Deep Dive #3: Incremental Payroll Deduction

This section provides an illustrative example of the mechanics behind the "double payroll" deduction available to qualifying partial C-Corp ESOPs under the current proposal.

Within standard provisions in the US Internal Revenue Code, C-Corporations can generally deduct most expenses tied to employing their US workforce (e.g. salaries, 401k contributions, healthcare benefits, etc.). Our proposal states that, for the first 5 years of a qualifying partial C-Corp's existence, it can avail itself of a deduction twice as large as this "typical" deduction. Then, starting in year 6, it would essentially revert to being a "typical" corporate taxpayer.

	Year 1		Year 5		Year 6	
	Non-ESOP	ESOP	Non-ESOP	ESOP	Non-ESOP	ESOP
Revenue	$1,000	$1,000	$1,250	$1,250	$1,350	$1,350
Material Expense	(250)	(250)	(300)	(300)	(320)	(320)
Labor Expense	(250)	(250)	(300)	(300)	(320)	(320)
Other Expense	(100)	(100)	(120)	(120)	(130)	(130)
Taxable Income	**$400**	**$400**	**$530**	**$530**	**$580**	**$580**
Incremental ESOP Deduction	--	(250)	--	(300)	--	--
Taxable Income (Adj.)	**$400**	**$150**	**$530**	**$230**	**$580**	**$580**

Within the 5 year window, qualifying ESOPs are able to deduct their eligible US labor expense a second time (i.e. one time above and beyond the "typical" ability to deduct such expense)

Starting in year 6, a qualifying ESOP is no longer eligible for any incremental labor expense deduction

The thought process behind this proposed mechanism is dual-purposed:

- It incentivizes "good" behavior.
  - It would now be cheaper for companies to grow their US workforce, pursue "onshoring" plans, increase pay levels for employees, etc.
  - Conversely, it becomes more expensive to pursue "bad" behavior (e.g. reductions in force)
- It is "sized" to be commensurate with the level of the benefit to employees.
  - While the 2x deduction can be quite large for some companies, we are proposing it to be temporary in nature (inherently limiting the ultimate value to the any company)
  - By providing the ESOP with a liquidation preference equal to the cumulative tax savings afforded by this structure, it ensures that employees are benefiting from **at least** this level of tax savings (and likely far more)

- That said, we expect this to still be attractive to potential ESOP investors, as this mechanism effectively allows the company to accelerate the realization tax benefits the ESOP may have otherwise been able to achieve in the future (in some ways this bears similarities to accelerated depreciation concepts that are widely utilized in corporate America today).