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ESOP CONNECT

EMPLOYEE STOCK OWNERSHIP PLANS' LEGACY FULL CIRCLE

Daniel M. Zugell, CLU, ChFC, LUTCF, Ambassador

A recent Price Waterhouse Coopers report indicated that 62% of the U.S. companies planning to sell all or part of their business will do so within the next 5-6 years. U.S. Department of Commerce's 2010 statistics show that Pennsylvania's Allegheny and the surrounding five counties account for 56,498 of non-farm privately held businesses, many of whom fall into this 62% and are planning to transfer their businesses to their children and/or management. However, the children and/or management often cannot afford to buy or borrow the funds needed to purchase the business and an outright gift is not financially feasible for the seller.

An Employee Stock Ownership Plan (ESOP) is a tax-qualified retirement plan used for business transfers that often results in the most after-tax seller proceeds than any other transfer method. Additionally, ESOPs are not affected by the significant increased taxation on a sale of a business taking effect on January 1, 2013 yet still preserves the family and community legacy of the business for generations to come.

ESOPs have the most advantageous tax benefit.

EMPLOYEE STOCK OWNERSHIP PLANS DEFINED

An ESOP is technically a defined contribution, tax-qualified retirement benefit plan designed to invest "primarily in employer stock." In practical terms, an ESOP has the most advantageous tax benefit transfer strategy for owners desiring to take all or partial "chips of the table" that keeps out unrelated third parties and allows corporate control to be transferred according to the seller's timeline.

HOW AN ESOP WORKS

Typically, the ESOP borrows funds from a bank or the seller takes back a note. The company makes income tax-deductible contributions to the ESOP which uses the funds to repay the loan incurred to buy the stock until the debt is repaid. The shares purchased by the ESOP are allocated to the employees of the company in proportion to their compensation as the loan is repaid.

ESOP BENEFITS

The seller enjoys an immediate buyer at full fair market value, may defer/eliminate all capital gains tax, and may retain salary, perks, benefits and control. The corporation receives a dollar-for-dollar income tax deduction on the entire stock sale price and may become a 100% federal and state income tax exempt entity. The employees receive enhanced retirement benefits, with no out of pocket costs, work at a more stable employer and participate in corporate growth as employee owners.

CORPORATE GOVERNANCE AND CONTROL

Stock ownership and control are not synonymous in an ESOP company. In an ESOP company, the shares outside the ESOP appoint the Board which names the ESOP Trustee. The trustee is usually directed by the board to ensure smooth business operations. Therefore, control can be maintained by even a minority ownership.

ESOP'S LEGACY FULL CIRCLE

Many owners want their children and/or management to eventually run and own the business, but they cannot afford to purchase the business nor obtain adequate financing to do so. Additionally, the seller has often been a significant contributor to the community by being a substantial employer, charitable benefactor and overall economic driver of the town. The ESOP can preserve both the family and community legacies while still accomplishing the seller's transition goals and objectives.

FAMILY/MANAGEMENT LEGACY

The seller can transfer control and/or ownership to the next generation at the seller's discretion without the interference of outside, unrelated interests. Control can be obtained by children and/or management with even a very small interest. To increase actual ownership, the company can use corporate cash to purchase employees' ESOP shares as they leave the

Shares Retired	Total Outstanding Shares	Shares Owned Inside ESOP	Shares Outside ESOP (Kids/Mgmt)	Percentage Outside ESOP (Kids/Mgmt)
0	100	90	10	10%
20	80	70	10	13%
20	60	50	10	17%
20	40	30	10	25%
20	20	10	10	50%
10	10	0	10	100%

company and retire them into treasury. As the overall outstanding shares decreases, the percentage of ownership that is held by outside the ESOP increases. In theory, when the last share is repurchased and retired, the shares held outside the ESOP by the children and/management represents 100% of the value of the company, as shown in the chart above.

COMMUNITY LEGACY

Studies show that ESOPs are a more stable employer that helps ensure the continuity of the level of the corporate contribution to the community. Third party, out of town buyers are notorious for making decisions that negatively affect the community such as consolidating operations, laying off duplicate divisions and even close local operations and liquidate assets. The entire community may be including the employees, suppliers, charitable beneficiaries, and professional service providers. In fact, many long-term business owners dread the idea of retiring and living in a community decimated by the decisions of his/her buyer.

In summary, an ESOP is a ready and willing buyer and a highly tax-advantaged business transition tool. An ESOP may be the ideal method to transfer a business on the seller's timetable to the next generation without the interference and costs of outside parties. As the window of record low capital gains rates are set to expire on December 31, 2012, baby boomer business owners in our region and around the country owe it to themselves to explore their options including ESOP's legacy full circle.

The author, Daniel M. Zugell, CLU, ChFC, LUTCF, is the Eastern U.S. Director for Business Transition Advisors, Inc., a business transition consulting firm specializing in ESOPs. Dan has been assisting business owners' transitions for over 13 years and resides in Cranberry Township, PA. Dan is immediate past-president of the Society of Financial Service Professionals (Pittsburgh), Chair of the 2012 Pittsburgh Business Ethics Awards. Dan can be reached at 724.766.3998 or dzugell@bta.us.com.