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# Employee Stock Ownership Plan Answer Book

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*Second Edition*

*2009 Cumulative Supplement*

Idelle A. Howitt  
Corey Rosen

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Wolters Kluwer  
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# **Employee Stock Ownership Plan**

## **Answer Book**

**Second Edition**

*By Idelle A. Howitt & Corey Rosen*

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*Employee Stock Ownership Plan Answer Book* provides a comprehensive overview of employee stock ownership plans (ESOPs), a potent force for increasing the involvement of employees in the expansion of the United States capital base since the passage of the Employee Retirement Income Security Act of 1974 (ERISA). It is intended as a guide for business owners, plan administrators, attorneys, investment bankers, accountants, and others who advise employer plans or have a role in administering ESOPs.

### **Highlights of the 2009 Cumulative Supplement**

The 2009 Cumulative Supplement to the Second Edition contains two completely revised chapters—Chapter 5 and Chapter 21. In addition, this supplement brings the reader up-to-date on legislative and regulatory developments in the past year that affect ESOPs and addresses related issues, including:

- What is the effect of the U.S. Supreme Court's decision in *LaRue* on ESOPs?
- What is the major reason that ESOPs are terminated?
- Does the Tribune Company deal by Sam Zell signal a return to multi-investor ESOPs?
- Do fiduciaries have a duty to monitor the CEO's compensation?
- What factors should an ESOP trustee consider when evaluating a proposed acquisition?
- What are the new DOL reporting changes on Form 5500?

**8/08**

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*To the memory of my father, Julius H. Howitt,  
the first business owner I ever met, who  
taught me the value of business.*

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# Preface

Employee stock ownership plans, commonly known as ESOPs, were created in 1974 when Congress passed the Employee Retirement Income Security Act (ERISA), legislation introduced by Senator Russell Long, the Louisiana populist. Long's legislation was inspired by Louis O. Kelso, an attorney and economist, and Patricia Hetter Kelso, an author, who believed that ESOPs would be "a device for expanding the national capital base among employees." Since then, more than 11,000 ESOPs have been established, covering 10 million employees throughout the United States and reaching a diverse range of businesses from small machine shops to America's largest corporations.

The Economic Growth and Tax Relief Reconciliation Act of 2001 made sweeping changes to defined contribution plans, including ESOPs, by raising contribution limits, making plans more flexible, and tightening rules for S corporation ESOPs to avoid abuses. New court rulings and government rulings have also added to our understanding of ESOPs, especially in the developing field of ESOPs in S corporations. The Enron scandal has brought new attention to the concept of employee ownership, be it ESOPs or other forms of employee ownership.

*Employee Stock Ownership Plan Answer Book* is designed for professionals who need quick and authoritative answers on whether to institute or continue an ESOP, the advantages and disadvantages of an ESOP, how to set up and administer an ESOP, and how to comply with the morass of federal requirements. This book uses simple, straightforward language and avoids technical jargon where possible. Citations of authority are provided as research aids for those who wish to pursue particular items in greater detail.

**Format.** The question-and-answer format breaks down complex subject areas into concise units and facilitates quick access to information. Each chapter contains introductory text that provides an overview of the subject that is covered in detail in the questions and answers. Cross-referencing facilitates locating information presented in other chapters.

**Numbering System.** The questions are numbered consecutively within each chapter (e.g., Q 1:1, Q 1:2, Q 1:3). In annual supplements, new questions may be inserted between existing questions of the main volume. For example, a new

question inserted between Q 1:8 and Q 1:9 would be designated Q 1:8.1. When a question in the main volume is revised, it is reproduced in the supplement.

**List of Questions.** The List of Questions helps the reader to quickly locate topics of interest. It provides both the question number and the page on which the question appears.

**Examples.** The text contains examples that illustrate specific points.

**Index.** A detailed topical index is provided at the end of the volume. All references in the index are to question numbers rather than page numbers.

**Acronyms and Abbreviations.** Because of the breadth of the subject area, a number of terms, statutory references, and names of organizations are abbreviated throughout *Employee Ownership Plan Answer Book*. The most common of these shorthand references are:

Code; I.R.C.—The Internal Revenue Code of 1986, as amended (Section references, unless otherwise qualified, refer to the I.R.C.)

DOL— Department of Labor

EGTRRA—Economic Growth and Tax Relief Reconciliation Act of 2001

ERISA—The Employee Retirement Income Security Act of 1974, as amended

FASB—Financial Accounting Standards Board

IASB—International Accounting Standards Board

IRS—The Internal Revenue Service

NCEO—National Center for Employee Ownership

NLRA—National Labor Relations Act of 1935

NLRB—National Labor Relations Board

PPA 2006—Pension Protection Act of 2006

SBJPA—Small Business Job Protection Act of 1996

SA '33—The Securities Act of 1933

SEA '34—The Securities Exchange Act of 1934

SOX—Sarbanes-Oxley Act of 2002

While the information in this book is current as it goes to press, readers should keep in mind that the legal climate involving employee benefits and federal taxation is dynamic and evolving. In addition, *Employee Stock Ownership Plan Answer Book* is a general reference tool and not a substitute for professional advice on the legal and financial aspects of ESOPs.

