

ESOP Advisory: An Introduction to ESOPs: Should I Consider One for My Business?



Amanda M. Daquelente
amd@muslaw.com

Today, more than ever, owners need to begin to plan for their business succession well in advance of their ultimate retirement. More often than not, owners also need to ensure that they are providing competitive salary and benefit packages in an effort to retain key employees that may be critical to the future success of the organization. An Employee Stock Ownership Plan (ESOP) may be an attractive consideration for owners looking to accomplish these goals.

An ESOP is a qualified defined-contribution employee retirement plan that can be used to purchase the stock of the sponsoring company. These plans have notable benefits for employees and owners alike, but companies must take care in how ESOPs are structured, implemented and managed to ensure that the ESOP is in compliance with ERISA rules, as the plans are overseen by both the Department of Labor and the IRS.

Nevertheless, an ESOP may be worthwhile to consider for many business owners.

Why are ESOPs growing in popularity?

As the name suggests, ESOPs give employees a stake in their company's success. ESOPs also have significant benefits for owners who have private, closely-held company stock and are interested in selling the company at fair market value, typically without a negotiated discount.

An ESOP creates a ready-made market with no third-party buyer required. Sellers can receive cash up-front and retain day-to-day operational control of the company until "cashed out," or they can opt to sell over time to diversify and ease out of the business gradually.

Perhaps, most important, ESOPs can offer substantial tax benefits, depending on the structure of an organization. For example, for an S-corporation, any profits attributable to the ESOP's ownership of stock is not subject to federal income tax. There are differing tax benefits for organizations structured as a C-corporation.

Should I consider an ESOP?

If you are interested in learning whether an ESOP is right for your business, follow these initial steps in collaboration with trusted advisors:

- Ask yourself, "Do I want to sell my business?"
- Arrange to have a feasibility study conducted, which will allow you and your advisors to assess how much cash flow the company has available to dedicate to the ESOP.

- Conduct an independent valuation. This will enable the sellers to determine if the value of the organization is low, which may indicate that the timing is not right for a sale, or if the value is high such that the company will not be able to afford the payments necessary to buy-out the selling shareholders.

Who are the best candidates for an ESOP?

ESOPs are not one-size-fits-all — each plan is tailored specifically to the sponsoring company. However, there are certain traits that most businesses should have before being a strong candidate for implementing an ESOP:

- Usually, at least 20 or more employees;
- Business valuation of at least \$5 million or an annual net income of at least \$1 million;
- Five-year history of profitable operations;
- Strong line of key employees;
- Necessary corporate structure.

What can Meyer, Unkovic & Scott do for your business?

We are deeply experienced in providing advice and assisting selling shareholder(s) through the ESOP process. We have a breadth of experience representing selling shareholder(s) interests in negotiations with both ERISA and trustee counsel to ensure the ESOP transaction is set up with proper protections for the selling shareholder(s).

To learn more, please contact Amanda Daquelente at amd@muslaw.com or Patricia Farrell at pef@muslaw.com.