to the shares allowing them to both increase in value and retain the money within the business.

In the form of **cash**

1969/70	12%	1970/71	11%	1971/72	15%	2017/18	3%
1972/73	18%	1973/74	15%	1974/75	13%	2019/20	2%
1975/76	13%	1976/77	15%	1977/78	18%		
1978/79	24%	1979/80	20%	1980/81	14%		
1981/82	16%	1982/83	16%	1983/84	21%		
1984/85	19%	1985/86	20%	1986/87	24%		
1987/88	24%	1988/89	22%	1989/90	17%		
1990/91	12%	1991/92	9%	1992/93	8%		
1993/94	10%	1994/95	12%	1995/96	15%		
1996/97	20%	1997/98	22%	1998/99	19%		
1999/00	15%	2000/01	10%	2001/02	9%		
2002/03	10%	2003/04	12%	2004/05	14%		
2005/06	15%	2006/07	18%	2007/08	20%		
2008/09	13%	2009/10	15%	2010/11	18%		
2011/12	14%	2012/13	17%	2013/14	15%		
2014/15	11%	2015/16	10%	2016/17	5%		

It was not until 1965 that the first moves to change from stocks to cash were introduced. The 12% bonus paid out in 1969/70 was the first to be paid fully in cash, a system which continues today.

Judy Faraday, Last updated 08/08/2023
https://jlpmemorystore.org.uk/content/being_a_partner/co-ownership/partnership_bonus/partnership_bonus_rates



The movement in annual bonus percentage for the years from 1919 to 2009. In order to avoid it looking unreadably spiky, for each year it shows the average for the previous five. Note the lean years before and after the war, and the long steady climb from 1953 to 1988.

John Lewis Partnership plc

IRS

IRS cautions plan sponsors to be alert to compliance issues associated with ESOPs

IR-2023-144, Aug. 9, 2023

WASHINGTON — As part of an expanded focus on ensuring high-income taxpayers pay what they owe, the Internal Revenue Service today warned businesses and tax professionals to be alert to a range of compliance issues that can be associated with Employee Stock Ownership Plans (ESOPs).

"The IRS is focusing on this transaction as part of the effort to ensure our tax laws are applied fairly and high-income filers pay the taxes they owe," IRS Commissioner Danny Werfel said. "This means spotting aggressive tax claims as they emerge and warning taxpayers. Businesses and individual taxpayers should seek advice from an independent and trusted tax professional instead of promoters focused on marketing questionable transactions that could lead to bigger trouble."

Werfel noted the IRS is working to ensure high-income filers pay the taxes they owe. Prior to the Inflation Reduction Act, more than a decade of budget cuts prevented IRS from keeping pace with the increasingly complicated set of tools that the wealthiest taxpayers may use to hide their income and evade paying their share.

"The IRS is now taking swift and aggressive action to close this gap," Werfel said. "Part of that includes alerting higher-income taxpayers and businesses to compliance issues and aggressive schemes involving complex or questionable transactions, including those involving ESOPs."

ESOPs are retirement plans that allow employees to own stock in their employer's company. Any company that has stock can sponsor an ESOP for its employees as long as the ESOP invests primarily in the securities of the employer. ESOPs can be complex arrangements since the ESOP can borrow funds from the employer or a third party to purchase shares of the employer.

In light of the complexity of ESOPs, the IRS has and will continue to undertake enforcement strategies to ensure compliance with tax law requirements by employers sponsoring an ESOP. In its current compliance efforts, the IRS has identified numerous issues, such as valuation issues with employee stock; prohibited allocation of shares to disqualified persons; and failure to follow tax law requirements for ESOP loans causing the loan to be a prohibited transaction.

Additionally, the IRS has seen promoted arrangements using ESOPs that are potentially abusive. For instance, the IRS has seen schemes where a business creates a "management" S corporation whose stock is wholly owned by an ESOP for the sole purpose of diverting taxable business income to the ESOP. The S corporation purports to provide loans to the business owners in the amount of the business income to avoid taxation of that income. The IRS disagrees with how taxpayers interpret this transaction and emphasizes that these purported loans should be taxable income to the business owners. These transactions also impact whether the ESOP satisfies several tax law requirements which could result in the management company losing its S corporation status.

Over the next year, the IRS will continue to use a range of compliance tools, including education, outreach and additional examinations to address compliance issues associated with ESOPs.

How to report

The IRS encourages people to report individuals who promote improper and abusive tax schemes as well as tax return preparers who deliberately prepare improper returns.

To report an abusive tax scheme or a tax return preparer, people should mail or fax a completed Form 14242, Report Suspected Abusive Tax Promotions or Preparers PDF, and any supporting materials to the IRS Lead Development Center in the Office of Promoter Investigations.

Mail:

Internal Revenue Service Lead Development Center
Stop MS5040
24000 Avila Road
Laguna Niguel, California 92677-3405
Fax: 877-477-9135

Alternatively, taxpayers and tax practitioners may send the information to the IRS Whistleblower Office for possible monetary reward.

For more information see Abusive Tax Schemes and Abusive Tax Return Preparers.

Page Last Reviewed or Updated: 09-Aug-2023

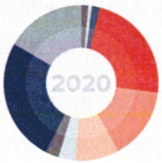
Employee Stock Ownership Plans in the United States

EMPLOYEE OWNERSHIP FOUNDATION

All ESOP Plans with Active Participants Trend

New ESOP Creation Trend

ESOPs by Business Sector

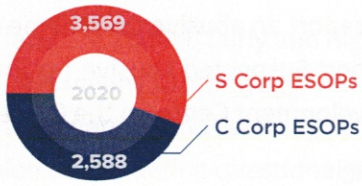


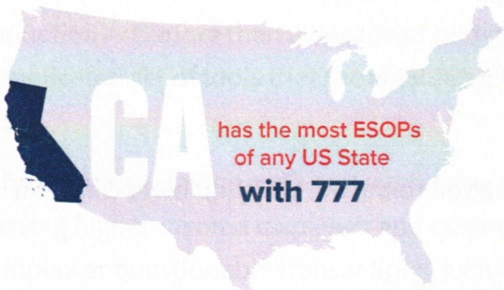
Top 3 By Number of Plans

1. Professional, Scientific, Technical Services
2. Manufacturing
3. Finance, Insurance, Real Estate

All ESOPs Total in 2020

6156 including **10,180,453** participants





has the most ESOPs of any US State **with 777**

Publix Supermarkets is the largets majority employee-owned ESOP, with 140,645 active participants.

