Institute for the Study of Employee Ownership and Profit Sharing

WORKING PAPER SERIES

FEBRUARY 2022

WORKING PAPER 2

Implementing Universal Capital Accounts in the U.S.
Fixing Our Broken Income Distribution System

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The views expressed herein are those of the author and do not necessarily reflect the views of Rutgers University, the School of Management and Labor Relations, the Institute, or any other organization. I thank Ray Boshara, Genevieve Melford, Katherine Lucas McKay, and Dwvonne Body of the Federal Reserve Bank of St. Louis for comments on an earlier version included in a volume published jointly by the Bank and The Aspen Institute. John Menke, Douglas Kruse, Adria Scharf, and Joseph Blasi provided useful input and edits. Early drafts were presented at the Beyster Symposium and the Kelso Workshop of the Institute and I appreciate the helpful feedback by both discussants on the paper and participants in the conferences. The remaining errors are mine.

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Implementing Universal Capital Accounts in the U.S. Fixing Our Broken Income Distribution System

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Institute for the Study of Employee Ownership and Profit Sharing Working Paper No. 2

March 2022

ABSTRACT

The concentration of ownership by the very wealthy is supported by a financial system that enables them to acquire income-producing capital basically on credit whereas no such financing strategy is available to the mass of the population. A solution lies in creating a system whereby every individual has the right and opportunity to acquire income-producing capital on a basis where the income produced is used to pay for the cost of capital acquisition, and thereafter the capital provides its owner with income indefinitely. In this proposed system, everyone with an active Social Security number would have an account in a nationwide fund that would make investments for all participants. The program puts in place incentives for publicly-traded corporations that would increase the amount of equity financing, as opposed to debt-financing and retained earnings, thereby enabling the mass of the population to participate in a meaningful way in the trillions of dollars of new capital created annually. This paper is a more detailed discussion of how the implementation and operation should be accomplished to create a Universal Capital Trust Fund.

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Introduction

In 2021, I published an essay proposing a system of Universal Capital Accounts to be managed by the U.S. Government. The essay, "Deriving Income from Universal Capital Accounts: Fixing Our Broken Income Distribution System," was included in the book *The Future of Building Wealth: Brief Essays on the Best Ideas to Build Wealth – For Everyone* published by the Federal Reserve Bank of St. Louis and The Aspen Institute (Boshara and Rademacher 2021). The essay contrasted the fact that the U. S. economy is physically capable of producing all of the goods and services that everyone needs or wants with the fact that a significant percentage of Americans have incomes below the poverty line. Indeed, much of the U.S. population lives a subsistence-level lifestyle while the top 5% of the population receive about 23% of the national income. In this Working Paper, I expand on that original essay to discuss in greater depth how to implement Universal Capital Accounts in the United States.

The source of the problem is the fact that most people earn their income based upon some form of labor input whereas the share of national income going to labor relative to capital has been declining, thereby making it more and more difficult for those who work for a living to receive a fair share of the national income.

The concentration of ownership by the very wealthy is supported by a financial system that enables them to acquire income-producing capital basically on credit whereas no such financing strategy is available to the mass of the population. A solution lies in creating a system whereby every individual has the right and opportunity to acquire income-producing capital on a basis where the income produced is used to pay for the cost of capital acquisition, and thereafter the capital provides its owner with income indefinitely.

In this proposed system, everyone with an active Social Security number would have an account in a nationwide fund that would make investments for all participants. The program puts in place incentives for publicly-traded corporations that would increase the amount of equity financing, as opposed to debt-financing and retained earnings, thereby enabling the mass of the population to participate in a meaningful way in the trillions of dollars of new capital created annually.

My original essay presented the analysis and the basic structure of the proposal, but it did not describe the many issues and specific procedures that will be required. What follows is a more detailed discussion of how the implementation and operation should be accomplished.

