ESOPS

A Win-Win for Business Owners?

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Employee Stock Ownership Plans (ESOPs) can create a win-win situation for business owners and their employees.

An ESOP can:

■ *Provide important retirement benefits* that pay off for owners and employees in terms of higher growth and higher rates of return.

■ *Create an exit strategy for business owners* - a way to cash out of the firm in a tax-advantaged way without the hassles of a sale to a third party.

■ *Give businesses a new tool to meet financial objectives.* Here's an example: A business owner can sell all or part of his or her stock in the business to an ESOP - quickly or gradually - and defer or eliminate the capital gains tax that ordinarily would be levied. This scenario has restrictions, of course, and professional help should be retained to structure a plan for a 1042 transaction, the Internal Revenue Service code section that governs ESOP transactions.

When you sell to an ESOP, you also achieve:

■ *Fair market value.* You establish a market for current and future stock sales at fair market value. How? An ESOP is required to pay no more than fair market value based on an independent appraisal.

■ *Control.* A business owner can sell as much as 99 percent of his or her stock to an ESOP and still maintain control of the business. Why? The owner will own the majority of non-ESOP stock. In private companies, voting rights for day-to-day operation of the business are not passed through to the ESOP participants except for certain critical issues, such as sale of the company, liquidation, etc. Also, the

board of directors appoints an ESOP committee that directs the ESOP trustee how to vote the ESOP shares. Who is the chairman of the board? The owner. Generally, ESOP shares are allocated to employees in proportion to their compensation at no cost to the employee. ESOPs also can be combined with a 401(k), often called a "KSOP," by matching employee 401(k) contributions with company stock.

There's more good news. ESOPs are provided with beneficial borrowing rules. The ESOP can borrow the money to purchase the owner's stock and repay the loan as contributions are made to the ESOP. The contributions are fully deductible to the employer. A firm in the 40 percent tax bracket would have to earn $1,667,667 to make a $1 million principal repayment on a traditional loan. If that company instead used an ESOP, it could borrow the $1 million, with ESOP stock as collateral. In effect, both principal and interest payments on the loans are deductible. Savings: $667,667.

ESOPs can help eliminate the difficulty of selling a private company in the open market. If you are a business owner and want a practical exit strategy, you may want to consider an ESOP. For thousands of U.S. companies, ESOPs are a win-win situation. Consult your financial or insurance professional for further information.

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