LOOK OUT for the **Silver Tsunami**

3.1 million companies (51% of all job-creating businesses in the U.S.) **have owners aged 55 years or older**

Small businesses make up 97% of all firms and provide 46% of all jobs in the U.S.

79% of ESOPs have 250 or fewer participants

$1.8 Trillion Total wealth of ESOP Participants

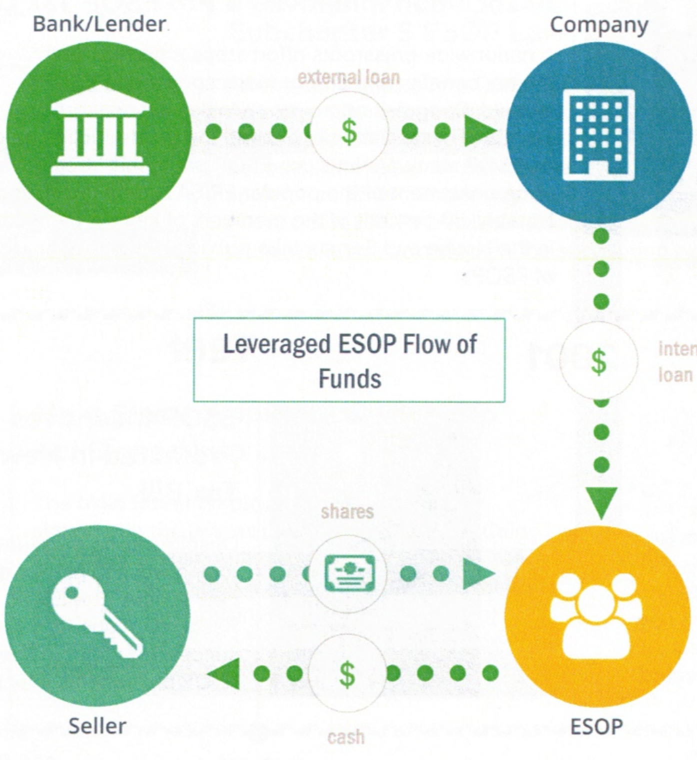
$180,292 Average Wealth per ESOP employee

71% Employees receive profit sharing in addition to their ESOP shares

Data provided by the Institute for the Study of Employee Ownership and Profit Sharing, Rutgers University, 2023, made possible with a grant from the Employee Ownership Foundation.

Financing an ESOP

PRAIRIE



Transaction Process

1. Bank/Lender loans $ to company, creating the external loan
2. Company loans $ to ESOP to fund the purchase, creating the internal loan
3. ESOP uses proceeds to purchase shares from seller
4. Purchased shares are held in "suspense" as collateral for the internal loan

Employee Ownership in America

Where We've Been: Major Legislative Changes to the U.S. ESOP Model Since 1974

Modern ESOPs Are Born

The Employee Retirement Income Security Act (ERISA) passes to address public concern that private pension plan funds were being mismanaged, and officially recognizes employee stock ownership plans (ESOPs). While employee ownership and equity (stock) plans have existed prior to this point, ERISA launches them formally as qualified retirement plans (QRPs) under federal law thereby subjecting them to regulation by the U.S. Department of Labor and the IRS.

1974

Special Tax Benefit Passed

1981 tax law changes include a special level of new tax deductible contributions of 25 percent of pay, plus interest, for leveraged ESOPs.

1981

Association Initiatives & Pro ESOP Tax Law

A nationwide grassroots effort stops a push to limit the tax benefits of S corporations sponsoring ESOPs. Instead, Congress approves an initiative sponsored by The ESOP Association to expand the tax deduction paid on ESOP stock. Various pro-ESOP proposals become law upon enactment of the popular ERISA reform legislation. Notably, 80 percent of the members of key tax committees in the House and Senate take public positions in support of ESOPs.

2001

EGTRRA Provisions Become Permanent

The ESOP Association and other employee benefit groups play a major role in Congress making permanent many Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) provisions that benefit sponsors of defined contribution plans, such as ESOPs.

2006

New Regulations on Fiduciaries

The Department of Labor proposes regulations that would make advisors to ERISA plans—including ESOP appraisers—fiduciaries under ERISA. A grassroots effort on Capitol Hill helps ensure the new regulations would not adversely affect ESOPs and the "fiduciary rule" is rejected.

2013

ESOP Incentives Protected in New Tax Bill

Despite strong pressure to find ways to pay for a new tax cut, The ESOP Association and its partners successfully fight to keep ESOP tax benefits intact.

2017

Landmark ESOP Legislation Signed Into Law

The Consolidated Appropriations Act of 2022 (P.L. 117-328) includes the Worker Opportunity, Readiness and Knowledge (WORK) Act. This bipartisan bill, sponsored by Senators Bernie Sanders (I-VT) and Jerry Moran (R-KS), creates the Employee Ownership Initiative at the U.S. Department of Labor (DOL) to promote employee ownership. The law also directs the DOL to finally provide formal guidance on the vital issue of how to properly value shares of company stock to be bought by an ESOP– a key rule long missing from the ESOP regulatory landscape. Though limited, the law included new tax provisions allowing business owners who found S corporation ESOPs to utilize the section 1042 tax deferral available to C corporation ESOPs.

