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"Is an ESOP right for your business?"

By Bill Loftus

If you are considering selling your company, consider the advantages of an employee stock ownership plan (ESOP). ESOPs, in existence since the late 1950s, provide significant tax benefits for those employers and companies that establish them. With higher taxes looming, ESOPs also present an alternative to private equity liquidity or a sale to a strategic buyer.

Mechanics: How They Work. We spoke to national ESOP expert Alex Meshechok, a managing director and co-founder of CSG Partners. To quote Meshechok: ESOPs create a "win-win for both employers and employees." To get the most out of these transactions, business owners must sell more than 30 percent of their company stock to an ESOP trust for the benefit of the employee. The sale will be tax deferred, or tax-free in some cases.

The employee must invest the proceeds in a diversified portfolio to qualify for the preferential capital gains tax treatment and may access this capital to do so. The company typically finances a portion of the purchase of the owner's stock through a bank loan, which may be nonrecourse to the seller/owner. The company receives a tax benefit equal to the value of the ESOP's purchase value, which can be used to offset income tax liability, greatly reducing the company's tax rate and providing capital for the loan repayment and company investment. The loan is repaid and the company stock is held by the employees for their retirement.

With tax rates rising, the economic benefit to the seller is remarkable, and even more so for the company. Compare a company with $10 million in earnings and a combined tax rate of 40 percent, versus an ESOP with the same earnings. The non-ESOP company would pay $4 million in taxes. Assuming the other company sold 50 percent of its stock to an ESOP at six times pretax earnings, the ESOP would buy $15 million of stock financed with a five-year bank loan. The company would pay approximately $3 million back each year plus interest, which would be tax deductible, so the company would pay roughly $1 million in tax.

Other Benefits. ESOP companies often perform better than non-ESOP companies since employees' interests are aligned with the owner's. ESOP employees often have more money in their retirement plans since the ESOP is a qualified plan and can be rolled into an IRA at retirement.

The Ideal ESOP Company. There are approximately 10,000 companies with ESOPs in the U.S., yet successful ESOP companies do not fit one particular mold. Ideally, a candidate company should be generating at least $2 million in annual pretax earnings (including shareholders compensation) and has minimally 15 employees. Any company meeting these basic criteria may want to explore this option.

What are the Steps? Meet with an ESOP expert, as this is a highly specialized field. Meshechok recommends an initial meeting to determine if an ESOP is possible, followed by an analysis, to outline a deal, and calculate the benefits to the selling shareholder and the company. You need a "quarterback" who can arrange financing and hire valuation experts and lawyers.

A "Win-Win." The benefits of an ESOP are significant for both sellers and buyers. Sellers may retain more of their proceeds on an after-tax basis as well as derive the "feel-good benefit of transferring ownership of a closely held business to valued employees." Companies may see a significant increase in performance and happier employees due to widespread equity ownership. Overall, an ESOP can be a great tool to utilize for many employers and employees.

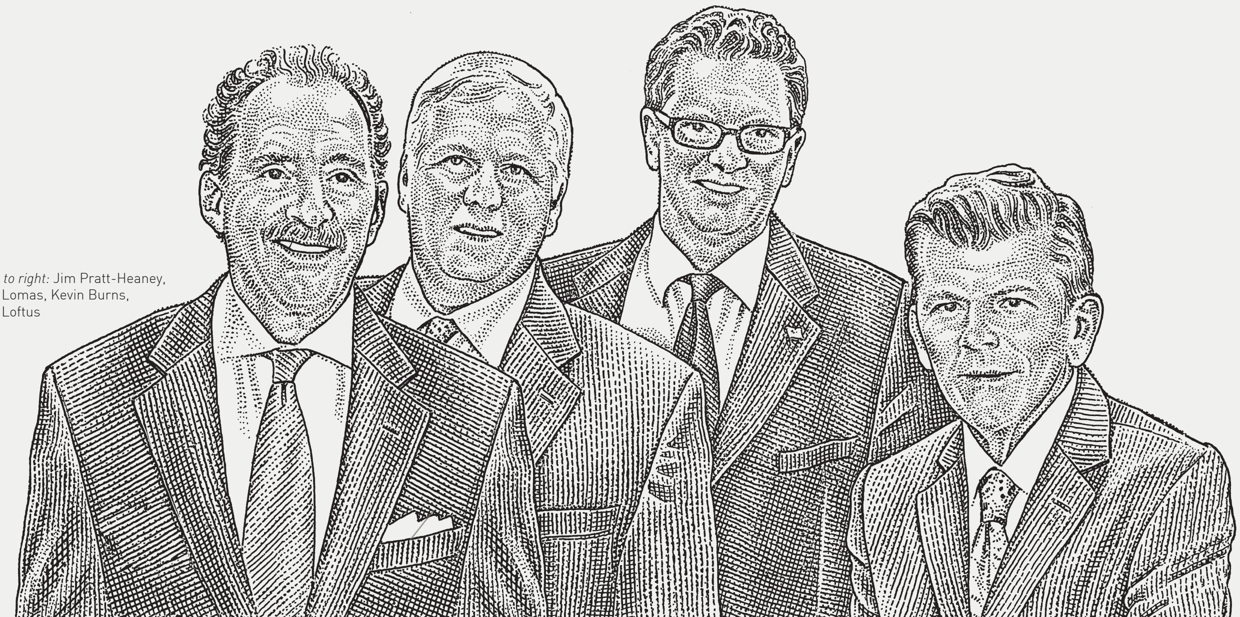
Past performance is no guarantee of future results. There is no guarantee the views and opinions expressed in this article will come to pass. LLBH Private Wealth Management, LLC (LLBH) is an SEC registered investment adviser located in Westport, Connecticut. For additional information about LLBH send for our disclosure brochure using the contact information herein.

"ESOPs provide significant tax benefits [and] with higher taxes looming, [they] present an alternative to private equity liquidity or a sale to a strategic buyer."

—Bill Loftus

How to reach Bill Loftus

I look forward to discussing how I can help you reach your financial goals. I can be reached directly at 203.683.1528.



Left to right: Jim Pratt-Heaney, Bill Lomas, Kevin Burns, Bill Loftus

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LLBH Private Wealth Management is a Registered Investment Advisory (RIA) firm, created to work with entrepreneurs and senior executives who became wealthy because they made great decisions. Our disciplined process ensures that we see the complete picture of your financial situation so that we can make informed and suitable recommendations to help you accomplish your goals and objectives. Our process also works for those who have been thrust into decision-making roles due to life-changing events such as retirement, the sale of a business, a divorce or a death in the family. Just as they do in their professional lives, our clients want a thorough and candid process in order to make smart decisions about their financial lives. Simply put, LLBH clients respect our ability to get things done.

Assets Under Management
$930 million

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
$10 million (investment services)

Largest Client Net Worth
$500 million

Financial Services Experience
120 years (combined)

Compensation Method
Asset-based

Primary Custodian for Investor Assets Pershing, A BNY Mellon Company

Professional Services Provided
Planning, investment advisory, money management, advanced wealth transfer planning and corporate services

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