Employee Stock Ownership Plans (ESOPs) Continue to Flourish

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PRACTICE AREAS

Employee Stock Ownership Plans (ESOPs)

For 25 years now, employee stock ownership plans (ESOPs) have played an important role in assisting a company with its ownership and management transition strategy. ESOPs remain a viable option for purchasing a retiring owner's stock and should be considered by an owner and/or management team.

An ESOP provides significant tax advantages to the company and to the selling shareholder. For example, if a selling shareholder sells stock to an ESOP established by any C corporation, he or she has the opportunity to defer capital gains by reinvesting those proceeds within 12 months after the sale. A million dollar sale to the ESOP can result in $200,000 tax savings to the selling shareholder(s). Company contributions to the ESOP are tax deductible, thereby permitting the company to purchase the selling shareholder stock with pretax (i.e., deductible) dollars. The company stock is held in a trust for the benefit of the company's employees including members of the management team and rank and file.

Several years ago, Congress passed legislation permitting an "S" corporation to establish an ESOP. The ESOP established by an S corporation assists in lowering or eliminating altogether taxes for the S corporation's shareholders. For example, a 50% ESOP in an S corporation would reduce by half the taxes paid by that S corporation's shareholders. If the ESOP owns 100% of the outstanding shares of the company, then all taxes at the shareholder level are eliminated. This provides a significant amount of cash flow to fund the ESOP purchase.

Owners, members of a management team and the company's professional advisors should consider utilizing an ESOP to assist in its ownership and management transition strategies. Please contact Foster Swift if you want more information regarding ESOPs.