December 2022

LEARN MORE ABOUT AMERICAN EMPLOYEE OWNERSHIP ADVOCACY AT

esopassociation.org/advocacy

EMPLOYEE OWNERSHIP FOUNDATION

DEFRA Includes Additional Major ESOP Tax Incentives

Several major tax incentives for ESOPs become law in the 1984 tax act, including:

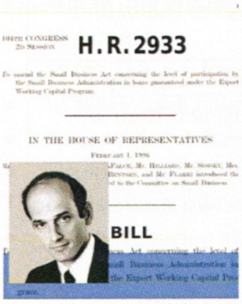
- Deductible dividends paid on ESOP stock.
- Tax-free rollover for gains on stock sold to an ESOP.

1984

The Tax Reform Act of 1986

Building upon the 1984 law, the Tax Reform Act of 1986 strengthens tax incentives for ESOPs. Deductibility of dividends on ESOP stock paid to plan participants <u>AND</u> deductibility of dividends used to pay debt are included in the landmark bill which overhauled the U.S. tax code.

1986



Improvements to Subchapter S ESOP Law

After a concerted effort, Congress and the Administration are persuaded to improve the 1996 Subchapter S ESOP Law, and beginning in 1998 it becomes allowable for Subchapter S Corporations to sponsor an ESOP. Previously, S-corporations could not sponsor ESOPs because qualified retirement plans could not own stock in the sponsoring company.

1997

The Deficit Reduction Bill

When early drafts of the 1989 deficit reduction bill included eliminating the deduction of dividends paid on ESOP stock, The ESOP Association successfully fights to preserve the deductibility of dividends.

1989

Main Street Employee Ownership Act Signed Into Law

The Main Street Employee Ownership Act is signed into the law, as part of the John S. McCain National Defense Authorization Act for Fiscal Year 2019. The law makes it easier for small companies to use the Small Business Administration's 7(a) program to finance a transition to an employee-owned business, such as an ESOP.

2018

Paycheck Protection Program Success

During the COVID pandemic, The ESOP Association works with Congress and the SBA to ensure ESOPs are eligible for Paycheck Protection Plan (PPP) loans under the CARES Act. This critical guidance was issued by the Small Business Administration (SBA) and Treasury Department, and was supported by key ESOP Congressional Champions.

2020

Inflation Reduction Act: Defending and Expanding

As part of President Biden's legislative agenda, the Inflation Reduction Act of 2022 becomes law. Among the policies enacted, a new excise tax is imposed on stock repurchases – with bipartisan support, ESOPs were specifically excluded from this tax, protecting the ESOP structure that relies on stock repurchases and creating a new incentive to form ESOPs. ESOPs become eligible transactions under the State Small Business Credit Initiative (SSBCI) loan program.

August 2022

Carris Reels: Ensuring Employee Ownership Rules Can Apply Internationally

The Oxford Symposium on Employee Ownership '23

Ensuring Employee Ownership Rules Can Apply Internationally

Many employee-owned companies have employees in more than one country. **Dave Fitz-Gerald, Chief Financial Officer, Carris Reels** outlines what can be done to reduce the obstacles to extending employee ownership models beyond a company's home jurisdiction. Carris Reels is:

• Manufacture reels as packaging for wire and cable industry	• "two circles and a barrel"
• Primarily serve North America	• Primarily we make reels out of plywood, nailed lumber, or plastic (raw materials) (40/40/20)
• Headquartered in Vermont	• And we make our own bolts
• Operate from 20 buildings	• And we make our own paper tubes
• We're in 8 US states, 4 CAD provinces, and in Monterey, MX	• We have our own trucking division/(s)
• Employees 560, US 150 US 65 MX (73%,19%,8%)	• Plus, we are "real estate tycoons" to the extent we own our own buildings
• Low tech, low margin, manufacturing business	• Plus, we have a captive insurance subsidiary
• Mature business, mature industry	• So, we are a more diversified business than we give ourselves credit for being

History

- Our company is 72 years old
- We have grown by start up (Indiana, North Carolina, Mexico)
- We have grown by acquisition (Virginia, Connecticut, California, Canada, Texas)
- Our ESOP was founded by 2nd generation ownership in 1995
- Not as an exit plan, but as a plan for a fairer way to own a business
- Uniquely, the selling shareholder gave away half of the company to ESOP before being paid for the other half
- We are 100% employee owned
- As an S-ESOP, taxes are paid by employees from distributions, not at the corporate level

Values

- Our company operates with three core values: safety, ownership, and customer-centric
- In the USA, the ESOP plan owns the ultimate parent company
- One employee/one vote (like co-ops)
- Internal BOD, includes former executives as outside directors and 2 employee owners on the BOD, 1 hourly and 1 salaried (some ESOPs do have this...)
- There is a 401k plan in addition to the ESOP (eggs in one basket)
- We're lower than comparables for diversification, usually about 30% (eggs in one basket)
- There is a profit share plan that pays "dividends" once a year, as a percentage of operating income (mid-term benefit)
- We fund our own charitable foundation, as a percent of operating income, and employee owner committees decide what charities to support (community) (founders' legacy)

Internationally

- In Mexico, we can't extend the U.S. ESOP to our employees
  So we established a phantom ESOP program – we pretend Mexican employees have stock in Carris
  - Founded Carris de Mexico in 1999/2000 to serve US customers in Monterey, MX
  - Began phantom ESOP in 2004, when Mexico began to be profitable
  - It is written to be "extra-legal"
  - There is no "trust" entity
  - It is external to the union, not within their purview
  - Longer vesting requirements 7/8/9 – 35/70/100 (now changing to 6 yr)
  - Rights forfeit if fired (for example stealing from the company)
  - We mirror allocations based on number of shares per $1,000 in the US plan

    - In Mexico, pay averages lower than the same jobs in US [1/5]
    - A 22-year, average pay employee has a $125,000 USD balance in her phantom account
    - Another long-term employee has just been paid out $240,000 USD at retirement
    - As it is, we pay corporate taxes in Mexico
    - If Mexico had an S-ESOP law, would we adopt one?
    - Not enthusiastic about having employee ownership at the subsidiary level
        - "One Carris"
        - Don't want to be haggling intercompany transactions
        - "All in this together" "wherever we are"
- In Canada, we have an annual cash profit sharing program
- We do not plan to bring phantom ownership to employees in Canada while we're still paying out the previous owner (Acquisition 2015)
- The pay imbalance that applies to Mexico goes the other way in Canada (also a problem)
- We don't like having a value that we can't apply consistently across the organization
- If Canada had an S-ESOP law, would we adopt one?