The Structural Set-Up

An Act of Congress would adopt the Universal Capital Plan ("UC Plan") which would comprise the following:

1. The Universal Capital Trust Fund ("UC Trust Fund") would conduct the actual investment banking function in the plan. [It would first establish specific eligibility criteria for corporations to participate in equity financing through the UC Trust Fund. (Such criteria

might consider industry, profitability, cash flow and other related factors, including compliance with the required characteristics of its stock.) The UC Trust Fund would develop promotional materials to inform the financial community of the UC Plan and find and consider prospective corporations to qualify for inclusion in the Trust Fund. It would negotiate the terms of purchases of a new class of "common stock with earned dividend" from eligible corporations and manage cash flows in and out of the UC Trust Fund reflecting stock purchases, funding from a variety of sources, debt repayment and dividend distributions. It would be subject to oversight by a "Universal Capital Administrative Committee" (see below). Committee members would be appointed by the President with U.S. Senate consent and would include six members, each for a term of six years with the term of two of the appointees expiring sequentially at two-year intervals. The UC Trust Fund would hire additional personnel as necessary to carry out its functions.

2. The Universal Capital Administrative Committee ("UC Administrative Committee") would be responsible for two essential aspects of the UC Plan:

(a) First, it would establish policies and procedures for the implementation and operation of the UC Plan, including standards and other criteria that must be met in order for a corporation to be accepted for equity financing through the UC Trust Fund. It would provide the administration of the UC Accounts reflecting the various transactions, funding sources and dividend distributions. The accounts would be conducted in tandem with Social Security Accounts – meaning each person with an active Social Security number would be a beneficiary of the UC Trust Fund – but the two programs would be independent of each other. It would provide oversight for the UC Trust Fund.

(b) Second, the UC Administrative Committee would develop and carry out a public information program designed to educate all Americans about the fact that the ownership of income-producing capital can represent a continuing source of regular income in the same way that labor produces a source of income. The details of the program would be well thought out and implemented nationally. Unless the American people can be educated to understand this principle, it is unlikely that the UC Plan will result in a meaningful "fix" of our broken income distribution system.

3. A Universal Capital Account ("UCA" or "UC Account") will be set up for each individual who has an active Social Security number and satisfies any other requirements for participation in the UC Plan. Each Universal Capital Account will reflect the number of shares of each corporation in which the UC Trust Fund invests, any debt associated with said shares, any funding or debt payments, and dividend receipts and disbursements to UCA owners.

<u>Key Issues for Success of the UC Plan</u>

Aside from the many procedural issues in implementing the UC Plan, there are two key issues that will determine the ultimate success of the UC Plan:

1. The degree to which the American people are educated to the fact that the ownership of capital can provide a continuing source of income in the same way that labor produces a source of income.

2. Whether the UC Account Owners actually receive dividend income based upon their capital ownership through their UC Accounts.

Certain Definitions

1. Blue Chip Company ("BC Co.") means any corporation that has been analyzed and found to be an acceptable candidate to obtain equity financing through the UC Trust Fund.

2. Blue Chip Company Stock ("BC Stock") means the stock of any BC Co. that satisfies the following requirements:

(a) It may be characterized as "common stock with an earned dividend."

(b) In all respects, it is identical to and has the same rights, preferences and privileges as the publicly traded common stock except that it must distribute to its holders, not less frequently than quarterly, at least 90% of the earnings per share (determined quarterly on both classes of stock as a whole) of said corporation. The Blue Chip Co. could elect to pay up to 100% of earnings per share.

(c) Earnings per share shall be determined in accordance with generally accepted accounting principles ("GAAP") and any determination made for a quarter that is not formally audited by an independent certified public accountant shall be certified by the corporation's Chief Financial Officer to be materially in accordance with GAAP to the best of their knowledge and belief.

(d) Since it is unlikely that Blue Chip Cos. will have a class of common stock with the required dividend distribution, it will be necessary for each Blue Chip Co. to authorize such a class of stock. This is the stock that will be purchased from the Blue Chip Co. by the UC Trust Fund.

(e) For situations where the UC Trust Fund determines that it is in the best interest of the UC Trust Fund to dispose of BC Stock, the BC Stock should, at the option of the UC Trust Fund, be convertible into an equal number of shares of non-BC Stock that are freely tradable on a stock exchange.

