

YOU'VE BUILT A SUCCESSFUL BUSINESS. NOW YOU NEED A SUCCESSION PLAN.



We Know ESOPs

Employee Stock Ownership Plans (ESOPs) create succession planning strategies; new opportunities for employee ownership; and tax benefits for employer and employees alike.

One of the benefits of an ESOP is that it gives employees an interest in the long-term success of the business. Owners and founders invested in the continued success of the company can still maintain a majority interest and control of the company to ensure the company continues the traditions of quality, while rewarding the employees who helped build the company. ESOPs provide a transition process from private ownership to employee ownership, based on the owner's terms and timeline.

Want to know more about the benefits of an ESOP for your company?

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Solve Your Shareholder Liquidity Problems With an ESOP!

You've worked long and hard over many years building up the value of your company. While you now have wealth on paper, you're becoming increasingly concerned whether you will have the ability to realize the value you've accumulated in the form of current spendable cash because, as a nonpublicly traded company, you have no ready market for your stock.

Many baby boomers are finding they are not alone. Much attention has been focused recently on the problems of stockholders in private companies and their inability to enjoy the benefits of their hard work in building the business. An Employee Stock Ownership Plan ("ESOP") may be the answer.

In addition to numerous tax benefits ESOPs can provide to all companies, a very important benefit is available to owners of private companies. Perhaps you are older, ready to retire; or younger, with most of your wealth tied up in the value of your company stock, and you wish to diversify your portfolio and obtain liquidity for all or a portion of your shares. Perhaps you are the executor of an estate of a deceased private company shareholder and need to liquidate the stock to provide cash for heirs.

Whatever your reason, if your corporate shares are not publicly traded, you can sell part or all of your stock to an ESOP and, in most circumstances, without paying current capital gains tax.

What is an ESOP? An ESOP is an employee benefit plan designed to invest in company stock. An ESOP is implemented by adopting a written plan and setting up a trust to hold your company's contributions (as you do with a standard profit sharing or pension plan). Contributions to the ESOP, normally in cash or company stock, are tax deductible to the company. An ESOP is also allowed to borrow money from a bank, repayable through annual tax deductible company contributions, which can be used to buy stock from a shareholder.

An ESOP also provides significant benefits to the owner of a closely held company in that the ESOP may provide not only a ready market for the "pretax" purchase of stock of a deceased shareholder, but also can provide liquidity to a shareholder during his/her lifetime, in many cases without giving up control of the company. In fact, a shareholder selling stock to an ESOP has the ability to defer and possibly totally avoid the payment of income taxes with respect to the sale. Many tax practitioners believe this to be the single greatest tax benefit available to corporate shareholders of non-publicly traded companies.

There are other benefits as well, including enabling employees to share, indirectly through their participation in the ESOP, both in the profitability and long-term growth of the company. Studies have shown this generally results in increased productivity by employees and a reduction in turnover.

Here's a hypothetical example of how you, as the owner of a private business, could use an ESOP to facilitate a successful transfer of ownership of your business.

You own all your company's stock and you're approaching an age when you'd like to retire. Several key employees have worked at your company many years and would like to take over management.

The value of your business is about \$7,000,000.

Your objectives are to be able to retire with an adequate and assured income, transfer control of your business to your employees over time, and protect the jobs of your company's long-term employees.

You have several alternatives.

First, you could sell the business to a third party. You'd have retirement security, but you give up the chance to pass control of the business to your key employees, assuring them job security. Moreover, you'd face federal and state taxes in excess

of 30% of the sale proceeds. Assuming you sell your stock for \$7,000,000, your total current tax liability will likely exceed \$2,000,000.

Second, you could have the company buy back all or a portion of your stock. Either you'd take back a note from the company or it would borrow the money to finance the transaction. There's no tax relief either way. You pay a large capital gains tax and the company is not entitled to any tax deductions in connection with the payments it makes to you (except for interest).

You face an additional problem: If you take back a note from the company, you still have all your eggs in one basket; and if the company doesn't continue to prosper, your retirement security is in jeopardy.

A third alternative is to sell your stock to an ESOP. As long as you sell at least 30% of your company stock to the ESOP, the sale qualifies for tax free "rollover" treatment. Example: If you sell one third of your stock to the ESOP for \$2,300,000, you could save about \$700,000 in federal and state income tax.

If the company borrows funds to repurchase your stock through an ESOP loan, its financing costs are greatly reduced because the company will be entitled to deduct the principal repayments on the loan as well as the interest. Assuming it borrows the full \$2,300,000 purchase price, the company will be entitled to \$2,300,000 in federal and state income tax deductions it would not otherwise have in repaying the loan. This will result in an approximate \$920,000 federal and state tax savings over the term of the loan. Combined with the \$700,000 in capital gain taxes that you will have deferred, the total tax savings can be at least \$1,620,000, or 70% of the total purchase price. If you sold your entire interest in the company to the ESOP, the savings would be proportionately greater.

If you use an ESOP as in this typical situation, you'll have created a ready market for your privately held company stock and be able to diversify your investments on either a tax free or tax deferred basis. Over time, your key employees may be able to assume control of the business, and your employees will enjoy job security and more incentive than ever to increase their productivity.

The many advantages ESOPs offer are not the result of temporary tax loopholes nor is their use aggressive tax planning. Congress enacted ESOP legislation nearly 50 years ago as an ongoing incentive program to encourage company ownership sharing and to increase worker productivity.

Of course ESOPs are not for everyone. Some business owners are not particularly concerned with liquidity of their wealth or contemplating retirement and may prefer to maintain sole ownership of their company. Some businesses may not be appropriate for ESOPs--such as companies that are unprofitable or have only a short-term industry outlook. But the benefits of ESOPs are by no means limited to large companies. Most small and medium sized businesses are well suited for ESOPs.



Marc Schechter

Marc Schechter specializes in the areas of employee benefits, ERISA, and business matters. He has extensive experience designing, drafting, and implementing all types of employee benefit programs for his clients, with special emphasis on ESOP transactions and ERISA-related litigation.