Extending internationally

- In summary:
- In the U.S. we have an ESOP and follow all the rule sthat apply to ESOPs
- In Mexico we have a phantom ESOP
- In Canada, we have for now a cash profit sharing program
- Couldn't we just have a "We are the World" approach to ESOPs *sigh*

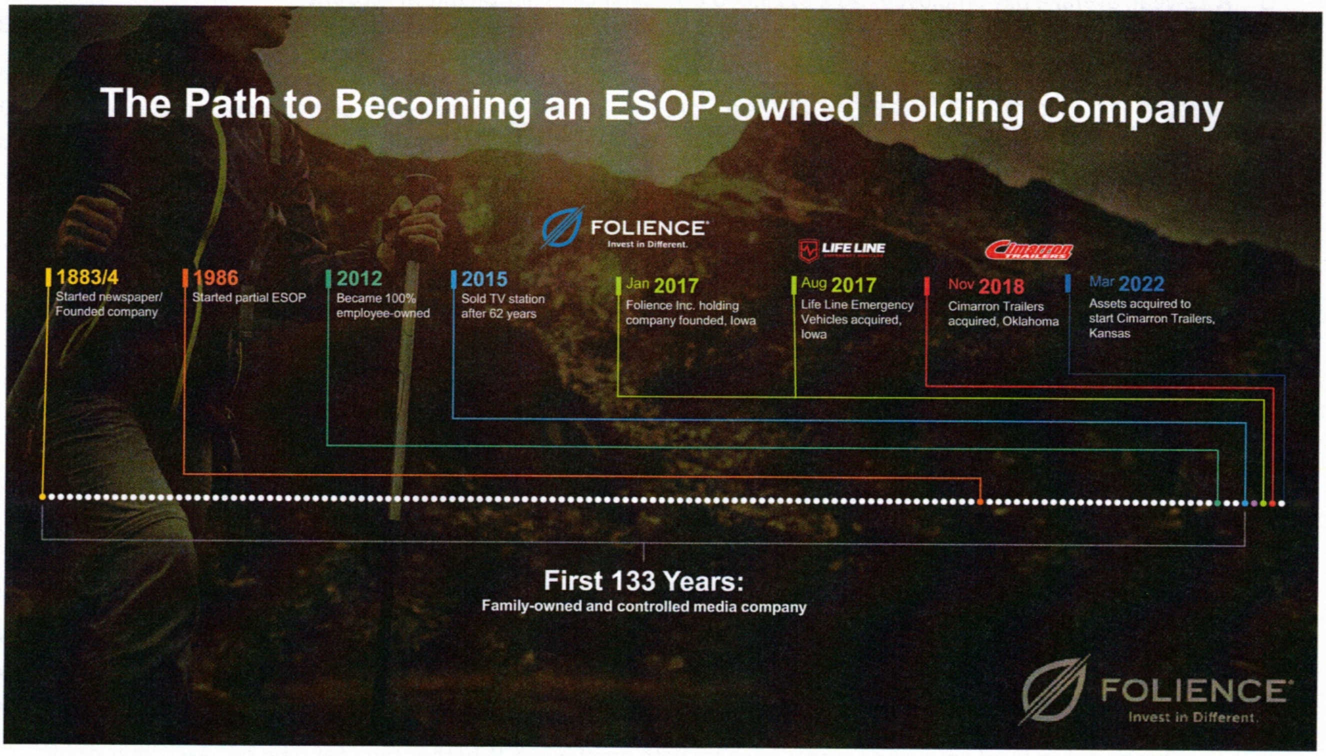
Thoughts about ownership

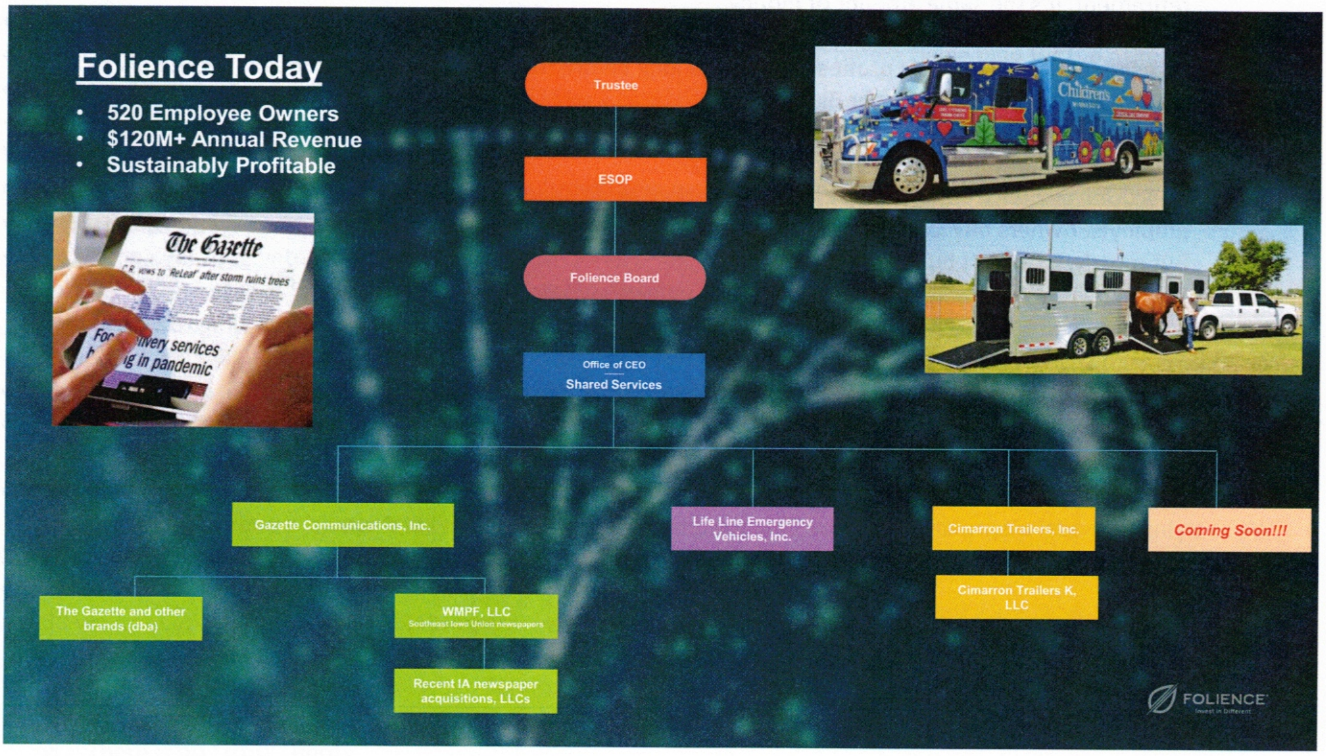
- Is profit sharing akin to ownership?
    - What do owners get? Profits. Future value. Decision-making/power
    - There's only a fixed amount of profits to share with employees. Whether they get paid out each year or on retirement, it's the same amount of money.
    - Professor Blasi's book, The Citizen's Share, published in 2014... makes the case that profit sharing is ownership. Carris has done profit sharing since long before the ESOP, but I never thought about it as ownership until I read Professor Blasi's book
    - IMHO, profit sharing can help with income inequality but not wealth inequality because of how employees behave when they get annual profit shares
    - Anecdotal evidence - after decades of observation, profit share is a spend more program. Sometimes it helps employee owners buy long lived assets, like a new fridge. It helps people pay down their credit card debt. But mostly, it doesn't build long term wealth
- Non-employee owned companies want employees to act like owners
- Sometimes, having an ESOP is like smelling a cake, cooking in the oven, all year long, but then having to wait until your birthday to share it with all of your friends
- Having a profit share is like, you and your friends all dipping their fingers in the batter, but the cake never gets put in the oven, and then, if you're not too grossed out, after you lick your fingers, it's gone
- Of course, we'd like to have a program where "have our cake and eat it too"
- Only, make mine a scone! [Lemon + Blueberry]
- We're trying to model a company where we balance the long term benefits of ESOP with the mid-range benefit of profit sharing, and the short-term benefits of having the culture of ownership... and make it sustainable through the generations
- How do we get to "Forever ESOP?"

Oxford

30 August 2023

Folience: The Path to Becoming an ESOP-Owned Holding Company





Canada's Federal Budget Takes a Step Toward Employee Business Ownership, But They Need to Get It Right

TORONTO STAR

Canada's federal budget takes a step toward employee business ownership, but they need to get it right

Canada's employee ownership proposal, writes Graeme Nuttall and James Bonham, appears to ignore clear evidence of what has worked in the U.S. and U.K. — but there's time to fix it.

By **Graeme Nuttall** Contributors
James Bonham
Sun., April 16, 2023 | 3 min. read

We have witnessed a recent surge in business transitions toward employee ownership in both the United Kingdom and the United States.

