ESOP Benefits for Business Owners

A sale to an Employee Stock Ownership Plan (ESOP) is a rarely used Exit Path, but business owners have begun taking interest in the possibilities they provide.

An ESOP can be many things, but in its simplest form, it's a qualified retirement plan that must invest primarily in the stock of a business owner's company. When pursuing an ESOP as an Exit Plan, business owners sell their stock in their businesses to the ESOP.

ESOP EXIT PATH

Top 6 Advantages

- Financial Security
- The Time Factor
- The Time Margin
- Tax Consequences
- Value-based Goal
- Successor

The Benefits

Financial Security

ESOPs can be advantageous for business owners because they allow business owners to attain financial security through a partial or complete sale of their ownership interest. Additionally, owners can stay in effective control until they are paid in full. Perhaps most appealing is that business owners can enjoy effective control even after they have been fully paid, which lets owners who always want to be a part of the business have their cake and eat it, too.

The Time Factor

Sales to ESOPs can be designed to accommodate an owner's desired departure date, whether that date is in a year, several years, or a decade in the future. The nimbleness of ESOPs gives business owners breathing room regarding when they exit.

The Time Margin

ESOPs are especially appealing for business owners who want to exit the business but have a hard time letting go of it. When selling to ESOPs, owners can leave their businesses gradually. At the same time, properly created ESOPs can allow owners to remain as president or CEO even after selling all ownership to the ESOP Trust.

Value-based Goals

Another rarely considered advantage of ESOPs is how well they serve business owners who want to take care of their employees, continue the company's culture, and keep the company in the community.

- An ESOP provides all employees with a stake in the future growth of the business. They become the new owners of the company, indirectly.
- Nearly every ESOP includes incentive plans for key employees.
- Transferring a company to an ESOP that is then managed by the former owner or a long-tenured management team can ensure the continuation of the culture and legacy of a business.
- ESOP ownership ensures the business remains in the chosen community.

Tax Consequences

The most tangible advantages of ESOPs are relevant to tax consequences. Consider the four following tax advantages ESOPs provide owners:

- If the company is an S corporation, future business income is not taxed if an ESOP owns the company. This frees up the company's available capital to invest and increase its cash flow.
- If a company is a C corporation, the proceeds from the sale of the business owner's stock to the company's ESOP may be entirely tax-deferred.
- The payments that the company makes to the ESOP, which in turn are used to buy the business owner's stock in the company, are tax-deductible.
- If the business owner's desired successors are the employees, and the owner wants the company to fund that purchase, there are significant tax advantages to using an ESOP compared to a management buyout.

Successor

Business owners who choose an ESOP as an Exit Plan indirectly make their employees their successors. The employees continue to be led by the existing management team, making the very people who helped build the company, its culture, and values the new owners. ESOPs can be a perfect Exit Path for owners who know their employees' capabilities well.

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