

ESOP LEGAL NEWS



March 2012 • Volume 1, Number 1

ESOPLEGALNEWS EDITORIAL BOARD



Michael R. Holzman
202.659.6931 • mholzman@dickinsonwright.com



William E. Elwood
202.659.6972 • welwood@dickinsonwright.com



Cynthia A. Moore
248.433.7295 • cmoore@dickinsonwright.com



Deborah L. Grace
248.433.7217 • dgrace@dickinsonwright.com



Christopher T. Horner
202.659.6961 • chorner@dickinsonwright.com

WEBSITES OF INTEREST

[Dickinson Wright ESOP Advisory Group](#)
[The ESOP Association](#)
[The ESOP Association Blog](#)
[National Center for Employee Ownership](#)
[Employee Ownership Foundation](#)

Disclaimer: ESOP Legal News is published by Dickinson Wright PLLC to inform our clients and friends of important developments in the field. The content is informational only and does not constitute legal or professional advice. We encourage you to consult a Dickinson Wright attorney if you have specific questions or concerns relating to any of the topics covered in ESOP Legal News.

INSIDE THIS ISSUE:

White House corporate tax reform may eliminate certain ESOP tax benefits; Iowa house passes pro-ESOP legislation; White House budget proposes clarification of 1042 rollover; official discusses re-proposal of regulation; sixth circuit addresses presumption of prudence; district court dismisses ESOP claims against ESOP trustees; ESOP participant seeks class certification in action against Kodak Company; pro-ESOP legislation pending in House and Senate.

THE WHITE HOUSE

White House Corporate Tax Reform Could Eliminate ESOP Tax Benefits

On February 22nd, the Obama Administration proposed corporate tax [reforms](#) [p. 10] that endorsed two commissioned tax reports proposing to eliminate ESOP tax benefits. The Administration explained that “[e]stablishing greater parity between large corporations and their large non-corporate counterparts should be considered as a way to help improve equity, reduce distortions in how businesses organize themselves, and finance lower tax rates.” The Administration further explained that “[a] variety of ways to do this have been proposed, including ones discussed in the 2005 report of [President Bush’s Advisory Panel on Tax Reform](#) [p. 126], and in reform options developed by [President Obama’s Economic Recovery Advisory Board in 2010](#) [pp. 74-77].” The reports propose to eliminate tax benefits achieved by organizing as an S corporation by imposing a corporate level tax on certain S corporations. The Administration cautioned that “[i]t is essential that any changes in this area should not affect small businesses.”

J. Michael Keeling, President of The ESOP Association, [responded](#) to the proposed tax reforms, stating “I find it incredulous that the President travels the country talking jobs, jobs, jobs, yet his corporate tax reform policy will stifle the best jobs sustaining program in the U.S. For example, the 2010 General Social Survey found that less than 3% of employees of companies with employee stock ownership, which include the ESOP model and other forms of employee stock ownership, were laid off in 2009-2010 compared to a 12% rate for employees without employee stock ownership. Our national leaders of both parties, need to understand that national policies to encourage employee stock ownership, and new policies to increase ownership among more working Americans, need to be considered as an effective way to ensure our national employment rate is where we all want it to be.”

White House Budget Seeks Clarification of 1042 Rollover

On February 13th, President Obama submitted a [budget](#) to Congress that proposed to clarify the law regarding the taxation of unrecognized gain upon the disposition of qualified replacement property. Under current law, a shareholder may elect to defer the recognition of capital gain realized from the sale of employer securities to an ESOP. The deferred recognition of gain is subject to the recapture tax triggered upon the disposition of the qualified replacement property. The Internal Revenue Code ("Code") provides that no gain is recognized on a transfer of property between spouses, including former spouses, if the transfer is incident to divorce. However, the Code speaks only to the transfer being treated as a gift to the transferee; it does not speak to the treatment of the transferor. The [Treasury Department](#) explains that the budget proposal is intended to resolve the question of whether a transfer incident to divorce is a disposition that triggers the recapture tax. The proposal is in line with [Private Letter Ruling 201024005](#) which concludes that a transfer of qualified replacement property by a former shareholder to his spouse incident to divorce would be treated as a gift by the transferor and would not trigger the recapture tax.

IN THE COURTS

Sixth Circuit Holds Presumption of Prudence Does not Apply to Motion to Dismiss Stage

On February 22nd, the United States Court of Appeals for the Sixth Circuit issued an [opinion](#) concluding that a plaintiff does not need to plead enough facts to overcome the presumption of reasonableness in order to survive a motion to dismiss. Judge S. Thomas Anderson, sitting by designation, held that the presumption of reasonableness adopted by the Sixth Circuit in *Kuper v. Iovenko*, 66 F.3d 1447, 1458 (6th Cir. 1995) is an evidentiary presumption and not a pleading requirement. Participants in the ESOP alleged the trustee breached fiduciary duties under ERISA by continuing to allow participants to invest in GM common stock even though reliable public information indicated that GM was headed for bankruptcy. The district court assumed the presumption of reasonableness applied at the pleading stage and concluded that the plaintiffs pleaded sufficient facts to overcome the presumption. The Sixth Circuit noted that district courts in the Circuit had split on the issue of whether the presumption created a heightened pleading standard. The Court held the presumption was not an additional pleading requirement and thus does not apply at the motion to dismiss stage.

