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DEBORAH GROBAN OLSON
ATTORNEY AT LAW

- Business succession planning
- Employee Stock Ownership Plans (ESOP)
- Equity compensation
- Business law and transactions
- Informal sharing and collaboration strategies
- Cooperatives


Photo by Marvin Shaouni

Thinking of selling your business?

An ESOP or worker co-op can save you money!

Most privately owned companies don't, leaving family members unprepared when the time comes. You and your family need not liquidate your company or sell to a distant buyer. Your company can continue to thrive with the people who helped you build it, while providing you and your family a tax-advantaged method for business succession by selling to an **employee stock ownership plan (ESOP)** or **worker cooperative**. An ESOP is an employee benefit plan that invests primarily in employer stock.

Example of a thriving ESOP buisness succession

Carris Reels is a company of employee owners where one hundred percent of the company's stock is held in an ESOP plan. What began in 1951 by Henry Carris with just two employees, Carris Reels has become a leader in creative packaging to the wire and cable industry. In 1980, Henry Carris had passed on the business to his son, Bill Carris, who built the company into one with 9 manufacturing plants (in the US, Canada and Mexico) and 8 assembly warehouse locations with 450 employees in the US. and sales estimated at $83 million. Being a strong believer in participation and community building, Bill Carris developed a long term plan to move his company from family to employee ownership. This move not only transformed the company's culture but provided longevity to the company as a whole. In 2013 Carris Reels CFO, David Fitzgerald said "Before the ESOP, we had 100% employee turnover in our Michigan and North Carolina facilities. Now that the ESOP owns the company, turnover is 20% companywide. Although many of our jobs are physically demanding, our company has become an employer of choice."

6 reasons to sell to your workers

1 You can get a fair price for your stock.

Many owners of closely held businesses are unable to find a buyer who will pay a fair price for their stock, especially if they are initially offering only a minority block of shares. An ESOP provides a market for closely held stock, at a fair price determined by an independent appraiser.

2 Your company can write off the expense of buying your stock.

The Company can deduct from taxable income the amount of contributions made to finance the purchase of your stock by the ESOP (within limits). In a leveraged ESOP, this means that the Company can, in effect, deduct interest and principal payments on the loan used to purchase your stock, and in some cases the use of stock dividends to repay purchase debt. Without an ESOP, only interest payments would be deductible. This savings boosts after tax profits and the Company's ability to buy your stock.

3 Your Sub-S company's ESOP pays no income tax.

An ESOP trust can be a shareholder in your SubS company. In fact, the more stock in the S company the ESOP holds, the more tax-free cash remains in the company. An ESOP has greater tax advantages than any other Sub S shareholder, in that its income is not taxed (due to its exemption from UBIT tax). Instead that income is only taxed to the ESOP participants when they take their distribution upon leaving the company. Employer contributions are deductible for up to 25% of covered compensation. There are no additional deductions for repayment of loan interest. An ESOP in combination with a 401(k) plan, allows the company match to be made in Company stock. A Sub-S ESOP is not eligible for the expanded tax or dividend deductions of a leveraged ESOP, nor the capital gains rollover.

4 Your proceeds from an ESOP stock sale may be tax-free.

If you sell your stock in a Subchapter C company to an ESOP and reinvest the proceeds from the sale in stock of another U.S. Company, your capital gain from the sale will not be taxed until you sell the newly acquired stock. If you decide not to sell the new stock during your lifetime, you may avoid taxation of the ESOP sale income entirely (depending on the estate tax basis rules applicable on the date of death). This benefit has increased in value since the increase in capital gains tax rates in 2013. This tax "rollover" is only available if, after the sale, the ESOP holds at least 30% of the Company stock. Certain other federal requirements must also be met.

5 ESOPs are very flexible.

ESOPs are very flexible. You can cash out all your shares immediately, or you can gradually sell your shares to an ESOP over many years.

6 Sale to an ESOP or worker co-op preserves the company's independence and rewards the people who made it a success.

You may be reluctant to sell your company to a buyer with no ties to the community. Frequently the sale of a local business to an outsider results in curtailment of operation, sale of assets, plant shutdown, or relocation. Sale to your employees through an ESOP or co-op may be the best way to ensure the continued success of your business.

"When we founded our ESOP I was afraid that I was asking too much because of the unique provisions I wanted. I had talked to several other potential attorneys and advisors. They said "Why, and you can't do that." Deb cut through ESOP law and got our ESOP exactly like I wanted and it has worked beautifully. Deb is smart, fast, knowledgeable and efficient. I would recommend her for anyone considering employee ownership."
– Bill Carris, selling owner & current board chair, Carris Reels, Inc.

How an ESOP Works

- **In a "leveraged" ESOP,** the ESOP borrows money and buys the owner's stock. The Company usually guarantees the loan, and contributes enough money each year to enable the ESOP to repay the loan.
- **In a "non-leveraged" ESOP,** the ESOP uses company contributions to purchase stock each year rather than to repay a loan.
- **The company deducts the contributions from its taxable income.**
- **The ESOP stock is allocated to employee trust accounts.** When employees retire they receive their shares, or the cash value of those shares.
- **There are many variations** on this arrangement. ESOPs are extremely flexible.