Canada is attempting to join this phenomenon with the introduction of Employee Ownership Trusts (EOTs) in the recently released 2023 federal budget. This should be great news as employee ownership can lead to greater household wealth for workers, greater job security, more stable local economies and healthier work environments.

Unfortunately for Canadians, the blueprint outlined in the recent budget lacks key incentives that have underpinned the success of employee ownership in both the U.S. and U.K.

As consultations are soon to begin on the Canadian government's proposed EOT legislation, we'd like to offer some advice. We've been directly involved in policy choices that have led to hundreds of new employee-owned businesses in both our countries and we think there's more Canada can learn from both the challenges and successes we've experienced.

Last September, a group of nearly 50 academics, practitioners and government officials from eight nations, including Canada, gathered at Oxford University to discuss the U.K.'s Employee Ownership Trust model and the ever-evolving American Employee Stock Ownership Plan (ESOP) model.

In the discussions, it became clear that to achieve meaningful growth in employee ownership, there are certain essential policy ingredients.

First, an owner needs to know the option to sell to employees even exists — and it needs to be attractive to them in comparison to a sale to a third party, like a competitor or a private equity firm. In both the U.S. and the U.K., it was the introduction capital-gains tax incentives that was the catalyst for the growth of employee ownership.

The tax benefit legitimizes what for most in the business community is an unknown business model, and forces advisers to mention employee ownership trusts when a client asks about succession options or risk dereliction of their professional duty. The increased capital gains reserve period proposed in the Canadian Budget, while helpful in some circumstances, won't have this effect

A tax incentive also levels the playing field with other possibly more lucrative options involving sales to third parties.

The second essential ingredient for a successful policy is availability of financing. In an EOT, benefits are available to all employees, and they don't pay for the company out of their pockets. That's why they've been so meaningful for low-wage workers in the U.S. and the U.K. This outcome is only possible because EOTs are funded by debt.

Banks in the U.S. regularly finance employee ownership, but additional debt is almost always required from the owner themselves. In the U.K. most sales of businesses to EOTs are financed entirely by the owner. In both countries, selling to an EOT means deferring proceeds over several years.

