

Model Employee Ownership Act¹

SECTION 1. FINDINGS AND INTENT. Employee ownership is a mainstream aspect of the U.S. economy with approximately 13.5 million workers participating in some form of employee ownership program at over 7,000 companies. The vast majority of such programs were the result of a transfer from the business owners to the employees and in accordance with federal law that seeks to facilitate such transfers. Employee ownership transfers are in the interest of business owners, who seek to liquidate their ownership interest and retire. Such transfers are also in the interest of the employees, who gain the opportunity to ensure the future survival of the firm and their jobs.

Employee-owned businesses are more productive with increased sales, enjoy lower turnover and greater longevity, offer better employment opportunities, are more likely to retain jobs in-state and less likely to relocate out-of-state, and sustain the state tax base through employee and corporate income tax, while saving costs on unemployment insurance and other state benefit programs. This Act amplifies federal programs in support of employee ownership at the state level and addresses significant policy gaps through:

(a) Tax incentives that promote a variety of broad-based employee ownership structures and encourage perpetual employee ownership.

¹ This model act was drafted by Christopher Michael. COWS would like to thank all those who provided feedback on this draft.

(b) Loans and loan guarantees that provide financing for the conversion of existing businesses to employee ownership.

(c) Procurement preferences that leverage public spending to benefit employee-owned businesses.

(d) Funding for a state university-based center to build awareness about the potential for employee ownership successions, as well as the programs available under this Act, among existing business owners.

SECTION 2. DEFINITIONS. In this Act:

(a) “Authority” means the [department of taxation].

(b) “Contracting agency” means the State, or any governing body of any county or municipality, or any department, board, commission, committee, authority, or agency of the State or a county or municipality.

(c) “Department” means the [department of economic development].

(d) “Direct share ownership plan” means an arrangement in which a portion of the highest class of voting stock of a corporation or voting membership interest of a limited liability company is held directly by all tenured employees. Such stock or membership interest may be nontransferable and callable upon termination or retirement of the employee.

(e) “Eligible transaction” means the qualified transfer of some or all of the stock of a corporation or membership interest of a limited liability company to an employee stock ownership plan, employee ownership trust, or direct share ownership plan. An eligible transaction includes an acquisition of stock or membership interest by an employee ownership association, as an intermediary, for the purpose of a qualified transfer to an employee stock ownership plan, employee ownership trust, or direct share ownership plan.

(f) “Employee ownership association” means a corporation, limited liability company, trust, or other entity that acts on behalf of the employees of an existing employer for the purpose of achieving the qualified transfer of some or all of the stock or membership interest of the employer to ownership by an employee stock ownership plan, employee ownership trust, or direct share ownership plan. An employee ownership association includes a corporation or limited liability company with an existing employee stock ownership plan, employee ownership trust, or direct share ownership plan that acts on behalf of the employees of another employer for the purpose of achieving a qualified transfer by means of a consolidation or merger.

(g) “Employee ownership loan” means any of the following:

(1) Any loan to a corporation, limited liability company, employee stock ownership plan, employee ownership trust, or employee ownership association, to the extent that the proceeds are used to acquire employer stock or membership interest of an employer for a qualified transfer.

(2) Any loan to a corporation or limited liability company to the extent that, within 30 days, stock or membership interest of an employer are transferred to an employee stock ownership plan, employee ownership trust, or direct share ownership plan in an amount equal to the loan and in accordance with the terms of a qualified transfer.

(h) “Employee ownership trust” means a trust, including a foreign trust, that holds the highest class of voting stock of a corporation or voting membership interest of a limited liability

company and that meets the requirements under section 2A, and may be a noncharitable trust, perpetual trust, or both.

(i) “Employee stock ownership plan” means an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

(j) “Employer” includes 2 or more persons who are treated as a single employer under sections 414(b), (c), (m), or (o) of the Internal Revenue Code.

(k) “Qualified transfer” means the transfer of any amount of stock of a corporation or membership interest of a limited liability company to an employee stock ownership plan, employee ownership trust, or direct share ownership plan if all of the following apply:

(1) The stock or membership interest has voting power equal to or in excess of the class of stock or membership interest of the employer having the greatest voting power.

(2) The stock or membership interest has dividend rights equal to or in excess of the class of stock or membership interest of the employer having the greatest dividend rights.

(3) If the transfer is to a direct share ownership plan, the largest amount of stock or membership interest transferred to any employee does not exceed a multiple of 10 times the smallest amount of stock or membership interest transferred to any tenured employee.

(l) “Tenured employee” means any employee or independent contractor who has provided at least 1,000 hours of services to the employer within the immediately preceding 12-month period unless, with respect to an employee ownership trust or a direct share ownership plan, a lower number of hours is established in the terms of the employee ownership trust or direct share ownership plan.