District Court Dismisses ERISA Claims Against Plan Trustees

On February 15th, the United States District Court for the Northern District of Illinois issued a [memorandum opinion and order](#) dismissing in part, and upholding in part, claims brought by former participants in the Kirk Corp. Employee Stock Ownership Plan. Kirk Corp. distributed benefits in the form of installment notes with a five-year term. It obtained a letter of credit to secure distributions and satisfy the Code's

adequate security requirement. Kirk Corp. obtained a letter of credit in the amount of benefits owed to participants receiving distributions through 2006 ("Mungai Participants"), but failed to increase the value of the letter of credit when it made distributions to participants after 2006 ("Thompson Participants"). Ultimately, Kirk Corp. filed for Chapter 11 bankruptcy protection and defaulted on payments under the installment notes. Both groups of plaintiffs asserted several claims under ERISA seeking to recover benefits.

The Mungai Participants asserted claims under ERISA Section 502(a)(1)(B) against the trustees and the ESOP. The Court dismissed the claim asserted against the trustees and upheld the claim against the ESOP on the ground that the plan, and not the trustees, was a proper defendant in the action.

Both groups of plaintiffs asserted a claim under ERISA 502(a)(2) against the trustees seeking to hold them personally liable for breach of fiduciary duties. The Court dismissed the claims on the ground that the plaintiffs failed to allege sufficient facts linking the trustees' fiduciary obligations to the act of securing the installment notes. Kirk Corp., and not the trustees, was the named fiduciary under the terms of the plan. In addition, the plan delegated to Kirk Corp. the power to provide adequate security for the installment notes. The Court further reasoned that even if the plaintiffs established the trustees were fiduciaries, the plaintiffs failed to allege the plan suffered any loss as a result of any alleged breach of fiduciary duty. Once the plaintiffs received distributions, they no longer held active accounts in the plan. Thus, the plaintiffs could not allege loss to the plan as a result of a breach of fiduciary duty that occurred while they were active participants in the plan.

The Court dismissed the Mungai Participants' claim seeking restitution from the trustees under ERISA Section 502(a)(3) on the grounds that the basis of the claim was legal and not equitable and thus precluded under Supreme Court precedent. In addition, the Court upheld promissory estoppel claims by the Thompson Participants against the trustees under ERISA Section 502(a)(3) and dismissed an equitable enforcement claim.

ESOP Participant Seeks Class Certification Against Kodak Company

On January 27th, a participant in the Kodak Company ESOP filed a [complaint](#) seeking class certification in the United States District Court for the Western District of New York. The complaint alleges members of the Board of Directors, members of the ESOP Committee, and the Plan Administrator breached fiduciary duties under ERISA. The plaintiff intends to amend his complaint after discovery commences to identify which individuals were fiduciaries to the ESOP.

AGENCY NEWS

DOL Announces Funding of Tribune Settlement

On February 23rd the DOL [announced](#) the funding of the \$32 million

settlement reached in a class action by a former participant in the Tribune Co. Employee Stock Ownership Plan. The settlement calls for Tribune Co., GreatBank Trust Co., and certain insurers to pay \$32 million, less legal and administrative fees, to plan participants.

DOL Official Comments on Re-Proposal of Regulation

On February 2nd, Louis Campagna of the U.S. Department of Labor's Employee Benefits Security Administration explained that the Department will focus its re-proposed regulation on valuations and appraisals that form the basis for "arm's-length commercial transactions. The [regulation](#) proposed on October 21, 2010 would have made appraisers providing appraisals or valuations plan fiduciaries. The Department [withdrew](#) its original proposal on September 19, 2011. Campagna indicated the Department expects to re-propose its regulation in May.

ON CAPITOL HILL

Pro-ESOP Legislation Pending in House and Senate

S. 101. The "[Employee Stock Ownership Plan Promotion and Improvement Act of 2011](#)" is currently pending before the Senate Finance Committee. The bill: amends Code Section 72 to exclude S Corporation distributions from the 10% penalty tax imposed on early distributions; amends Code Section 56 to allow a deduction from the Alternative Minimum Tax for dividends paid on employer securities held by an ESOP; amends Code Section 1042 to allow an S Corporation shareholder to defer recognition of capital gain realized from the sale of employer securities to an ESOP; amends Code Section 1042 to permit certain mutual funds to qualify as qualified replacement property; and amends the Small Business Act to permit a corporation eligible to participate in loan, contracting assistance, or business development programs to remain eligible to participate after an ESOP acquires 50% or more of the corporation.