3. Earned Dividend means the dividend paid on Blue Chip Company Stock in excess of any dividend paid on non-Blue Chip Company Stock. Non-BC Stock means the common stock of the BC Co. that is not BC Stock. For example, assume that the earnings per share of a Blue Chip Co. is $10. The Blue Chip Co. pays a dividend on all of its shares of common stock of $2 per share. In addition, the Blue Chip Co. satisfies its obligation to pay at least 90% of its earnings

per share to the UC Trust Fund by paying an additional dividend to the UC Trust Fund on the BC Stock of $7 per share. The Earned Dividend would be $7 per share. If the Blue Chip Co. paid 100% of its earnings per share to the UC Trust Fund, it would pay $8 per share and the Earned Dividend would be $8 per share.

<u>Funding Sources</u>

It is anticipated that funding will come from a variety of sources, both for the initial set-up of the UC Plan and on an annual basis to subsidize and accelerate the rate at which the ownership of capital becomes more broadly owned and less concentrated in the hands of the few. Stock purchases will be shares of Blue Chip Cos. purchased by the UC Trust Fund from Blue Chip Companies. There will be at least two basic types of funding sources.

1. "Borrowed Funds" are funds that the UC Trust Fund has borrowed and must be repaid. This would include any funds borrowed by the UC Trust Fund in connection with the initial purchase of stock from the Blue Chip Co., any stock purchases in subsequent years and any refinancing of existing debt. To the extent that the funds come from commercial lenders or any other source, the Federal Government could establish an FHA-type loan guarantee program that would reduce the effective cost of the stock purchase. The Federal Reserve could make substantial Borrowed Funds available on favorable terms that would facilitate the providing of equity financing to Blue Chip Cos.

The existence of any such debt would be reflected pro-rata in the Universal Capital Accounts as an encumbrance on a non-recourse basis. Repayment of the debt would come from either Earned Dividend income, Grant Funds from various sources, other Borrowed Funds or some combination thereof. Although Earned Dividends would be available to repay debt, it is anticipated that the debt would be paid with other Borrowed Funds or Grant Funds or some combination of both. By not using Earned Dividends to repay debt, the UC Account Owners receive more dividend distributions thereby enhancing the likelihood of acceptance of the UC Plan by the American people as a regular source of income.

2. "Grant Funds" are funds that the UC Trust Fund has received from various sources and do not have to be repaid. They may come at the inception of the UC Plan and on a continuing basis from year to year.

(a) It is anticipated that the Federal Government will make grants both at the inception of the UC Plan and in subsequent years.

(b) Based on a variation of quantitative easing, the Federal Reserve may have, or could be given by Congress, authority to grant credit to the UC Trust Fund that would not have to be repaid.

(c) The Internal Revenue Code should be amended so that contributions to the UC Trust Fund are tax-deductible. It is anticipated that individuals such as Warren Buffet, Bill Gates, other wealthy individuals, Foundations, Charitable Trusts, etc. who have a desire to support the future of Capitalism would make meaningful contributions that they may feel inclined to support since it has produced great wealth for them. Any limitation on the amount of the deduction should be eliminated since all such funds go directly toward the broadening of capital ownership.

Certain Allocation Rules

1. All Grant Funds received by the UC Trust Fund will be allocated in equal amounts to all UC Accounts. Grant Funds are received for the UC Plan as a whole and all Universal Capital Accounts should share equally in all such amounts.

2. Earned Dividends on stock held in the UC Trust Fund and allocated to Universal Capital Accounts will be allocated to the Universal Capital Accounts that hold shares of the dividend paying corporation in proportion to the number of shares held in each Universal Capital Account. This rule reflects the goal that the owners of the stock should actually receive the income earned by those shares.

3. Stock purchased with Borrowed Funds will be allocated in an equal number of shares to each Universal Capital Account. Said Borrowed Funds will be reflected in said Universal Capital Accounts as encumbrances in proportion to the number of shares allocated to each Universal Capital Account. In the event that new Borrowed Funds are used to service said debt, the amount of new Borrowed Funds will be allocated to the applicable Universal Capital Accounts in proportion to the amount of debt that was wholly or partially paid.

Taxation and Incentives for Equity Financing

Each of the tax benefits discussed in this and the following section will require an amendment to the Internal Revenue Code. They are relatively far-reaching and will have a significant impact on U.S. Government revenues. They are included to describe the strongest incentive to expand capital ownership. Accordingly, depending upon the degree of public support for the UC Plan, the size of the tax benefit could be reduced to make it politically feasible.

