

# ESOPs

The following responses to common ESOP questions are intended to provide a brief overview of this important option for qualified business owners, who may be in search of an exit strategy from their business or looking to diversify their asset holdings.

## **What does ESOP mean?**

**Employee Stock Ownership Plan** - A legal mechanism to transfer stock ownership of a business to family members or employees, with favorable capital gains consequences.

## **What are the main uses of an ESOP?**

The main uses of ESOPs include: Business succession (to family members or to reward employees), a buyout of a partner, for purposes of estate planning, to diversify an owners net worth away from a concentration of privately held stock.

## **What types of corporate entities can create an ESOP?**

Qualified corporate entities include: C Corporations, S Corporations, and LLCs that are taxed as C Corporations. The company must be profitable and generally has sales between \$5 million and \$250 million.

## **How much of the stock must be sold to the ESOP?**

The ESOP must own at least 30% of the company as a result of the sales transaction.

## **How do I defer capital gains taxes?**

To defer capital gains taxes, the company must be a corporate entity, as listed above, must transfer 30% of the company stock to the ESOP, and the business owner must have owned the stock for three years prior to the sale to the ESOP.

## **How long does it take to complete the required process?**

Depending on the structure of the sales transaction, the process takes a total of six to twelve weeks.

## **How do you determine the value of the company's stock and who makes that determination?**

A valuation is performed of a privately held company based on the company's historical and projected performance, adjusted for unusual occurrences. An independent third party, i.e., a qualified business appraiser, performs the valuation.

## **Will it still be possible to sell the company after the ESOP is setup?**

Yes. The original owner retains a majority of the company's stock. He/she may elect to sell that stock at a later date.

## **Can the ESOP be eliminated or does it become a permanent part of the company?**

The ESOP is a trust, over which the owner is likely to have voting control of the stock. The owner may elect to re-acquire the stock sold to the ESOP and regain 100% ownership.

ESOPs can be a brilliant alternative to a sale or equity partner (VC) to provide liquidity to you and your business.