(m) “Total cost” means all reasonable and necessary costs to be incurred in the course of an eligible transaction, including the fair market value of the business interest to be acquired, as well as costs for any additional construction, land acquisition, improvements, equipment, pertinent rights and easements, and associated technical, engineering, legal, and financial services.

SECTION 2A. EMPLOYEE OWNERSHIP TRUSTS.

(a) The employee ownership trust must fulfill all of the following:

(1) Purposes.

(A) Subject to subsections (a)(1)(B), (C), (D), and (E), the employee ownership trust has the exclusive purposes of creating employee ownership by obtaining and holding stock or membership interest of an employer and promoting the financial and nonfinancial interests of all tenured employees.

(B) The exclusive purposes of an employee ownership trust may include preserving the ability of all tenured employees to exercise the voting rights of the trust on a one person, one vote basis. This subsection (a)(1)(B) does not exempt the trustee from an obligation to carry out the express terms and purposes of the trust in the case of a conflict with the majority decision of all tenured employees.

(C) The exclusive purposes of an employee ownership trust may refer to both current and prospective tenured employees.

(D) The exclusive purposes of an employee ownership trust may include maintaining any of the purposes under subsections (a)(1)(A), (B), and (C) in perpetuity, as well as preserving the employer in perpetuity.

(E) An employee ownership trust may prioritize certain exclusive purposes over others.

(2) No principal or income of the employee ownership trust is distributed or allocated to any party other than a tenured employee, except that principal and income of the trust may be distributed to one or more charitable organizations. The employee

ownership trust may distribute principal to current and past tenured employees if the trust sells stock or membership interest of the employer by establishing a cutoff date for the inclusion of past tenured employees.

(3) Principal and income of the employee ownership trust that is distributed or allocated to employees is administered proportionally to all tenured employees on the basis of hours worked, salary, seniority, or any combination of these factors.

(b) Trustee liability.

(1) An employee ownership trust may limit trustee liability if the stock or membership interest of the employer are voted by the trustee in accordance with the direction of all tenured employees and on a one person, one vote basis and all of the following apply:

(A) The trustee votes all employer stock or membership interest as a unit in accordance with the majority decision of all tenured employees.

(B) Before voting, the trustee furnishes each tenured employee with the information statement and other materials provided to shareholders or members in in connection with the shareholder or member meeting, together with a form on which confidential voting directions may be given to the trustee or, if the trustee is not independent of the employer, to an independent 3rd party designated by the trustee, who tabulates votes and provides instructions to the trustee. The trustee or a 3rd party may not disclose the confidential voting directions of any tenured employee to the employer.

(2) This subsection (b) does not exempt the trustee from an obligation to carry out the express terms and purposes of the trust in the case of a conflict with the majority decision of all tenured employees.

(c) An employee ownership trust is not disqualified solely because the terms of the trust do any of the following:

(1) Authorize the trustee to employ an entity, such as a corporation, a limited liability company, or another trust, to hold the stock or membership interest of the employer.

(2) Require that the employer obtain membership in one or more nonprofit associations.

(3) Require that the employer pay market rate wages or benefits or both.

(4) Require that the employer retain a percentage of annual net income as permanent reserves that will never be distributed to employees.

(5) Impose other requirements that promote the long-term financial health of the employer and the continued ability of the employer to provide high-quality jobs under conditions of employee ownership to all current and prospective tenured employees.

(6) Appoint a trust protector or cotrustee or both to enforce the trust and approve amendments to the trust.

SECTION 3. TAX INCENTIVES FOR EMPLOYEE OWNERSHIP.

(a) Capital Gains Exclusion. Gross income of an individual shall not include any of the gain or income from a qualified transfer, except that the gain or income from a qualified transfer to a direct share ownership plan that may be excluded under this subsection (a) may not exceed the smallest amount of stock or membership interest transferred to a tenured employee multiplied by the number of all tenured employees.

(b) Interest Income Exclusion. Gross income of a bank or other commercial lender shall not include any of the interest income derived from an employee ownership loan.

(c) Corporate Income Exclusion.

(1) Contributions to an employee ownership trust or a direct share ownership plan, including contributions applied to repayment of principal and interest on an employee ownership loan, are excluded from the gross income of a corporation.

(2) The exclusion under subsection (c)(1) is subject to the limits under section 404(a)(3)(A) of the Internal Revenue Code. The amount of the exclusion under subsection (c)(1) for contributions to a direct share ownership plan may not exceed the value in the taxable year of the smallest amount of stock or membership interest distributed to a tenured employee multiplied by the number of all tenured employees.

(3) Contributions under this subsection (c) may be in cash, stock, or membership interest. For purposes of this subsection (c), the taxpayer shall submit with the taxpayer's return a copy of the findings of an independent appraiser regarding the fair market value of stock or membership interest.

(d) Trust Income Exclusion. An employee ownership trust shall be exempt from taxation.

