



## Tax Reform Proposals and ESOPs

November 7, 2005

Earlier this year, President George Bush established an Advisory Panel on Tax Reform to identify the major problems in our federal income tax laws and to recommend options to make these laws simpler, fairer, and more conducive to economic growth. The President also directed the panel to make recommendations designed to raise approximately the same amount of money as the current tax system.

On Tuesday, November 1, 2005, the President's Advisory Panel on Federal Tax Reform delivered its final report to the Treasury Department. Among the numerous recommendations contained in the report are proposals for elimination of the alternative minimum tax (the AMT), eliminating the state and local tax deduction, imposing limitations on the home-mortgage interest deduction, and simplifying the rules relating to retirement plans. It is important to note that these recommendations are a long way from becoming law. They simply provide a starting point for discussions that may lead to specific proposals that eventually may be considered by Congress.

The panel has proposed to change the tax rules relating to individual savings and retirement plans by, among other things, combining the various kinds of defined-contribution plans authorized under current law into one kind of plan, known as a "Save at Work" plan. The panel noted that the rules relating to tax-qualified retirement savings are among the most complex in the Internal Revenue Code tax code and that this complexity may be a barrier to additional retirement savings by workers. The panel described inconsistencies in the treatment of a number of different kinds of defined-contribution plans, but did not specifically mention ESOPs. Nevertheless, it appears that the tax incentives currently provided for the establishment of ESOPs would be eliminated under the Save at Work plan, which does not, at this stage, seem to contemplate investments in employer securities. It is noteworthy that, although the tax incentives for ESOPs would appear to be eliminated under the proposals, the panel expressed no criticism of ESOPs or of employee ownership in its report. The panel's apparent proposal to eliminate the ESOP tax incentives appears to be a byproduct of its overriding objectives to simplify the tax code and eliminate the AMT, while maintaining revenue neutrality.

In assessing the likelihood that the tax laws relating to retirement plans will be overhauled in the manner recommended by the panel, we would note that the proposed Save at Work plan is substantially similar to the proposals for employee retirement savings accounts that the Bush administration has presented without success in recent budget proposals. We would also note that the proposals of the Panel are just that—proposals—and they are subject to change by the Treasury Department and by the tax writing committees. The proposals are not part of any proposed legislation presently pending

before any committee of the House of Representatives or of the Senate. For the proposals to become law, they would have to be approved by Congress and the President.

Among the numerous uncertainties regarding the recommendations are whether they will be changed by the Treasury Department, whether bipartisan support for the recommendations can be generated in Congress, and whether the Bush administration can effectively promote any proposal for tax reform. The proposals include numerous controversial provisions which already are generating substantial opposition, and several members of Congress and Congressional staffers have stated that the tax-reform proposals have little chance of being enacted. However, although the proposals are unlikely to pass as written, the reform package now being drafted at the Treasury Department can be expected to be taken seriously by Congress. Therefore, we join with The ESOP Association, the National Center for Employee Ownership, Employee Owned S Corporations of America and other organizations in urging interested parties to express their views on these proposals (as they affect ESOPs or more generally) by contacting the Secretary of the Treasury, John W. Snow and/or your representatives in the U.S. Congress. In the meantime, we will keep informed of future developments.

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