We've learned that owner-financing comes with the added benefit of continuing their engagement in the business after the sale, ensuring the transition to employee ownership goes smoothly. A capital-gains tax incentive is again important here, as it will compensate business owners for the cost and risk of accepting deferred payment.

Of secondary importance, Canada should consider incentives for banks to enter the market, such as loan guarantees or a reduction in the tax rate on interest paid by EOT-owned companies. The U.S. successfully implemented the latter approach in the early days of the ESOPs existence.

Finally, for a successful EOT policy, there needs to be regulatory clarity and government guidance from transaction through to the post-transaction enterprise. Regulatory clarity and simplicity have been instrumental in the growth of employee ownership in the U.K., but remains the major obstacle to faster employee ownership growth in the U.S

The U.S. Congress is finally intervening and has directed the regulator to issue guidelines — nearly 50 years after the passage of the law creating ESOPs. The EOT structure proposed in Canada's budget appears simple but raises many practical questions about how EOTs are to be implemented. We encourage detailed supporting guidance prior to its in-force date.

Canada has a unique opportunity to learn from the U.K. and the U.S. and create a transformative EOT model.

As it stands, the government's proposal appears to ignore clear evidence of what has worked in our countries. With legislation still months from being introduced, there is time and opportunity to change course and get things right from the outset.

The outcomes for employees and communities are worth the effort.

Ensuring Employee Ownership Rules Can Apply Internationally

1. Summary of Mexico Employees' Participation in Taylor Guitars ESOP (With contributions from ESOP Law Group, LLP) 8-20-2023

Overview:

The Taylor Guitars ESOP generally treats employees working in Mexico as if they were employed by the U.S. parent for most purpose under the ESOP. That means the Mexican employees are eligible to join the ESOP, vest in benefits and ultimately receive benefit distributions in much the same way as its U.S. employees.

Legal Structure:

The specific legal structure has been left out as it is proprietary to the legal firm that designed the approach. Generally, wholly-owned Mexican subsidiaries are treated as an LLC by the US's tax agency (the IRS). As a result, Mexican employees are treated as if they were directly employed by the US parent, including vis-à-vis the ESOP. As long as Mexican employees are full-time at Taylor and tax residents of Mexico, they qualify for the ESOP.

Differences in treatment of Mexican Employees in the ESOP:

The Board of Taylor Guitars can (but doesn't necessarily) set different contribution levels at the different companies, but within each company they need to abide by ESOP rules (i.e. using an equal terms formula).

2. Challenges in Canadian (and other) Employees Qualifying for US ESOPs:

To my understanding, the primary challenge is that the ESOP is a qualified US retirement plan. Each country has their own rules around retirement plans, which means there are significant tax implications for employees of other countries if they were to participate. For example, a Canadian employee would be taxed on their allocation of units in the trust each year, adding complexity and significantly reducing the value of the benefit.

Taylor Guitars, for example, has employees all over the world. Other than in Mexico, none of them are directly part of the ESOP.

Many US-based ESOPs have expressed frustration about their inability to include their Canadian workers. Our current EOT legislation will not improve this situation, and frankly it seems a very difficult problem to solve through regulation. It would certainly be great if we could, as likely tens of thousands of Canadians work for companies owned at least in part by a US-ESOP. However, even if Canada adopted the exact structure as the US-ESOP, differences in tax laws and retirement plan laws would likely create complexity and challenges to overcome.

My understanding is that many US-ESOPs with non-US operations use a phantom share structure to similarly reward non-US employees, but it does not have the same impact (either financially or emotionally) as being a beneficiary of the ESOP.

3. Restrictions on Eligibility for Proposed Canadian EOT

When initially released in conjunction with March's Canadian Federal budget, eligibility for companies to sell to the proposed Canadian EOT was very narrow. The Ministry of Finance proposed a very specific terminology which would have in effect limited usage to companies that operated almost exclusively in Canada, and continued to do so throughout the life of the EOT.

We were thankfully able to get these rules relaxed, and in the latest iteration, the requirement is merely for companies to be Canadian-controlled private corporations. This will prevent foreign-owned companies from selling to a Canadian EOT, which is an odd restriction, but one we'll likely have to live with for the moment.

4. Treatment of Non-Canadian Employees in the Proposed EOT

Unlike the UK-EOT, the proposed Canadian EOT provides no tax benefits to employees. So, there are no advantages that would be provided to Canadian employees versus an employee in another country. In addition, as the Canadian EOT is not a registered retirement plan, it does not present the issues that the US-ESOP does for non US-based employees.

The draft legislation has no restrictions on non-Canadian employees being beneficiaries of the trust or trustees of the trust. We don't expect any issues with a Canadian EOT paying dividends to employees in other countries. However, the Canadian legislation includes an "even hand" rule, requiring an element of equality in distributions. It is unclear how this rule would be applied, but if an employee in a low-income jurisdiction had the same role as an employee in Canada, the rule might require adjustments to distributions if they would otherwise be based on total wages. This is speculation, but this rule, which comes with little guidance, will likely lead to confusion for trustees and their advisors.

If there is a capital distribution (i.e. in the event of a company sale), that might create tax issues for employees in other countries. We don't yet have a firm answer on whether these distributions would qualify as capital gains in Canada, but these kinds of distributions often have tax implications in other countries.

Overall

At SCP we have looked at employee ownership in many jurisdictions, but we are neither legal nor tax experts. We agree it should be a policy goal for employees in each country to be able to benefit equally to employees in the home country of employee-owned companies. However, that goal ranks significantly behind the policy objective of increasing overall employee ownership by increasing the appeal for owners to sell to their employees (through tax incentives, grants, reduced regulations, etc.).

