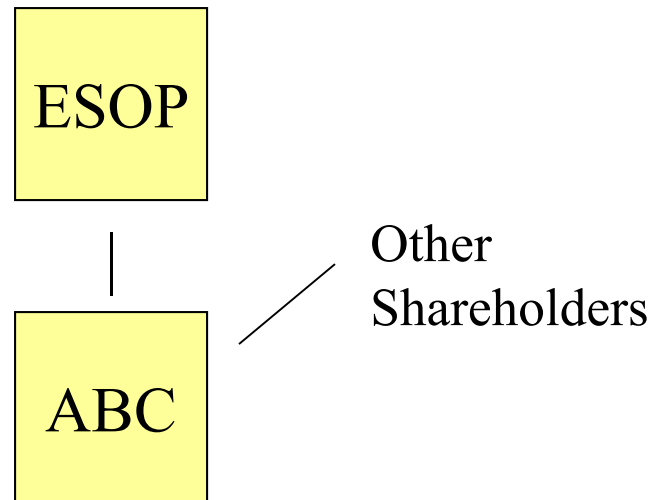

ESOPs as Legacy and Liquidity Vehicles For Company Owners

Maryland XPX
Rolling Road Country Club

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20,000 Foot View

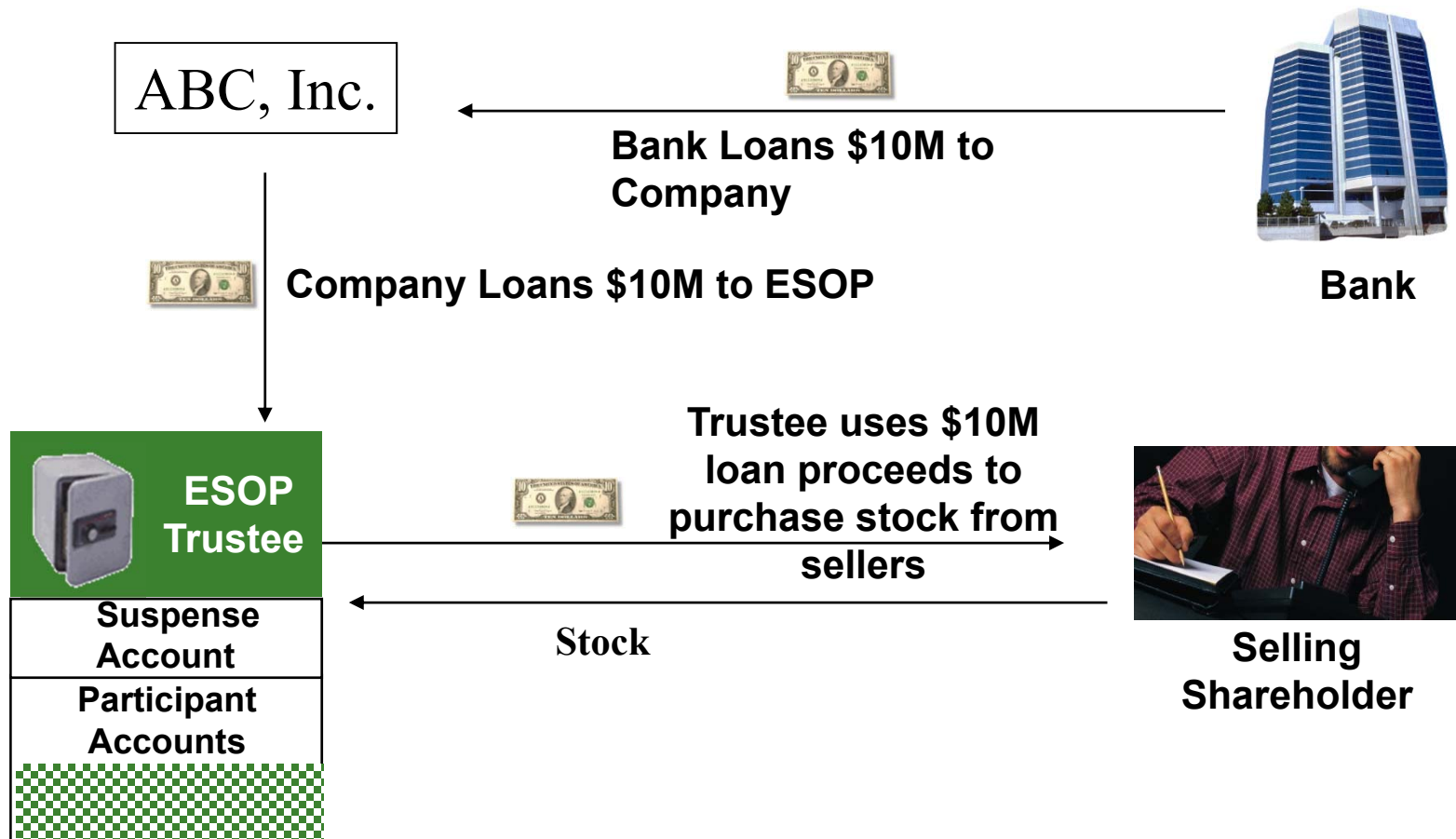
ESOP is a tax-qualified retirement plan that is allowed to purchase and own “employer securities” shares of stock in the Company which sponsors the plan:



