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Corporate PACs and Employee-Stockholders: Changed Your Company's ESOP Lately?

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A fundamental challenge all corporate-sponsored PACs face is how to increase employee participation in their federal PACs' activities, especially employee contributions. Federal election laws make this challenge all the more difficult by limiting the employees who may be solicited for contributions. Hourly employees, secretaries, laborers, persons without professional or administrative responsibilities, and even some mid-level supervisors are all off limits for solicitations, regular contributions and participation in PAC activities—even if they want to participate and even if they support the PAC's cause. Therefore, many corporate PACs often are stymied in their efforts to expand broad and democratic participation throughout the company ranks.

Corporate PACs, however, have another option open to them—soliciting their company stockholders—and recent tax changes may well allow the company to solicit more employees who are also stockholders. Many of those hourly employees, secretaries, laborers and supervisors who are otherwise off-limits on the basis of the positions they hold nonetheless own stock in the company through their retirement plans. Depending on the company's retirement plan details, holding such company stock may make the employees solicitable by the PAC under FEC rulings.

For decades federal election law has been wary of recognizing employees as *bona fide* stockholders, because of significant withdrawal and dividend restrictions inherent in many companies' Employee Stock Ownership Plans (ESOPs) and 401(k)-type plans. Federal election law and the Federal Election Commission (FEC) have demanded that an employee have the right to receive direct payment of dividends earned on his or her company stock or the right to withdraw shares without any restriction in order to qualify as a *bona fide* stockholder who can be solicited by the company's PAC. At the same time, such FEC-conforming features of ESOP and retirement plans were disadvantageous under federal tax laws and, therefore, were rarely offered. Nevertheless, corporate PACs may find that their company's retirement plans have changed in response to 2001 federal tax law changes and may soon find they have a new crop of employee-stockholders ready and willing to support their cause.

EGTRRA Makes ESOPs More Attractive & Alters Dividend Policies
The Economic Growth And Tax Relief Reconciliation Act of 2001 (EGTRRA), President Bush's major tax relief measure which took effect in 2002, enacted several tax reforms that make ESOPs more attractive and less administratively cumbersome. Some corporations have begun to alter their ESOPs' dividend policies in

response to the new tax law. These changes may qualify employees who participate in the ESOP as "stockholders" who may be solicited by the corporation's federal PAC. A corporate-sponsored PAC looking for ways to expand participation may wish to inquire into any changes in the company's ESOP.

EGTRRA makes company ESOPs more attractive by raising the tax-deductible limit on each employer's matching contributions. Furthermore, an employee's voluntary contributions to a 401(k) account no longer reduces the tax-deductible limit on the amount the employer can contribute on the employee's behalf to an ESOP.

EGTRRA also provides each company a relatively simple procedure under which both the employer and employee can avoid tax on dividends earned by stock held in an ESOP. Corporations now receive a business expense deduction for the value of dividends paid on company stock held in an ESOP if the dividends are reinvested in company stock voluntarily by ESOP participants and participants also have the choice to receive the dividends in cash.

Prior to EGTRRA, a corporation could deduct the value of ESOP dividends only if they were used to repay an ESOP loan or paid directly to participants. Many corporations did not offer direct payments of dividends in order to take a deduction because employees reacted negatively to forced distributions of ESOP dividends. When corporations tried to offer employees the ability to re-invest their ESOP dividends in their 401(k) accounts, they encountered administrative difficulties and strict limits on the amount of money that could be contributed under prior tax laws. Therefore, many companies simply did not offer to pay dividends directly to participants.

In EGTRRA, Congress attempted to eliminate these problems and to make the dividend deduction more widely available and attractive to most companies. As a result of the new tax law, it is anticipated that many companies will reform their ESOP plans to offer all participants a straightforward choice to receive direct payments of dividends or to reinvest their dividends.

Corporate PACs May Solicit Employee-Stockholders

As more corporations begin to offer their employees direct dividend payment options in connection with the stock they own through the company's ESOP, corporate-sponsored PACs may find that they can solicit ESOP participants as "stockholders" of the corporation.

Under the Federal Election Campaign Act (FECA) and FEC regulations, a corporation and its corporate-sponsored PAC are permitted to solicit voluntary contributions from the corporation's stockholders. 2 U.S.C. § 441(b); 11 C.F.R. § 114.5(g).

The FEC defines "stockholder" as:

"A person who

[i] has a vested beneficial interest in stock,

[ii] has the power to direct how that stock shall be voted, if it is voting stock, and

[iii] has the right to receive dividends."

11 C.F.R. § 114.1(h).

The FEC consistently has recognized that employees who own company stock as part of an ESOP or other retirement and savings plans may qualify as "stockholders" so long as their stock ownership rights satisfy the three criteria noted above, i.e., that their rights are vested, they can vote the stock and they have a right to receive dividends. *See e.g.*, FEC Advisory Opinion 1998-12, Fed. Election Camp. Fin. Guide (CCH) ¶ 6265 (1998); FEC Advisory Opinion 1996-10, Fed. Election Camp. Fin. Guide (CCH) ¶ 6192 (1996).

The first two criteria—vested stock and the right to vote stock—generally can be clearly determined and have not been the subject of legal controversy in FEC analysis of employee benefit plans. The third criterion—the right to receive dividends—has received the most analysis and has engendered significant legal debate within the FEC over several decades.

The controversy arose in the context of retirement plans that automatically reinvested dividends in each employee's ESOP account *and* restricted each employee's right to withdraw stock in order to actually receive a dividend. The debate yielded a fact-specific test for determining whether an employee holds an actual "right to receive dividends" under 11 C.F.R. § 114.1(g): "whether participants are able to withdraw at least one share of stock purchased...without incurring a suspension period."*See* FEC Advisory Opinion 1998-12, Fed. Election Camp. Guide (CCH) ¶ 6265 (1998) (collecting prior opinions). Other restrictions on withdrawal rights also had to be analyzed to determine if the employee actually had an unfettered right to obtain a dividend.

More ESOP Participants Will Qualify as "Stockholders" Under EGTRRA

Now, however, under EGTRRA, companies receive a tax deduction for the dividends paid on ESOP stock *if* they offer employees the choice to reinvest their dividends or to receive them directly, and many companies are changing their dividend policies accordingly to obtain the deduction. Once each participant is offered an unrestricted right to receive direct payments of dividends earned by his ESOP stock, there is no need to go through a complicated analysis of ESOP withdrawal restrictions.

Opportunity for Increasing PAC Participation

Corporate PACs would be wise to track changes in their company retirement and ESOP programs. As corporations change their ESOP dividend policies in response to EGTRRA, corporate-sponsored PACs may find that more and more ESOP participants now qualify as "stockholders" and can be solicited for PAC contributions and payroll deduction.

It is often said that legislative reforms have unintended consequences. PACs looking for ways to increase participation may find the tax reform of 2001 had some good consequences for them by opening new doors to an entirely new class of supporters.