



ESOPs - Unlocking the Wealth of Privately-Held Businesses



By: Brian Eagle, J.D.

Do you represent clients who are owners or managers of privately held companies? Are they looking for exit strategies that will:

- Reduce or eliminate the company's income taxes;
- Reduce risk by diversifying an owner's investments; and,
- Increase the wealth of the company's managers and employees?

Advisors of privately held companies who answer yes to these questions are considering Employee Stock Ownership Plans (ESOPs).

What is an ESOP?

An ESOP is a qualified retirement plan with special exemptions allowing the plan to use debt to acquire "employer securities" which consists of common and convertible preferred stock.

How are ESOPs mostly used?

ESOPs are used primarily for business succession and exit strategies in privately held companies. However, ESOPs are also used as pure employee benefits; going-private instruments; spin-off instruments; alternative to third party sales and leveraged buy outs, and cash-flow improvement instruments.

ESOPs as part of a longer-term succession plan – non-family controlled:

- Most ESOPs are currently created where the owner of the business has indicated that majority control of the equity of the company does not need to be passed to family members.

ESOPs as part of a longer-term succession plan – family controlled:

- When most business succession planners hear that the business owner desires to transfer control or all of the business to family, an ESOP is not typically brought

to the client's attention. This fact is understandable; however, not necessarily what is ultimately best for the client and all of the client's affected parties. An ESOP can provide the family with asset diversification and can be used to further bind the workers to the next generation of family ownership. Economic benefits to family members and employees are enhanced due to tax subsidies supporting the transaction

ESOPs can be an excellent vehicle for aiding a client transfer control to the family and creating liquidity for the older generation.

The Benefits of ESOPs

Benefits of the ESOP to the Seller

- Diversification of non-liquid and highly concentrated equity position For C Corporation sales – tax deferral and potential elimination of capital gains
- Creates the necessary cash flow for advanced estate planning strategies
- For S Corporations – converts ordinary income to capital gains
- Leaves a lasting legacy and provides for the continuation of the business

Benefits of the ESOP to the Company

- Increases cash flow by allowing tax deductions for both principal and interest payments
- Increases cash flow by allowing non-cash share contributions to ESOP to increase cash flow
- Increases employee productivity by making employees, "Employee-Owners"
- Keeps jobs in the community v. the potential of losing jobs with a sale to a third party
- Creates tax free entity for 100% ESOP owned S Corporations

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Benefits of ESOP to Employees

- Provides Employees an Equity interest in the Corporation without cost
- Creates a “we can” attitude v. an “us” and “them” and “we can’t” attitude
- Provides Employees with increased retirement plan contributions
- Allows employees to maintain positions and remain employed
- Allows senior management to maintain control

Brian A. Eagle, J.D. is a nationally known speaker and member of the WealthCounsel. He is a member of the ESOP Collaborative which is an interdisciplinary group of advisors that provide turn key solutions to advisors and clients desiring to explore ESOPs. He may be reached at beagle@eagleandfein.com or at www.eagleandfein.com.