20,000 Foot View

- An ESOP is a qualified retirement plan, similar to 401(k)
- Contributions are deductible
- Earnings of trust are tax-exempt
- Must invest “primarily” in qualified employer securities, provide for pass through voting rights on “major” corporate transactions, independent appraiser and repurchase obligations where stock is not publicly traded
- Must cover at least 70% of all employees with more than a Year of Service
- May be leveraged (with loan) or non-leveraged (cash warehouse or stock bonus plan)

What a Leveraged ESOP Looks Like



Collateralizing the ESOP Loan

- Collateral for ESOP Loan may include:
 - Shareholder assets
 - Real estate
 - Pledge of sale proceeds (burned off as loan repaid)
 - Corporate assets
 - Real Estate
 - Accounts Receivable
 - Inventory
 - Equipment
 - ESOP Stock Pledge

Leveraged ESOP: After the Sale



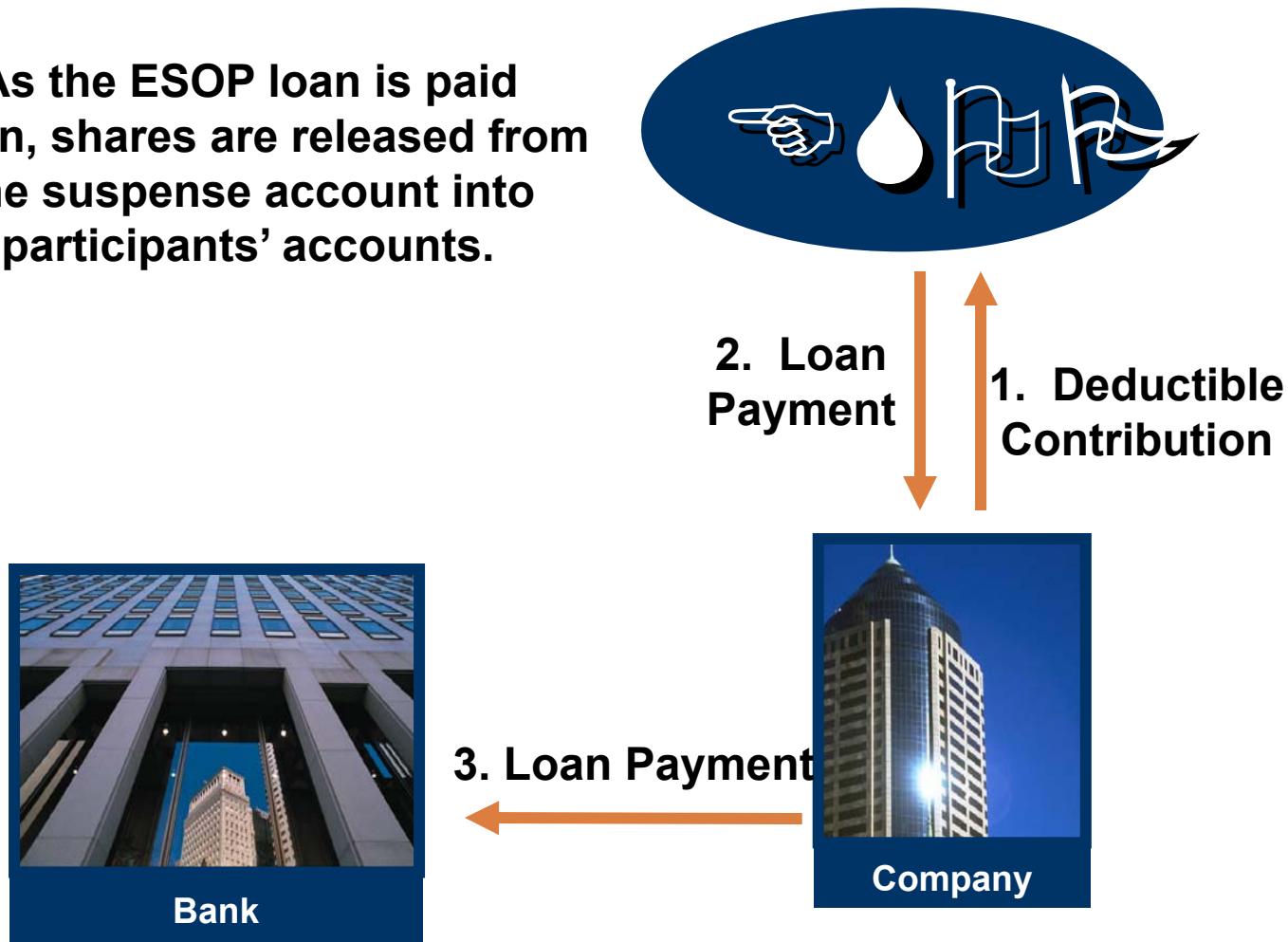
Assets:	\$10 million in shares
Liabilities:	<u>(\$10 million owed to Company)</u>
Net:	\$0