1. The Earned Dividend on Blue Chip Stock (i.e., that amount in excess of the amount paid on Non-Blue Chip Stock) of at least 90% of earnings per share (or any additional such dividend up to 100% of earnings per share) will be tax-deductible by the Blue Chip Co.

2. A potential concern is the effect on retained earnings as a source of capital for future investment. Thus, an additional tax deduction should be established in order to neutralize the effect of the Earned Dividend on cash flows available for investment so that, as a greater percentage of Blue Chip Co. capital is owned by the UC Trust Fund, the Earned Dividend will not have a negative effect on economic growth. The additional tax deduction should be determined as follows:

(a) Determine the effective tax rate on the layer of earnings between the amount, if any, of the dividend on non-BC stock and the amount of BC Co. dividend actually paid, up to 100% of earnings per share, provided that said rate shall not be less than 15%.

(b) Multiply the effective tax rate by the Earned Dividend (i.e., the dividend paid in excess of any dividend paid on non-BC stock).

(c) Deduct the amount determined in (b) above from said Earned Dividend to arrive at the necessary additional tax benefit.

(d) Divide the additional tax benefit determined in (c) above by the effective tax rate to determine the additional tax deduction necessary to neutralize the cash flow effect of said Earned Dividend.

3. To support and accelerate the rate at which the ownership of capital is broadened, there should be tax incentives to use equity financing through the UC Trust Fund. The percentage of the BC Co. owned by the UC Trust Fund might be a way to incentivize the use of equity financing through the UC Trust Fund. This could be done by providing a tax credit based on the amount of the equity financing, increasing as the percentage of ownership increased. For example, where the percentage is below some percentage, such as 5% (or a suitable minimum percentage), there would be no tax credit. But as the percentage of ownership increased, the tax credit would be increased incrementally, presumably in small increments in order to maximize the incentive to do the next round of equity financing. The top ownership percentage at which the tax credit would stop increasing might be around 50%, although a higher percentage could be considered depending upon the degree of public support for the program.

<u>UC Plan Administration and UC Account Owner Taxation</u>

The following is a series of examples describing how the various types of transactions are accounted for based on funding sources and Earned Dividend income and their tax effect upon the UCA Owners.

For background, let's consider theories about expanding capital ownership. A key element of Louis Kelso's theory (1958) is the fact that new capital is not created unless its owner believes that it will pay for itself and provide a continuing source of income. The wealthy can obtain credit for such purposes thus contributing to the concentration of capital ownership, whereas the mass of the people are not able to take advantage of this strategy. A foundational element of the UC Plan is that everyone participates in a plan whereby he/she acquires capital ownership and pays for it out of the income that it produces.

In the following first and second examples, the transaction with either all Grant Funds or all Borrowed Funds is presented to illustrate the basic rules for allocation. In practice, it is likely that actual transactions will include various combinations of Grant Funds and Borrowed Funds as illustrated in the third and fourth examples.

For the first example, we will illustrate the simplest situation. Assume that the purchase price is covered by Grant Funds obtained by the UC Trust Fund that do not have to be repaid. The shares would be allocated to all UC Accounts with each UC Account receiving an identical number of shares, free and clear of any debt. On an ongoing basis, as Earned Dividends are paid by the BC Co., they would be allocated to the UC Accounts and distributed to their owners. Until the total amount of Earned Dividends equals the cost of the BC Stock, the dividends would be tax-free to the UCA Owner. Thereafter dividends would be taxable as "qualified dividends."

For the second example, assume that the UC Trust Fund obtained Borrowed Funds that will have to be repaid and these funds are used to purchase stock from a BC Co. For simplicity, assume that no Grant Funds come in to assist in this purchase or thereafter for the term of the loan. (This is unlikely since the UC Plan is intended to be supported and subsidized by the various sources of Grant Funds as previously discussed.)

The number of shares purchased will be allocated to all UC Accounts, as in the first example. The UC Accounts will also reflect the amount of the debt incurred. As Earned Dividend income comes in, it is used to repay the debt. Although unlikely to occur, if no Grant Funds came in, Earned Dividends would be so used until the debt was repaid. Thereafter, Earned Dividends would pass through to the owner indefinitely. While the Earned Dividend was used to repay the debt, there would be no taxable income to the UC Account Owner. Once the debt is repaid the dividend would be taxed as a qualified dividend.

