Employee Stock Ownership: Empowering It Through A New Law

Broad-based employee stock ownership is one way to ensure that the wealth created in startups is widely shared by those who helped create the wealth.

But broad-based stock ownership in private companies is thwarted by our tax code. Our tax code discourages the sharing of stock ownership among a company's workers by taxing workers on the receipt of illiquid shares as if the shares could be sold to generate cash to pay the taxes.

We Need To Fix Our Tax Laws To Change This

The U.S. House of Representatives ***passed a bill*** recently entitled the "Empowering Employees through Stock Ownership Act."

The purpose of the bill, as you might imagine, is to promote employee stock ownership. The bill attempts to do this by allowing corporations to transfer stock to their employees without the employees suffering an immediate tax hit. This is something I have been advocating for a while.

Currently, the tax law makes it hard for companies to share equity with their workers. How does it do this? By taxing the transfers of illiquid shares to employees as if the illiquid shares were cash.

Let's do an example

Suppose you work for a private company. Let's suppose the company wants to transfer you shares representing 1% of the company in consideration of your services to the company. If the company transfers fully-vested shares to you, you will have to pay tax on the value of the shares you receive as if you received cash equal to the value of the shares, and you used the cash to buy the shares.

If you are an employee, you will have to write the company a check to cover the employee side of income and employment tax withholding.

This quickly becomes prohibitively expensive for workers.

If your company transfers stock to you worth $100,000, for example, you will have to write a check to the company in excess of $25,000. (The supplemental income tax withholding rate is typically around the 25% range, and then on top of that is the employee side of FICA, which is 7.65% until you hit the FICA wage cap after which point the Hospital Insurance component is 1.45%). A lot of employees don't have the money in the bank to send to the IRS and have to pass on the opportunity to own stock in the company they work for.

The work around here is a stock option--but stock options are not the same as stock ownership. Options have to be set to expire, and frequently optionees never realize the economic benefits of an option grant because their options expire.

H.R. 5719 aims to fix this

Below is a plain English summary of the bill from Congress.gov. The bill is not perfect. It attempts to do too many things, and it could be cut down in length and complexity. But it is fun to see Congress trying to fix our anti-worker tax code.

From Congress.gov:

> **Empowering Employees through Stock Ownership Act**
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> This bill amends the Internal Revenue Code to allow an employee to elect to defer, for income tax purposes, income attributable to certain stock transferred to the employee by an employer.
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> The employee may defer the inclusion of income from the stock until the year that includes the earliest of the dates on which:
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> - the stock is sold, exchanged, or otherwise transferred;
> - the employee becomes an excluded employee;
> - stock of the corporation becomes readily tradable on an established securities market;
> - seven years has passed after the rights of the employee in the stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier; or
> - the employee elects to include the amount in income.
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> The stock must meet specified requirements and be transferred to the employee from an eligible corporation in connection with the performance of services as an employee.
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> A corporation is eligible if: (1) no stock of the corporation is readily tradable on an established securities market during the year or any preceding year, and (2) it has a written plan under which at least 80% of all employees have the same rights and privileges to receive stock for the year.
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> Employees are excluded if they are or have been: (1) a 1% owner, the chief executive officer, or the chief financial officer of the corporation; (2) a family member of the specified individuals; (3) or one of the four highest compensated officers of the corporation.

The corporation transferring stock must notify employees regarding the option of deferring income and meet specified withholding and reporting requirements.