H.R. 1244. The "[Promotion and Expansion of Employee Ownership Act](#)" has 63 co-sponsors and is currently pending before several House Committees and one House Subcommittee. The bill: amends Code Section 1042 to allow an S Corporation shareholder to defer recognition of capital gain realized from the sale of employer securities to an ESOP; adds a new section to the Code permitting banks to deduct 50% of the interest received from a qualified securities acquisition loan; adds a new section to the Code requiring the Secretary of the Treasury to establish the "S Corporation Employee Ownership Assistance Office" to foster employee ownership of S Corporations; and amends the Small Business Act to permit a corporation eligible to participate in loan, contracting assistance, or business development programs to remain eligible to participate after an ESOP acquires 50% or more of the corporation.

S. 1232. "[A bill to modify the definition of fiduciary under the Employee Retirement Income Security Act of 1974 to exclude appraisers of employee stock ownership plans](#)" has 6 cosponsors and is pending before the Senate Committee on Health, Education, Labor, and Pensions. The Bill amends ERISA Section 3(21)(A) to affirmatively exclude from the definition of the term "fiduciary" any person to the extent that person is providing an appraisal or fairness opinion with respect to qualifying employer securities.

S. 1512. The "[Promotion and Expansion of Private Employee Ownership Act of 2011](#)," which is the companion bill to H.R. 1244, has 9 cosponsors and is currently pending before the Senate Finance Committee. The bill: amends Code Section 1042 to allow an S Corporation shareholder to defer recognition of capital gain realized from the sale of employer securities to an ESOP; adds a new section to the Code permitting banks to deduct 50% of the interest received from a qualified securities acquisition loan; adds a new section to the Code requiring the Secretary of the Treasury to establish the "S Corporation Employee Ownership Assistance Office" to foster employee ownership of S Corporations; and amends the Small Business Act to permit a corporation eligible to participate in loan, contracting assistance, or business development programs to remain eligible to participate after an ESOP acquires 50% or more of the corporation.

H.R. 3070. "[A bill making appropriations for the Departments of Labor, Health and Human Services, and Education, and related agencies for the fiscal year ending September 30, 2012, and for other purposes](#)" is currently pending before the House Appropriations Committee. The bill prohibits funds appropriated under the bill from being used to promulgate or implement the recently withdrawn DOL regulation which would amend the definition of the term "fiduciary" under ERISA Section 3(21)(A) to include appraisers providing appraisals and fairness opinion with respect to qualifying employer securities.

STATE LEGISLATURE

Iowa House Passes Pro-ESOP Legislation

On February 17th, the Iowa House approved [House File 2284](#) by a 93-2 vote. The bill appropriates \$1,000,000 from the general fund of Iowa to provide a loan program, technical assistance, and education to Iowa businesses interested in establishing an ESOP. The bill authorizes financial assistance to businesses to hire independent contractors with financial expertise in the formation of ESOPs. The bill excludes from gross income the net capital gain realized from the sale or exchange of employer securities of an Iowa corporation to a qualified Iowa ESOP owning at least 30% of all outstanding securities issued by the corporation. The exclusion applies retroactively to the tax year beginning January 1, 2012. The bill is currently under consideration in the Iowa Senate.

Dickinson Wright Offices

Detroit

500 Woodward Avenue
Suite 4000
Detroit, MI 48226
Phone: 313.223.3500

Lansing

215 S. Washington Square
Suite 200
Lansing, MI 48933
Phone: 517.371.1730

Ann Arbor

301 East Liberty Street
Suite 500
Ann Arbor, MI 48104
Phone: 734.623.7075

Troy

2600 W. Big Beaver Rd.
Suite 300
Troy, MI 48084
Phone: 248.433.7200

Grand Rapids

200 Ottawa Avenue, NW
Suite 1000
Grand Rapids, MI 49503
Phone: 616.458.1300

Washington, D.C.

1875 Eye Street, NW
Suite 1200
Washington, DC 20006
Phone: 202.457.0160

Toronto

222 Bay Street, 18th Floor
PO Box 124
Toronto, ON, Canada M5K 1H1
Phone: 416.777.0101

Nashville

424 Church Street
Suite 1401
Nashville, TN 37219
Phone: 615.244.6538

Phoenix

5009 East Washington Street
Suite 125
Phoenix, AZ 85034
Phone: 602.244.1400

Las Vegas

7201 West Lake Mead Blvd.
Suite 503
Las Vegas, NV 89128
Phone: 702.541.7888