(e) Individual Income Exclusion. Gross income of an individual shall not include stock or membership interest distributed through a direct share ownership plan, except that the amount of the income that may be excluded under this subsection (e) may not exceed the amount of income derived in the taxable year from the smallest amount of stock or membership interest distributed to a tenured employee.

(f) Gift Tax Exclusion. Any gift to an employee stock ownership plan, employee ownership trust, or direct share ownership plan in accordance with the terms of a qualified transfer shall be exempt from gift tax.

(g) Optional Preapproval of Sale Price.

(1) Application for preapproval of a qualified transfer for benefits under subsections (a) and (b) may be made at the time and in the manner as the authority may prescribe. An application shall include the findings of an independent appraiser with respect to the fair market value of any stock or membership interest.

(2) The authority shall make a preapproval decision, and inform the applicant of the authority's decision, no later than 30 days after the authority receives the applicant's application for preapproval of the sale price under subsection (g)(1). If the authority requests that an applicant supplement its application by submitting additional

information, the authority shall have an additional 15 days after receiving the additional information by which the department must make a preapproval decision and inform the applicant of the authority's decision.

SECTION 4. EMPLOYEE OWNERSHIP LOANS AND LOAN GUARANTEES.

(a) Establishment of Program. The department shall establish and administer an economic development program under this section to make employee ownership loans and employee ownership loan guarantees to eligible applicants.

(b) Application. Any corporation, limited liability company, trust, or employee ownership association may apply to the department for an employee ownership loan or employee ownership loan guarantee or both to finance an eligible transaction.

(c) Loans and Loan Guarantees. The department may contract with an applicant under subsection (b) to do any of the following:

(1) Make an employee ownership loan to the applicant equal to up to 40 percent of the total cost.

(2) Guarantee up to 100 percent of employee ownership loans made to the applicant by lenders other than the department. All loan guarantees made to an applicant under this subsection (c)(2) may not exceed 80 percent of the total cost.

(d) Timeliness. The department shall make a loan decision or a loan guarantee decision under subsection (c), and inform the applicant of the department's decision, no later than 30 days after the department receives the applicant's application for an employee ownership loan or employee ownership loan guarantee under subsection (b). If the department requests that an applicant supplement its application by submitting additional information, the department shall

have an additional 15 days after receiving the additional information by which the department must make a loan decision or loan guarantee decision under subsection (c) and inform the applicant of the department's decision.

SECTION 5. PUBLIC PROCUREMENT FOR EMPLOYEE OWNERSHIP.

(a) Contracting agencies shall attempt to ensure that 5 percent of the total amount expended in each fiscal year is paid to businesses that satisfy any of the following:

(1) A percentage, as established by the contracting agency by rule, of employer stock or membership interest, of the type required for a qualified transfer, is held by an employee stock ownership plan or employee ownership trust.

(2) A percentage, as established by the contracting agency by rule, of employer stock or membership interest, of the type required for a qualified transfer, is held through a direct share ownership plan where the ownership stake of the direct share ownership plan is calculated by determining the smallest amount of such stock or membership interest held by a tenured employee, multiplied by the total number of tenured employees.

(3) A percentage, as established by the contracting agency by rule, of nonprofit corporation membership, with voting power equal to or in excess of that class of membership having the greatest voting power, is held by all tenured employees as a class, and the tenured employees vote as members on a one person, one vote basis.

(b) Any contracting agency may purchase goods and services from any business specified in subsections (a)(1), (2), or (3) submitting a bid that is no more than 10 percent higher than the apparent low bid. In administering the preference for businesses specified in subsections (a)(1), (2), or (3), the contracting agency shall maximize the use of businesses specified in subsections (a)(1), (2), or (3) that have their principal place of business in this state.

SECTION 6. STATE UNIVERSITY-BASED EMPLOYEE OWNERSHIP CENTER.

(a) Establishment of Center. Not later than 180 days after the date of enactment of this section, the department shall establish a state university-based center for employee ownership.

(b) Duties of Center. The center shall:

(1) Provide education and outreach to inform business owners about the benefits of employee ownership successions and the provisions of this Act.

(2) Organize workshops and conferences on employee ownership successions.

(3) Prepare and distribute materials concerning employee ownership successions.

(4) Provide initial consultations to business owners exploring the possibility of transferring full or partial ownership to employees.

(5) Provide a referral service to help business owners find legal, financial, and technical advice in connection with employee ownership successions.

(6) Partner with key organizations, such as professional and trade associations, financial institutions, unions, economic development organizations, and other nonprofit entities, to promote employee ownership successions.

(7) Support the growth of associations of employee-owned businesses.

(c) Government Relations. The center shall:

(1) Provide access to information regarding government rules and regulations that relate to employee ownership.

(2) Develop, in partnership with appropriate state and local government agencies, proposals for changes in policies to promote employee ownership.

(3) Conduct investigations, research, studies, and analyses on the subject of employee ownership.