The ESOP Association

Core Guiding Principles of What Is an Employee Stock Ownership Plan (ESOP)

Introduction:

ESOPs are experiencing increased attention in the U.S. and worldwide from policy makers as well as private interest groups. Several factors contribute to this renewed attention: business succession opportunities driven by the silver tsunami of retiring baby boomers; an increase in the desire for meaningful worker involvement and voice; the rise of artificial intelligence and automation creating potential workforce displacement; and, overall recognition of the potential for ESOPs to address wealth and income inequality, among other reasons. This surge in interest brings with it a wave of ideas and policy proposals intended to change or alter existing laws related to Employee Stock Ownership Plans (ESOPs).

Since 1978, The ESOP Association (TEA) has uniquely served as the only public policy voice for all ESOPs (C-Corporation, S-Corporation, and B-Corporation) and has led, guided, and supported efforts to promote and protect ESOPs throughout their history in America. In this capacity, The ESOP Association has been called upon to draft policy proposals; evaluate proposals made by others; engage constructively with regulatory and government activities; and, at times, defend the very existence of ESOPs when cases of abuse have come to light in high profile ways. The ESOP Association has needed to defend the tax structure and benefits afforded to ESOPs; and protect the core requirements and structural elements of ESOP plans under the Employee Retirement Income Security Act of 1974 (ERISA).

Beyond ESOPs, the broader employee ownership universe includes many other models such as cooperatives, employee ownership trusts, and various equity compensation and profit-sharing plans. Some have been recognized by Congress as worthy of receiving certain tax or other incentives and inducements, others have not. These public benefits flow based upon a recognized, and proven, benefit back to society. **In the case of ESOPs, the various tax benefits flow entirely because of the retirement plan structure embedded in the ESOP model.** Congress has bestowed these benefits in recognition that ESOP plan beneficiaries will have more retirement security and financial resources and thereby be less reliant on other public resources in old age. **The entire reason ESOPs have any special tax treatment is because they are constructed as a *qualified* retirement plan.**

Each different model brings its own unique structural and legal requirements, as well as potential public benefits. **The term Employee Ownership itself is generic, rather than specific, and is used to capture a wide range of possibilities.** Globally, Employee Ownership may also look different among nations, each adopting and adapting different types of employee ownership to its unique culture, legal system, tax system, and economy. Within this diverse landscape, **the ESOP remains a distinct, well-defined, and precise structure within federal law, embodying certain specific, core characteristics that have proven highly effective.**

The ESOP Association takes positions on matters affecting ESOPs, their legal definitions, and the laws and regulations that affect them. The ESOP Association, while appreciative toward other forms of Employee Ownership, is an organization comprised of ESOP companies and therefore generally does not take positions or expend resources on policy matters outside of ESOPs, unless they have an impact on ESOPs.

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In the U.S., **ESOPs are defined by both the Employee Retirement Income Security Act (ERISA, section 407(d)(6), codified at 29 U.S.C. section 1107(d)(6)) and the Internal Revenue Code.** ESOPs provide dramatically increased retirement security at no cost to employees, enhance conditions for workers, boost company productivity, and offer communities greater economic stability and resilience. For these compelling reasons that have been driven by the core requirements of ESOP plans embedded in ERISA, Congress has aligned public policy, including tax benefits, to support and promote the proven ESOP model.

Policy proposals are routinely shared with TEA that other groups or individuals believe could be submitted to Congress and other policymakers to advance employee ownership in various forms, including ESOPs. To thoughtfully formulate, assess, and evaluate these proposals, TEA has articulated the core structural principles of what qualifies an employee ownership plan as an ESOP. Maintaining and building upon these principles provides the framework and guiding criteria for TEA's advocacy efforts.

These core principles guide TEA leaders and professional staff in the evaluation of any proposal to change, alter, or redefine any aspect of existing law related to Employee Stock Ownership Plans.

Core Principles of an ESOP Plan:

1. **Employee Owner Fiduciary Protection** – As a qualified retirement plan under ERISA, ESOPs must have the important safeguard of an ERISA fiduciary, responsible solely for protecting the beneficial interests of ESOP plan participants. This Trustee/fiduciary is a valuable part of balanced corporate governance, entrusted with prudent decision-making about plan assets and benefits, including determining the fair market value of the company's stock based upon the analysis of an independent and qualified valuation advisor. The existence of an ERISA fiduciary with an exclusive duty of loyalty to the employee owners—committed to their interests rather than those of sellers, investors, or executives—with meaningful power and voice in the company's governance structure, is an essential and empowering structural element of an ESOP.

2. **Broad Based and Non-Discriminatory** – ESOPs must benefit workers throughout an organization who meet pre-defined minimum participation standards (known as "minimum coverage" standards) and ensure equitable treatment by not favoring highly-compensated employees. Plan sponsors maintain accountability to the appropriate government regulator for compliance with minimum coverage standards and nondiscrimination rules, ensuring that ownership benefits reach all eligible employees.

3. **Mandated Transparency** – ESOPs must conduct annual, independent valuations and disclose to employee owners the specific current dollar amount of their vested interest in the company. Further, ESOPs must be governed by a written document workers can access and review to understand their enforceable ownership rights in the plan. Many ESOP companies enthusiastically extend this principle by sharing detailed corporate and financial information beyond an annual valuation. The core ESOP commitment to transparency—regarding the current and ongoing value of the company, how that value was determined, and the value of each individual's vested interest—is a foundational strength of the ESOP model.

4. **Irrevocable and Enforceable Ownership Rights** – ESOPs create individual accounts with an irrevocable ownership interest that grants beneficiaries certain rights enforceable by law. These rights remain intact regardless of the reason for separation from the company, whether retirement, voluntary resignation, involuntary separation or reassignment, or even death, where the ownership interest passes to a surviving beneficiary. The beneficial ownership of equity in ESOP companies is genuine and enduring, not dependent upon unknown, undisclosed, or shifting external qualifiers, hurdles, or performance metrics.

5. **Intentional Constraints on Distributions** – ESOPs are designed as retirement plans and receive tax-preferred status that enables compounding growth based on this quality. While certain limited exceptions may exist, ESOP accounts promote compounding retirement savings, not simply easily accessible wealth for workers or bonus compensation designed to achieve corporate goals. This structure (which exists because the company, not employees, contributed) rewards workers and society over time through the power of

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compounding. Additionally, the legal obligation to repurchase stock is reliable and structured—not based on unenforceable promises, profitability hurdles, corporate incentive goals, or non-independent valuations—providing security for both the company and the employee owner.

6. **Long-Term Orientation** – As a qualified retirement plan, ESOPs are thoughtfully designed with a Long-Term Orientation (LTO), fostering business continuity that extends well beyond the initial founding transaction. Most ESOPs form as part of a business succession transition, meaning the company, the jobs, and the wealth they produce all remain dedicated to the goal of sustainable, long-term ownership. This approach aligns with the public policy interest of building retirement security through the compounding value of an ownership interest in a thriving business.

Conclusion:

TEA will use these core principles to evaluate any proposal(s) that seek(s) to modify, amend, or alter the current definition and core principles of ESOPs. Proposals that do not align with and strengthen these essential principles will be viewed as seeking to redefine and weaken the core elements of the current, successful ESOP model. Because of the interests of the existing membership of ESOP companies, this conclusion will merit the engagement of The ESOP Association to amend, improve, or directly oppose such policy proposals in the interest of its membership.