Our third example will assume that a stock purchase is paid for partly with Borrowed Funds (60%) and partly with Grant Funds (40%). Repayment of the Borrowed Funds will be entirely out of Grant Funds which will be made available on an annual basis as payments on the debt become due.

As with the other examples, the shares are allocated equally to all UC Accounts. Sixty percent of the shares will be deemed encumbered on a non-recourse basis. Forty percent of the shares will be deemed to be owned free and clear of debt.

Annually there will be two sources of funds, Earned Dividend income on all of the shares and Grant Funds equal to the amount of debt service. The Earned Dividend income will be paid to the UC Account Owner. The Grant Funds will be used to make the debt payment and thereby releasing shares from encumbrance. (Shares could be released based on either principal and interest method or the principal only method.)

While any of the debt remained unpaid, Earned Dividends in cash passed through to the UC Account Owner would be tax-free. Once all debt had been repaid, Earned Dividends paid to the UC Account Owner would be taxable as qualified dividends.

For the fourth example, assume that the stock purchase will be paid 60% with Borrowed Funds and 40% with Grant Funds. Repayment will be made 75% with Grant Funds and 25% out of Earned Dividends on the subject stock. (In practice, it is more likely that the repayment percentages will vary year to year but the basic rules would simply be applied to the amounts for the particular year.)

As with all examples, the BC Stock would be allocated to all UC Accounts in an equal number of shares. Sixty percent of the shares will be deemed to be encumbered and the 40% will be free and clear of all encumbrances.

Repayment of the Borrowed Funds will be out of Grant Funds and from the Earned Dividend income on the subject shares. It is assumed that 75% of the debt service will be paid with Grant Funds which will release a portion of the shares from encumbrance (using principal and interest method or the principal only method). The 25% paid from Earned Dividend income will also release a portion of the shares from encumbrance. Hopefully not all of the Earned Dividend will be required for debt service, in which case the amount not so used would be distributed to the UC Account Owner. In these types of situations, the UC Administrative Committee would have some degree of discretion where the objective would be to maximize the amount distributed to the UC Account Owner.

While any debt was outstanding, the Earned Dividends would be tax-free to the UC Account Owner. Once all debt is repaid, Earned Dividend income would be taxable as a qualified dividend.

<u>The UC Plan in Operation</u>

1. The public information program is being implemented extensively by the UC Administrative Committee to educate the American people regarding the importance of capital ownership.

2. A complete description of equity financing through the UC Trust Fund in a educational manner is disseminated throughout the financial community by members of the UC Trust Fund.

3. Substantial financial resources are obtained by, or made available to, the UC Trust Fund, initially mostly from the federal government as Grant Funds but significantly from other sources of Borrowed Funds and Grant Funds.

4. The UC Trust Fund and UC Administrative Committee would begin an analysis of publicly traded corporations that could qualify as BC Cos.

5. The UC Trust Fund would commence its investment banking function in making deals to provide equity financing to BC Cos.

6. The UC Administrative Committee will have established an accounting system in tandem with the Social Security Administration for administering the UC Accounts.

<u>Summary of the Benefits</u>

For Individuals:

1. Increased purchasing power as people receive dividend income due to their capital ownership.
2. Decreased poverty as poor people acquire income producing capital.
3. Increased sense of ownership and responsibility as people acquire increasing amounts of capital and the dividend income that the capital produces.
4. Increased political freedom as more people are less dependent upon politicians, lobbyists and representatives of the top 1% who determine who gets what and how much government determines income.

For the Economy:

1. Increased consumer purchasing power as people acquire increasing amounts of income producing capital.
2. An ongoing economic stimulus program through incentives for equity financing and the resulting increase in income from capital ownership in addition to their wages.
3. A reduction in the concentration of capital ownership that benefits the already wealthy and an increase in capital income by citizens.
4. An increase in the support for Capitalism by individuals as they become part of the Capitalist system and receive its benefits.
5. A reduction in the number of mergers and acquisitions, which concentrates corporate power and monopolies, by requiring that corporations pay out most of their earnings and are thereby motivated in engage in equity financing.

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