



Paul formed WorkPlace Consultants, LLC in 2007 to assist clients with their ESOP and benefits-related issues. He has served as Chair of The ESOP Association's Ownership Culture Committee, and as a member of The ESOP Association Board of Governors, the Employee Ownership Foundation Board of Trustees, and the NCEO Board of Directors. Paul is a frequent author and speaker on ESOPs and other benefits topics.

Paul received a BA degree in mathematics and a minor in business from the State University of New York at Binghamton in 1980, graduated from Boston University School of Law in 1983, and earned a Master of Laws in Taxation from Georgetown University Law School in 1987. Paul is a member of the Massachusetts and California Bars, and also has earned the SPHR certification from the Society for Human Resource Management.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Paul Horn", written in black ink over a horizontal line.

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HOUSING SECURITY:

- *No* ESOP respondents reported being behind on their rent or mortgage, compared to *more than 25 percent* of their non-ESOP peers.

3. 2020 Aspen Institute Report. ESOPs are helping to narrow the wealth inequality gap, according to a Report that draws on multiple studies funded by the Employee Ownership Foundation.

One study compared the wealth of employee owners at a group of ESOP companies to national averages. It found that employee owners earning low- and moderate-incomes had ESOP accounts with a median value of \$165,000—far outpacing the typical median American household, which had only \$17,000 in savings.

Employee owners who were closer to retirement fared even better: Of the low- and moderate-income employee owners surveyed, those ages 60 to 64 had *10 times more wealth* than the typical American in the same age group.

4. ESCA Survey. A 2018 survey of S corporation ESOPs conducted by the NCEO with support from the Employee-Owned S Corporations of America (ESCA) found that ESOP participants have more than twice the average total retirement balance of Americans nationally, and that those making less than \$26,000 a year also have on average more than double the retirement savings compared to similar workers nationally.

C. Paul Horn Biography

Paul has been actively involved in the employee benefits field since beginning his career as an attorney with the IRS Office of Chief Counsel in 1983. He litigated retirement plan cases before the Tax Court, worked on tax rulings, and coordinated IRS positions with other government agencies such as the DOL, PBGC, DOJ, and EEOC.

Paul then worked at major law firms in San Francisco and Washington, D.C. He returned to government service as FDIC Benefits Counsel, serving as the national coordinator for all employee benefits and tax matters involving FDIC bank receiverships.

Following completion of his FDIC appointment, Paul joined American Systems, where he had responsibility for all benefit and compensation programs. He played an integral role in the organization's transition to one of the country's largest 100% S Corp. ESOP companies in 1997. Paul served as President of The ESOP Association's Mid-Atlantic Chapter for six years, was named ESOP Chapter Officer of the Year in 2003, and helped the Chapter win the ESOP Association Chapter of the Year Award.

- Improving company performance – Studies like the ones below show that ESOP companies out-perform comparable companies, while exhibiting more resilience during economic downturns.

1. Rutgers/SSRS Study. During the pandemic, ESOP companies are dramatically outperforming other firms in such key areas as securing employees' jobs, and maintaining work hours, salary, and workplace health and safety. (Study conducted by Rutgers University and SSRS, funded by the Employee Ownership Foundation.) Key study findings show that, compared to other businesses, ESOP firms were:

- 3-4 times more likely to retain non-manager and manager employees.
- 3.2 times more likely to retain staff—*even when other businesses received funding through the Paycheck Protection Program and the employee owned firms did not.*
- Significantly less likely to reduce employees' hours or pay.
- More likely to send employees home to work during the pandemic—and did so earlier.
- More likely to provide employees with personal protective equipment, such as gloves and masks.

From an economic perspective, the study found ESOP companies “kept considerably more money in employees' hands—and in the economy” than other firms.

2. John Zogby Strategies. Zogby surveyed a sample of mid- and lower-level employees at employee-owned private companies and a sample of other non-ESOP employees and “found a world of difference between the two groups” in key measures during the pandemic, including:

JOB RETENTION:

- Non-ESOP employees reported experiencing job losses or downsizing at *six times the rate* of their peers at employee-owned companies.

