



Testimony of

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HOUSE COMMITTEE ON SMALL BUSINESS

HEARING ON

**“S IS FOR SAVINGS:
PRO-GROWTH BENEFITS OF EMPLOYEE-OWNED S CORPORATIONS”**

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Good morning Chairman Chabot, Ranking Member Velazquez, and distinguished members of the Committee. My name is Stephanie Silverman and I am the President and Executive Director of the Employee-owned S Corporations of America (ESCA). Thank you for the opportunity to testify today about the success of S corporations that are owned by their employees – so-called “S corporation ESOPs” - and on bipartisan legislation that would expand employee ownership and in doing so generate significant new economic benefits to workers, companies and communities around the country.

ESCA represents S corporation ESOP companies operating in every state, in industries ranging from heavy manufacturing to construction to grocery stores to school photography. There are almost 3,000 S ESOPs in the U.S. accounting for \$92 billion in direct economic output. The top four industries by employment are manufacturing (94,000), professional services (80,000), retail trade (73,000) and construction(48,000).

It was twenty years ago that, thanks to the efforts that began with discussions in this committee, Congress ultimately passed legislation creating S corporation ESOPs. Congress’ goal in 1996 was to encourage employee ownership of private industry, enable workers to benefit from their labor, and create a path for building meaningful retirement savings. Data shows that today, S ESOPs are doing exactly that. I’m here to report that Congress did something very right. Twenty years later, private employee-owned companies have been a remarkable success story, a bright spot in an economy characterized by sluggish growth, anemic job creation, and worker insecurity.

Many studies, including those by renowned economists from across the ideological spectrum, tell the story about how S ESOPs are powerful for workers as a retirement savings and economic security tool, and how they have contributed substantially to communities and the broader national economy. I will just touch on a few key points from the most recent studies:

- Earlier this year, economist Jared Bernstein, formerly Vice President Biden’s chief economist, released a study that shows that ESOPs reduce wage and wealth inequality. Moreover, Bernstein found, ESOP companies pay their

workers better wages and provide them with more stable employment than other businesses. With Congress searching for solutions to improve savings rates as well as job prospects and wages for American workers, ESOPs tell us that we can achieve this goal by increasing capital ownership among our workers.

- At a time when almost half of working Americans do not have *any* retirement plan at work, ESOPs also provide unparalleled retirement savings opportunities for many workers. Employee-owners are able to amass more retirement savings if they are in an ESOP. Indeed, EY's Quantitative Economics and Statistics practice found that, from 2002-2012, S ESOPs outperformed the S&P 500 in terms of total return by participant by 62%, net assets increased over 300%, and distributions to participants totaled nearly \$30 billion.
- The additional savings benefit to employees also does not come with additional risk to them: S ESOP companies are a safe investment for their employee owners as private, employee-owned businesses are proven to be more stable than their counterparts. In June 2014, the National Center for Employee Ownership released data showing that the default rate on bank loans to ESOP companies during the period 2009-2013 was, on average, an unusually low 0.2 percent annually. This compares to mid-market companies defaulting on loans at an annual rate of 2 to 3.75 percent.
- Finally, it's worth noting that in ESCA, nearly 80 percent of our companies offer not just ESOP-based savings, but at least one other defined benefit or defined contribution plan.

About eight years ago, as Members of Congress began to hear from companies and workers in their districts the tremendous benefits of employee-owned companies, they began asking, "What can Congress do to encourage more ESOPs, and with them more savings, job security and wage equality?"

The answer to that question prompted what is currently H.R. 2096, the Promotion and Expansion of Private Employee Ownership Act. First introduced by

Congressman Ron Kind in the 111th Congress, the bill has been introduced in the next three Congresses, and led by Congressman Dave Reichert and Kind. Last April, Congressman Reichert and Kind were joined by six additional members of the House Ways and Means Committee as original cosponsors of HR 2096 -- Reps. Tiberi, Neal, Boustany, Blumenauer, Paulsen and Pascrell. Today, that measure has 67 cosponsors, including 21 members of the Ways and Means Committee. In the Senate, the counterpart measure – S. 1212 – has 28 cosponsors, including 8 members of the tax-writing Senate Finance Committee.

In short, it would:

- Provide incentives to owners of existing S corporations to sell their stock to an ESOP. Today, such incentives exist only for owners of C corporations: Section 1042 of the Tax Code allows a C corporation owner to defer the recognition of gains when the owner sells shares to an ESOP when the proceeds are reinvested into other securities. Extending parity to S corporation owners is the most significant legislative action that Congress could take to encourage more of the millions of S corporation owners to choose an ESOP when they consider how to transition their business from their current ownership.
- Encourage banks to lend to S ESOPs for the purpose of creating more ESOP ownership of a company. Under this proposal, banks could deduct 50% of interest income received on certain loans made to an ESOP. This incentive is vital because employees often lack the funds to buy the company directly, and not all banks understand the ESOP structure, which may cause them to limit their lending to these vibrant businesses.
- Provide assistance to would-be S ESOP companies by providing for an S Corporation Employee Ownership Assistance office at the Department of Treasury that can aide business owners who may be interested in forming an S corporation ESOP and, finally,
- Permit an SBA-certified small business to remain eligible for SBA programs after becoming majority-owned by an ESOP as long as employee demographics remain the same.

Quite simply, more S ESOPs means more worker savings, wealth and wage equality, job stability and national economic benefit. That is why we hope this Committee and your colleagues in Congress will help advance this vital measure.

CONCLUSION

Mr. Chairman and committee members, on behalf of ESCA and the thousands of employee-owners from our member companies, as well as the almost half a million Americans who work for S ESOP companies today, we thank you for holding this hearing to highlight the savings and other economic benefits of S corporation ESOPs and employee ownership. We look forward to working with all of you to grow support for and move H.R. 2096. I would be happy to answer any questions.