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Small Business/Pass Throughs Working Group  
Committee on Ways and Means  
U.S. House of Representatives  
Washington, DC 20515  
[tax.reform@mail.house.gov](mailto:tax.reform@mail.house.gov)

Re: Section 1042 Tax Deferred Rollover for S-Corporations Creating ESOPs

Dear Representatives Buchanan and Schwartz:

As a tax practitioner for over forty years, and having represented numerous S-corporations that could have benefitted from a fairer tax code with respect to the situation described below, I respectfully submit this comment for the consideration of your working group.

The current tax code gives rise to an inequity between the owners and employees of S corporations compared to those of small C corporations. The inequity results from the unavailability of the Section 1042 tax-deferral rollover to the owners of S-corporations who sell their stock to an ESOP created for the company's employees.

The purpose of the ESOP provisions is, of course, to encourage owners of small and mid-sized businesses to make their employees part-owners of the enterprise (and often sole owners upon departure of the founder). Owners of C corporations are incentivized to do so by Section 1042's tax-deferred rollover. By the terms of Section 1042(c)(1)(A), however, that incentive is limited to the owners of C corporation stock.

In fairness, the rollover benefit of Section 1042 should likewise be available to the owners of S corporations who consider creating an ESOP for the benefit of their employees. The employees of S-corporations are no less entitled to share in the ownership and future growth of the company through the company's stock allocated to their account in an ESOP, and to the substantial benefit that provides them upon retirement. Consequently, the owners of the stock of such S-corporations should have the same rollover incentive under Section 1042 that is available to the owners of C corporation stock.

IRS may argue that making the incentive of Section 1042 available to the owners of S-corporation stock would have an adverse effect on the fisc, inasmuch as the flow-through income of the S corporation would not be subject to tax in the ESOP. However, this result is no different than that available under current law for C-corporations that elect S-corporation status after their

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stock has been acquired by the ESOP. Moreover, if this becomes an obstacle, the problem is easily remedied by taxing the S-corporation's distributions to the ESOP.

These matters were sought to be addressed in S. 101 during the 112<sup>th</sup> Congress. I encourage the Ways and Means Committee to include similar language in any comprehensive tax reform legislation. Moreover, it seems likely that such a provision would be revenue-neutral because owners of S-corporation stock otherwise simply hold on to their stock and forego creating an ESOP, or, alternatively, sell it to another company in a tax-free "B" reorganization.

Thank you in advance for taking these comments into consideration. I am sending similar comments to Representatives Tiberi and Kind as Chair and Vice Chair of the Pensions/Retirement Working Group.

Sincerely,

*s/Bruce Graves*

Bruce Graves