Going forward, we expect innovations like the one used at Taylor Guitars to be the order of the day, relying on employee-owned companies (and their former owners) wanting to solve these problems in a bespoke fashion. Ideally, there will be lots of sharing between companies and countries on the best way to solve these problems.

OECD Pillar 2

What is it, how could it affect ESOPs, and what has been the reaction?

Background

For around a decade, the tax policy, enforcement, and regulatory communities, both domestically and internationally, have discussed addressing corporate base erosion and profit shifting (often cited as BEPS) – often resulting in low, near-zero or single-digit global effective tax rates for income derived from valuable and profitable intangible property. As recent examples, the U.S. Congress passed the Tax Cuts and Jobs Act in 2017 which created the global intangible low-taxed income (GILTI) tax, the Foreign-Derived Intangible Income (FDII) deduction, and the base erosion and antiabuse tax (BEAT) regime to help ensure a global minimum rate of taxation on certain income. As part of this BEPS effort internationally, the Organisation for Economic Co-operation and Development (OECD) continues working to negotiate a global tax framework subject to implementation of its Member nations, culminating in what many call the "Two-Pillar" proposal released in October 2021, which largely sets out some agreed-upon principles and a framework for future action. In additional guidance and model rules from late 2022 on "Pillar 2" efforts focused on a minimum tax, the OECD proposed several additional details on an international tax agreement, with the general target being a 15% global minimum corporate tax that would be enforced through a new income inclusion rule (IIR) and undertaxed payments rule (UTPR). The U.S. Department of the Treasury and the U.S. Ambassador to the OECD are the principal U.S. negotiators on the project. Following release of the 2022 Pillar 2 model rules, OECD member country Finance Ministers began discussing plans to move forward with implementation in several jurisdictions. There is significant debate at the OECD, Treasury, and in corporate America about the extent to which the 2017 U.S. international reforms in TCJA, particularly GILTI and FDII, may comply with the concepts in Pillar 2. In comparison, the proposed "Pillar 1" concept, focused on nexus of activity and taxation, is somewhat further behind the Pillar 2 process. Both Pillar 1 and Pillar 2 represent fluid, long-term situations on the tax policy horizon.

Concerns for ESOPs?

Employee ownership is not unique to the United States -- nations around the world have, or are considering, various forms of employee ownership. In every widely successful policy framework, tax incentives for the business owner to sell to employees combined with unique tax treatment for the employee-owned business exist. However, seemingly unique to the U.S. is the S corporation ESOP. Under an S corporation ESOP, the company would not be expected to pay any federal income taxes as this corporate structure provides for income to be "passed through" to the individual owner(s) and taxed as ordinary income at the individual taxpayer level rather than at the corporate level (a tax treatment with bipartisan support, historically, set up to promote employee ownership). It is conceivable, however, that under the current Pillar 2 guidance certain S corporation ESOPs that meet the criteria (multinational corporations with more than 750 million euros in annual revenue) might be perceived as paying 0% tax. So, an S corporation company conceived under this tax treatment and is currently accounting and tax planning in this manner would suddenly pay a new 15% corporate tax on an international accounting regime (the IIR and UTPR). In contrast, many corporations like C corporations (including ESOPs) have net positive income tax liability and may be less affected by the proposed shift. However, for these companies, there remain general questions about what deductions, credits, and other U.S. tax benefits would be allowable in determining net income and what their effective tax rate is considered to be for purposes of the OECD rules. For those companies affected, this OECD Pillar 2 agreement – if wrongly interpreted and implemented – could be a massive tax increase for S-corp and other ESOPs, leading to several unacceptable choices.