Note:

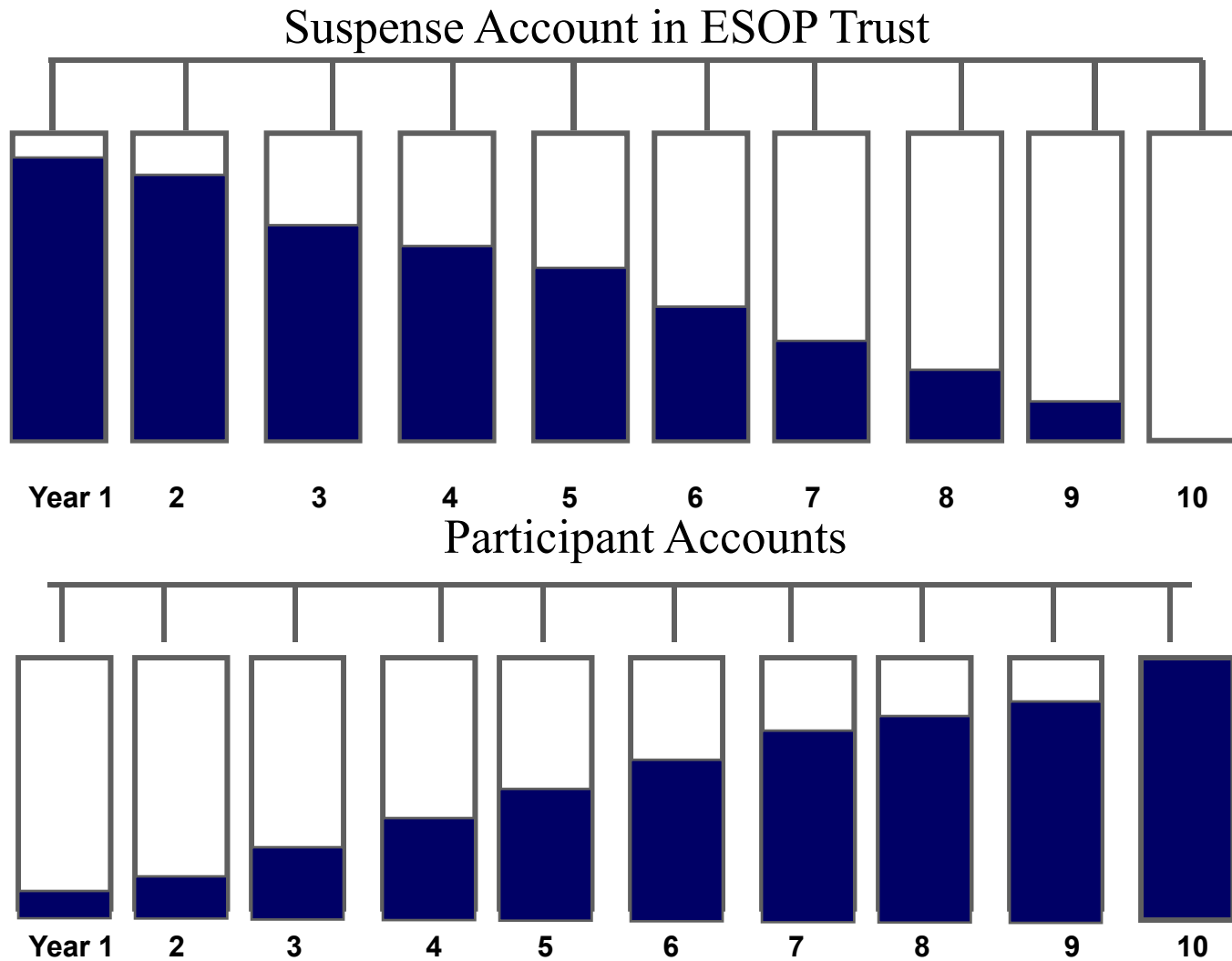
- The shares purchased by the ESOP collateralize the Company loan and are held in a suspense account within the ESOP
- The ESOP needs funding in order to pay its loan and release shares from the suspense account to participants

How Stock Gets Into Employee Accounts

As the ESOP loan is paid down, shares are released from the suspense account into participants' accounts.