EXAMPLE of succession with an ESOP

- **Mr. Fulton owns 100% of the shares** of Tool & Die, Inc., a Sub Chapter C company worth $6 million. Mr. Fulton is getting older and would like to sell his company and enjoy the proceeds.
- **If he sells to an outside buyer, he will pay taxes,** perhaps at the 20% rate, on his net long-term capital gain. If his original basis in the stock was -0-, he would pay $1,200,000 and keep $4,800,000 after taxes.
- **If the company, instead of an outsider, buys him out** by borrowing money or using cash reserves, Mr. Fulton faces the same tax sting. In addition, the payments will not be deductible to the company and might impoverish it (perhaps making it impossible for the company to complete a gradual buyout).
- **The ESOP finances the purchase** with company contributions, or by borrowing from a lender through the ESOP. The company typically would guarantee the loan. The purchase price of the stock is set by an independent appraisal.

Avoid or defer all capital gains tax

- If Mr. Fulton initially sells at least 30% of outstanding company stock to the ESOP, he can "rollover" the proceeds of the sale into stock or bonds in U.S. companies and *avoid paying any tax* on the proceeds unless and until he sells that "replacement" stock.
- Any replacement stock that remains in his estate until his death may get a stepped-up basis (depending on applicable estate tax laws in the year of death). Where the stepped up basis applies, the capital gain is never taxed.
- The company deducts the full amount of contributions to the ESOP used to buy Mr. Fulton's stock, or to make interest and principal payments, within limits, on a loan used to buy Mr. Fulton's stock.
- If the company is taxed at a corporate rate of 36%, this deduction would mean that $2,160,000 (36% of $6 million) of the cost of cashing out Mr. Fulton would be paid out of company funds that otherwise would have been used to pay taxes.

The stock is held in trust for employees.

- When they retire or leave the company they are paid their vested and allocated stock or the cash value of that stock, usually in installment payments over five years (or longer if the company stock was purchased with borrowed funds).
- If the Company then makes an S election after all Mr. Fulton's stock has been sold to the ESOP, the Company will not pay income taxes on its retained earnings as they accrue in the ESOP. Rather it will make distributions from the ESOP to participants upon their termination of employment, at which time the employees will owe taxes on the value of the ESOP stock.
- There are several permissible vesting schedules so that employees who leave with less than five years of service need not get any stock upon termination.

Seller, company and employees all win

- Mr. Fulton defers (and perhaps avoids) $1,200,000 in taxes on his capital gains.
- If he wishes, he can retain control over his company while he gradually sells to an ESOP over many years.
- The company saves more than $2.1 million by deducting the $6 million in ESOP contributions used to buy stock.
- This savings over the years should strengthen the value of company stock as the buyout proceeds, and enhance the ability of the company to raise the cash needed to purchase the owner's stock.
- The employees become beneficiaries of a trust that holds stock in their company. They each have an individual stock account in that trust.

Our law practice focuses on business succession and employee ownership

Our firm is dedicated to helping local companies and communities successfully compete in the global marketplace, by building strong, sustainable, local businesses.

Since 1981 Attorney Deborah Groban Olson has created and advised employee-owned companies using ESOPs, cooperatives and other structures, representing sellers, buyers, companies, trusts, unions, employees and consumers.

A 1976 Order of the Coif graduate of the University of Wisconsin Law School, she has an AV peer rating from Martindale Hubbell as a preeminent attorney in her field. A former chair of the National Center for Employee Ownership, Olson serves on the boards of Once Again Nut Butter Collective and Circle Pines Center.

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4 reasons to consider an Eligible Worker Owned Co-op (EWOC)

1 You can get a fair price for your stock with less regulation.

Owners of closely held businesses are often unable to find a buyer who will pay a fair price for their company. A worker co-op provides a market for closely held stock, and is not subject to the ERISA regulations of an ESOP stock valuation.

2 Your proceeds from a stock sale to a worker co-op may be tax-free.

If you sell your stock in a Subchapter C company to an "eligible worker owned co-op" (EWOC) and reinvest the proceeds from the sale in stock of another U.S. company, your capital gain from the sale will not be taxed until you sell the newly acquired stock. If you decide not to sell the new stock during your lifetime, you may avoid taxation of the EWOC sale income entirely (depending on the estate tax basis rules applicable on the date of death). This tax "rollover" is only available if, after the sale, the EWOC holds at least 30% of the Company stock. Certain other federal requirements must also be met. The Sub-chapter S corporation tax benefits do not apply to EWOCs.

3 Co-ops are less expensive and less regulated than ESOPs.

A co-op is a business entity not an employee benefit plans. There is no trust, no trustee, and no pension regulation.

4 Sale to Co-op keeps your company independent and rewards those made it a success.

You may be reluctant to sell your company to a buyer with no ties to the community. Frequently the sale of a local business to an outsider results in curtailment of operation, sale of assets, plant shutdown, or relocation. Sale to your employees through a worker co-op may ensure the continued success of your business.

Services

Our services include legal advice and assistance on:

- Tax advantaged family business transitions and succession
- Feasibility, design, structuring and advising employee owned businesses
- Structuring new businesses
- Restructuring existing businesses
- Employee Stock Ownership Plans
- Co-operatives
- Business contracts and transactions
- Business resource sharing contracts
- Non-profits
- Participatory management system consulting