Reaction in Congress

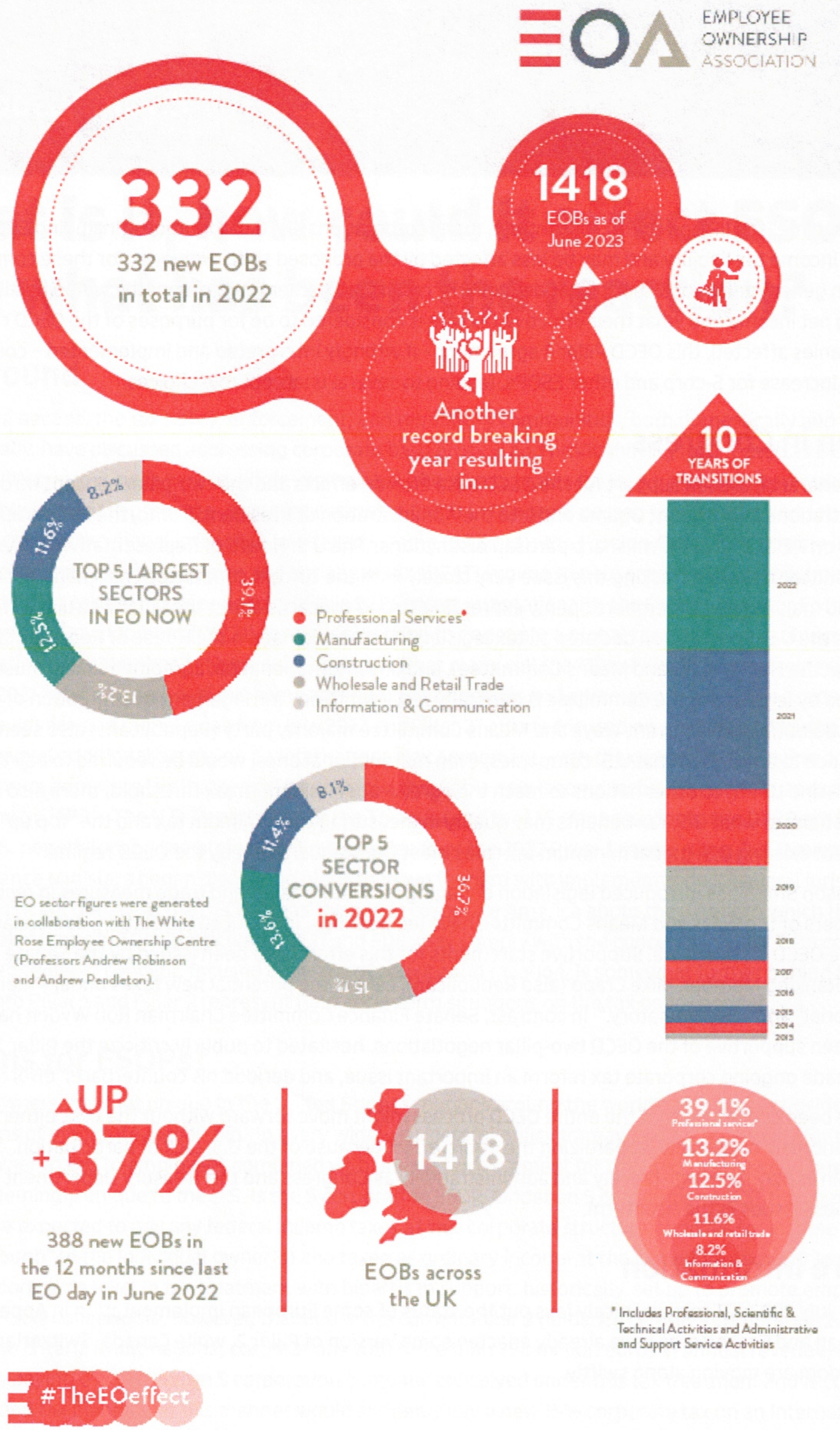
Following general bipartisan support for the OECD base erosion efforts and the two-pillar concept throughout the Administrations of President Obama and into the Administration of President Trump, the 2022 proposed model rules on Pillar 2 have drawn sharp partisan distinctions. The U.S. House of Representatives Ways and Means Committee has been tracking this issue very closely with the current committee chairman, Jason Smith of Missouri, and majority party members openly expressing strong concerns about the Pillar 2 structure for several reasons. As the U.S. Constitution declares all tax legislation must originate in the House of Representatives (and hence in the House Ways and Means Committee), and any international tax agreement likely must be implemented by legislation, the Committee is generally resistant to any infringement or usurpation of its authority. Additionally, the current Ways and Means Committee majority party (Republicans) also seem unified in their resistance to any notion that U.S. companies, even multinational ones, would be required to pay these "top up" taxes (IIR and UTPR) to other nations to reach the agreed-upon minimum tax threshold; there also remain the related questions of what U.S. tax benefits may qualify in measuring the minimum tax and the "top up" taxes, and to what extent existing U.S. global minimum tax rules meet the standards set by the OECD regime.

Chairman Jason Smith has introduced legislation engaging retaliatory taxes and trade measures in response, and other members of the Ways and Means Committee have led hearings, introduced legislation, and spearheaded letters to the OECD on this issue. Supportive statements for this effort have been issued by the Senate Finance Committee Ranking Member, Mike Crapo (also Republican), calling the potential new taxes under Pillar 2 "extraterritorial" and "discriminatory." In contrast, Senate Finance Committee Chairman Ron Wyden has generally been supportive of the OECD two-pillar negotiations, hesitated to publicly criticize the Pillar 2 model rules, has made ongoing corporate tax reform an important issue, and derided his counterparts' effort.

Others have been concerned that the entire OECD process might move forward without the U.S., either leaving the U.S. an anomaly or possibly jeopardizing the entire effort because of the U.S. lack of participation. Several issues remain in play here legislatively and administratively as Congress and the Treasury Department continue to debate these issues in the near term.

For More Information

JCX-35-23, a July 2023 JCT release, nicely lays out the status of some European implementation in Appendix B; notably, Japan and South Korea have already enacted some version of Pillar 2, while Canada, Switzerland, and the United Kingdom are moving along swiftly.


EMPLOYEE OWNERSHIP ASSOCIATION
332
332 new EOBs in total in 2022
1418
EOBs as of June 2023
Another record breaking year resulting in...
10 YEARS OF TRANSITIONS
2022
2021
2020
2019
2018
2017
2016
2015
2014
2013
TOP 5 LARGEST SECTORS IN EO NOW
39.1%
13.2%
12.5%
11.6%
8.2%
Professional Services*
Manufacturing
Construction
Wholesale and Retail Trade
Information & Communication
TOP 5 SECTOR CONVERSIONS in 2022
36.7%
15.1%
13.6%
11.4%
8.1%
EO sector figures were generated in collaboration with The White Rose Employee Ownership Centre (Professors Andrew Robinson and Andrew Pendleton).
UP +37%
388 new EOBs in the 12 months since last EO day in June 2022
1418
EOBs across the UK
39.1%
Professional services*
13.2%
Manufacturing
12.5%
Construction
11.6%
Wholesale and retail trade
8.2%
Information & Communication
* Includes Professional, Scientific & Technical Activities and Administrative and Support Service Activities
#TheEOeffect

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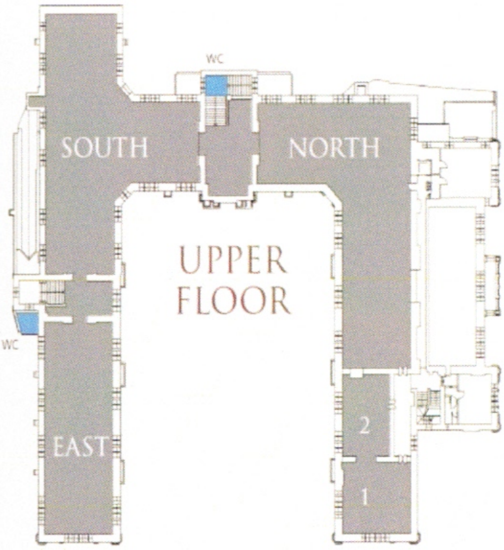

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