Testimony for the Vermont House Ways and Means Committee, March 23, 2016

I'm Don Jamison, Executive Director of the Vermont Employee Ownership Center, an organization that has been promoting and fostering employee ownership in Vermont for almost 15 years now. We worked with Rep. Kitzmiller on H.551, now part of H.868, and we support the two initiatives it contains, both of which are intended to encourage the creation of more employee-owned businesses in Vermont through Employee Stock Ownership Plans (ESOPs) and worker cooperatives. The first of these would provide matching funds to subsidize feasibility studies that could lead to the formation of more employee-owned companies. The second would provide a 50% exclusion from tax of capital gains to the seller of "capital assets" to an Employee Stock Ownership Plan or worker cooperative, the two most common forms of employee ownership.

The premises behind that tax exclusion are, first, that one of the purposes of state tax policy is to support and encourage socially-beneficial behaviors and institutions and, second, that employee-owned companies merit such support. A good summary of the arguments for that second premise are contained in the "findings" section of Act 170, passed by the legislature in 2006:

The General Assembly finds:

(1) Employee ownership of businesses promotes job growth, provides job protection, and maintains local ownership of businesses. Employee-owned companies tend to provide superior employee benefits, including health care. As with home ownership, employee ownership provides an effective way for working people to build wealth.

(2) Employee ownership can provide an excellent means for small business owners to transition ownership when they are ready to retire. The continuation of these businesses is in the economic interest of Vermont and assures that employees continue to use their skills productively, and that the state benefits from the continued tax revenues generated from the business and the jobs.

[(3) Employee buyouts of plants scheduled for closure will preserve jobs that would otherwise be lost or moved out of state.]

(4) Employee ownership coupled with employee participation has proven to be a combination that improves productivity and overall workplace quality, thereby creating companies that are better able to compete in the global economy.

(5) The United States government provides substantial support for employee ownership by offering beneficial tax treatment to Employee Stock Ownership Plans and worker cooperatives. Enhanced state support for employee ownership can bring the benefits of more employee ownership to Vermont and further leverage federal support.

Rep. Kitzmiller asked JFO to estimate the cost to the state in lost tax revenue from the proposed exclusion, but there wasn't time to get far with that. Joseph Blasi, a leading researcher into employee ownership who is a professor at Rutgers, recently wrote a memo for the New Jersey legislature pertaining to a similar bill there in which he came up with the number of $3,144,089 in lost revenue if a similar measure were to be enacted there, assuming that the rate of formation of ESOPs and co-op would double (he believes this is "highly likely"). If we reduce that number in proportion to the population of New Jersey relative to Vermont, we get $219,278.61

I worked with the Tabitha Croscut, the President of our board and a well-known ESOP attorney, to try to come up with a better guesstimate for Vermont. She estimates there are currently an average of 2 deals in VT closed annually. Some years there is a big deal ($20-50M); more often they are relatively small ($3-10M) … "if you assume most sellers have $0 basis, you could then assume approximately $15M of aggregate capital gains from these deals in a year." Applying the 40% reduction of adjusted net capital income, you reduce gain to $9M; then apply 9% tax (a little over the maximum tax rate) to get ~$800,000 of tax. If the 50% exclusion is in addition to the 40% exclusion that's already allowed, then the gain to be taxed would be 50% of the amount left after the 40% exclusion, i.e. $9M -- so $4.5M. Applying the 9% tax (the top bracket) to that results in a tax of a bit over $400,000. Net "loss" to the state would then be ca. $400,000.

The purpose of this exclusion, of course, would be to encourage more deals to happen. Joseph Blasi's memo cites the effect of a federal level capital gains rollover in the 1980s and estimates that the contemplated state level tax break would "double the ESOP activity per year." It seems more reasonable to hope for an increase of 50% -- so a net loss to the state of $600,000 in capital gains tax per year.

On the other side of the tax revenue ledger, consider the impact of the retention of jobs and the income tax revenue from that. When a successful Vermont company is acquired by a strategic buyer or a private equity firm, the result is often that operations are consolidated and people are laid off. In worst case scenarios, the company's operations are moved out of state. Imagine Vermont without King Arthur Flour, Gardener's Supply, Sonnax Industries.

But employee ownership is about more than avoidance of job loss. It is now well-documented that employee-owned companies create more jobs, offer (on average) better pay and benefits, and weather downturns better. This is a sector we'd like to see grow.

A convenient summary of the research on employee ownership can be found here:

https://www.nceo.org/articles/studies-employee-ownership-corporate-performance

and here:

https://www.nceo.org/articles/research-employee-ownership-corporate-performance