## Preface

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Because *Employee Stock Ownership Plan Answer Book* draws, in large part, on conversations with professionals involved with ESOPs, readers are encouraged to submit questions to us for inclusion in future editions. In this way, the book will keep abreast of the changing issues and concerns associated with ESOPs and prove to be the most complete and timely information resource on the subject.

Idelle A. Howitt  
Corey Rosen  
June 2008

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## About the Authors

**Idelle A. Howitt** is the founder and managing director of Howitt & Associates, a strategic consulting firm in Manhattan that specializes in the financial valuation of business and securities for legal and tax matters. She has provided expert testimony before the U.S. Senate Finance Committee, the U.S. Department of Labor, and the Internal Revenue Service on pending federal regulations for ESOPs and other estate planning and business valuation matters. For the past two decades, Ms. Howitt has been the editor of the *Federal Tax Valuation Digest*, the only annual legal compendium of primarily United States Tax Court cases regarding the valuation of closely held securities. She also has been published in numerous other business and trade journals, including *Valuation Strategies*, where she is a member of the editorial advisory board.

Previously, Ms. Howitt worked for an international valuation consulting firm, a global money center bank, and a Fortune 500 company. In those positions, she had P&L responsibility for an operating division, directed national sales and marketing efforts, and was responsible for public affairs, legal, and legislative matters, respectively. Ms. Howitt began her career in Washington, D.C., as an attorney for the Federal Reserve Board and the U.S. Commission on Civil Rights.

Ms. Howitt is the founder of Women on Board and is a member of numerous organizations dedicated to the advancement of women in business and the law. She holds a Masters in Business Administration in finance from New York University, a Juris Doctor from Temple University, and a Bachelor of Arts in history from Boston University. She has chaired arbitration panels for the National Association of Securities Dealers (NASD), and is a formally trained mediator, specializing in business and financial matters.

**Corey Rosen** has been the executive director and co-founder of the National Center for Employee Ownership in Oakland, California, since 1980. The NCEO is the largest employee ownership organization in the world with approximately 2,500 members. *Inc.* magazine (August 2000) called the NCEO "the single best source of information on employee ownership anywhere in the world." The NCEO has performed several major research projects, has published dozens of books and studies, edits and publishes the only legal journal in the field, operates the most extensive and visited Web site on employee ownership

([www.nceo.org](http://www.nceo.org)), and holds over 45 conferences and seminars annually. The NCEO is funded entirely by the work it does, rather than by grants or contributions. Dr. Rosen has spoken on the subject of employee ownership all over the world with government, business, and union leaders and is regularly quoted in leading magazines and newspapers as well as the professional press. He has appeared on a number of national television and radio programs, including the *Newshour* on PBS, CNN's *Newstand*, *All Things Considered* on NPR, and BBC World Radio.

In addition to his work on *Employee Stock Ownership Plan Answer Book*, Dr. Rosen has co-authored numerous books on employee ownership, including *Equity: Why Employee Ownership Is Good for Business* (Harvard Business School Press, 2005) as well as over 100 articles for various business, academic, and professional publications. Dr. Rosen received a Ph.D. in political science from Cornell University in 1973. He taught Politics at Ripon College from 1973 to 1975 and was a legislative assistant in the United States Senate from 1975 through 1980.

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The *Employee Stock Ownership Plan Answer Book* would not exist in its current form without Corey Rosen, and it is to him I would like to express my very sincere appreciation. This edition was composed primarily from two sources: articles written by various ESOP professionals for the NCEO, and the NCEO Q&A Disk, which was written by Corey. With Corey's generous permission, I was able to use these materials extensively. Further, he was gracious enough to take the time to review the manuscript as technical editor and to serve as co-author. I was primarily the book's compiler and editor.

In addition, I would like to thank Bob Smiley and Dennis Long, who began creating the *Employee Stock Ownership Plan Answer Book* in the late 1990s. Among other contributions, they were instrumental in selecting many of the ESOP professionals who drafted all, or significant parts of, the chapters in the First Edition. That work is the foundation for the Second Edition, and their contribution is gratefully acknowledged. Those individuals include: David Ackerman, Gregory Brown, Steven D. Huff, David R. Johnson, Kenneth Marshall, Rebecca Miller, Helen H. Morrison, Deborah Groban Olson, Peter J. Prodoehl, and Kevin B. Reilly. Other participants included Kim S. Abello, Bruce L. Ashton, David M. Binns, Kim M. Blaugher, Ben A. Buettell, William H. Campbell, Michael Coffey, John E. Curtis, Jr., Robert J. Dema, Jeffrey Farrel, Ronald J. Gilbert, Lawrence A. Goldberg, Bruce Grussing, Duncan Harwood, Bradley E. Henschen, Charles C. Hinners, Mary Sullivan Josephs, Jared Kaplan, David Kelly, John A. Kober, Bruce Krenzel, Ronald L. Ludwig, Anthony I. Mathews, William W. Merten, James R. Raborn, Timothy J. Regnitz, Robert Sapolsky, Gary Schokmiller, Charles R. Smith, Charles H. Stryker, and Peter A. Wuebel.

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Idelle A. Howitt  
June 2008

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