EMPLOYEE OWNERSHIP REPORT

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ISSUE HIGHLIGHTS

- The story of the Mermaid Frappuccino and the idea of the "adjacent possible" can help make your employee involvement more effective. See page 3 for ideas you can use today.
- At the employee-owned company Gripple, 25% of revenue must come from products patented within the last five years. See page 4 to learn how they do it.
- How many ESOPs are part of 401(k) plans? How many ESOP participants are in KSOPs? See the Q&A on page 5 for the answers.
- One main driver of the sustainability of repurchase obligation is the ratio between ESOP stock and covered payroll. Page 6 has data from the 2017 Repurchase Obligation Survey that includes contribution levels and repurchase projections.
- Social psychologists find some surprising connections between the work place and love. See page 7.
- If your board is looking for ideas to evaluate the performance of the CEO, take a look at the sample survey on page 8.
- Janis Hittle retired from employee-owned Davey Tree in 2017, and, looking back, she reflects on what employee ownership means for her in the First Person column on page 11.
- The *Harvard Business Review* covered employee ownership. See page 12.
- China continues its exploration of equity compensation plans for employees in state-owned enterprises. See page 12.
- One of the best ways to understand how an ESOP works is to see how they are like—and unlike—401(k) plans. See page 15.

RESOURCES CONTACT SHARE
CASE STUDY OWNERS' PAGE

Tax Reform's Impacts on Employee Ownership

On December 22, President Trump signed the tax reform bill, making its provisions the law of the land. The law's accelerated timeline ensures that tax experts will uncover new implications of its many changes, especially to business taxation.

The tax reform bill's most direct impact on broad-based employee ownership is through its provisions on certain broad-based equity compensation plans in private companies. The provisions do not apply to all forms of equity compensation, and they only affect private companies with broad-based plans, but employees of companies that meet the law's requirements will find more favorable tax treatment of their plans.

The bill also affects ESOP companies, not directly through any changes to ESOP-specific laws but indirectly through some of its other provisions, such as the new limitations on how much interest expense is deductible, the new treatment of state and local taxes, the new rate for C corporations, and the 20% deduction on pass-through income.

Deductibility of Interest Expenses

The tax bill limits net interest deductions for businesses to 30% of EBITDA (earnings before interest, taxes, depreciation, and amortization) for four years, at which point the limit decreases to 30% of EBIT (not EBITDA). In other words, starting in 2022, businesses will subtract depreciation and amortization from their earnings before calculating their maximum deductible interest payments.

New leveraged ESOPs where the company borrows an amount that is large relative to its EBITDA may find that their deductible expenses will be lower and, therefore, their taxable income may be higher under this change. This change will not affect 100%-ESOP owned S corporations because they don't pay tax.

Many questions remain on the impact of this change. Importantly, it is not yet clear whether the limit on deductibility of interest will apply to loans made after the bill goes into effect or if it will apply retroactively. It is also unclear what impact the bill will have on alternative structures, such as replacing simple interest with warrants or payment-in-kind (PIK) interest. People thinking about

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THE NCEO is a self-sustaining nonprofit membership organization that provides practical resources and objective, reliable information on employee stock ownership plans (ESOPs), equity compensation plans, and ownership culture. Our publications, meetings, webinars, and research are designed with you in mind.

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