FINANCIAL SECURITY:

- Non-ESOP workers have been adversely affected by the pandemic economy at *more than three times the rate* of employees at ESOP companies.
- *Twice as many* non-ESOP respondents as ESOP respondents are concerned about their ability to pay down debt.
- *Three times as many* ESOP employees say they are able to cover an emergency \$500 expense, compared with their non-ESOP counterparts.
- *Twice as many* ESOP workers expect to retire by the age of 60 compared with workers at non-ESOP companies.

Recent National Center for Employee Ownership (NCEO) data chart shows 114 ESOPs in Maryland covering 25,866 participants.

Many “baby boomers” who own private Maryland businesses will be retiring in the near future -- the so-called grey tsunami. If they sell the business to a third party, the buyer may consolidate corporate staff via layoffs, move the headquarters out of state, and/or close certain operations. In contrast, these issues can be avoided if the owner sells to an ESOP and current management continues to run the company. This can benefit all parties – the seller, the employees, the community, and Maryland and local governments.

The seller may be subject to significant capital gains tax on the sale of shares to a third party buyer. SB 561 would encourage the sale of shares to an ESOP because this capital gains tax would no longer apply.¹

Importantly, tax is not “avoided” but can be viewed as being deferred. Why? Eventually, employees will receive distributions from the ESOP which will be taxable or, if rolled over to an IRA, ultimately taxable when distributed therefrom. Moreover, the ongoing ESOP-owned business will continue to pay employment and other taxes, and its employees will of course continue to pay their applicable taxes on their paychecks.

By enacting SB 561, Maryland will keep pace with other states that have already enacted, or are considering enactment, similar rules to promote ESOPs.²

B. Recent Research Documents ESOP Success

The key benefits of ESOPs are noted below and followed by some recent supportive studies.

- Preserving jobs and community impacts – ESOP companies keep jobs in the communities where they are rather than moving or losing them.
- Helping companies attract and retain good employees – ESOP companies have engaged cultures and higher retention rates.
- Improving wages and benefits – ESOP companies tend to have higher wages and better benefits.
- Enabling employees to build wealth over time – ESOP companies give employees a meaningful equity stake in the future growth and success of the business.

¹ Section 1042 of the Internal Revenue Code provides an exemption from federal tax on the sale to an ESOP, but only if numerous requirements are met. These requirements can be quite restrictive and, consequently, limit the widespread utility of this provision.

² These efforts include legislation and/or regulations (a) in the form of subsidized or guaranteed loans, tax credits, or other incentives for implementing an ESOP, and (b) tax credits and contractual set asides like those now existing for minority owned and similarly disadvantaged companies.



February 15, 2022

To: Chair Guzzone and the Members of the Budget and Taxation Committee

From: Paul Horn, President, WorkPlace Consultants, LLC

Re: Support for SB 561 / Hearing Date February 16, 2022

I am pleased to provide the following written, personal testimony **in strong support** of SB 561 which would eliminate Maryland tax on the sale of shares to an Employee Stock Ownership Plan (“ESOP”). This provision would encourage more Maryland business owners to create ESOPs which would be positive for their employees, the business owner, the community, and the government. This is because employee-owners at an ESOP company work with each other, not for someone else.

This testimony has three parts:

- A. ESOP Background
- B. Research Supporting ESOPs
- C. Paul Horn Biography & Contact Information

A. ESOP Background

An Employee Stock Ownership Plan (ESOP) is a tax-qualified retirement plan with an accompanying trust which buys shares from the company’s owners via loaned funds and/or cash contributed by the company.

Shares held in the ESOP trust are allocated on annual basis as the loan is repaid to individual employee accounts with the shares typically allocated on the basis of relative pay. Unlike a 401(k) matching contribution which is predicated on employee contributions, employees only need to contribute their time and effort to receive annual ESOP share allocations. As in any retirement plan, employees vest in their account based on years of service. When employees leave the company, they receive the value of their shares which are paid for by the company. ESOP companies must have an annual independent valuation to determine the price of their shares.

Based on recent IRS Form 5500 filings, there are over 6,500 ESOPs holding total assets of over \$1.4 trillion and covering over 14 million participants. ESOPs are the most common and successful form of employee ownership in America.