Release of Shares



Basis of Allocation

Shares Released
in Current Year

x

Employee Compensation
Total Covered Payroll

Example: 3,000 shares released

Employee's compensation: \$50,000

Total Covered Payroll: \$5,000,000

Shares Allocated to Employee Account: 30

(3,000 shares x \$50,000/\$5,000,000 = 30 shares)

Corporate Governance: ESOP Pass-Through Voting

ESOP Trustee votes all shares owned by the ESOP on routine corporate matters. Ongoing Trustee may be inside manager(s) of Company.

An independent ESOP Transaction Trustee is normally appointed to approve valuation and deal structure

ESOP participants vote the shares allocated to their accounts on major corporate matters – merger or consolidation, recapitalization, liquidation, dissolution, sale of substantially all assets, merger, or similar transactions.

ESOP Trustee votes unallocated shares.

Tax Benefits of ESOP

- To Corporation

- Interest and principal on ESCP acquisition loan are tax deductible
- Dividends Paid Deduction
- S corporation ESOP Tax Holiday

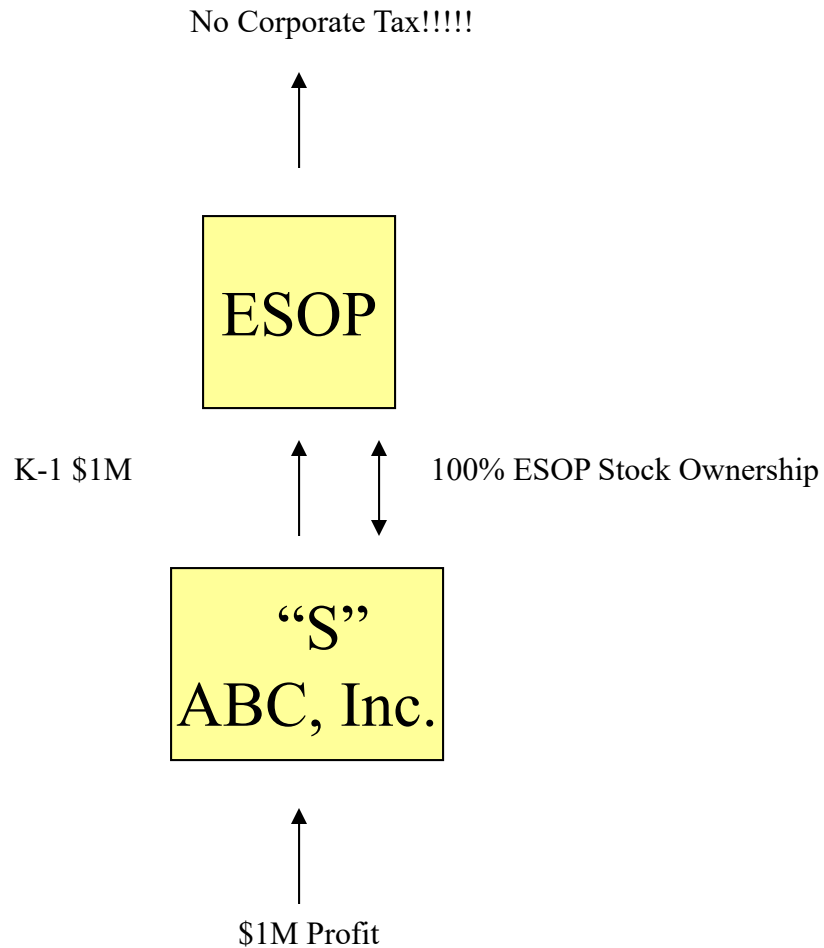
- To Selling Shareholder

- Gain Rollover under Code §1042, or
- Deferred Capital Gains under Installment Sales Method

Benefits of S Corporation ESOP

- S corporation as a pass-through entity does not pay an entity level tax
- ESOP trust is tax-exempt under section 501(a) of the Code
- **Therefore, if an ESOP is the only shareholder, no tax is paid on earnings of the business**
- Employee participants pay tax at ordinary rates on fair market value of stock when distributed (generally at separation from service or retirement)

Benefits of S Corporation ESOP



Gain Rollover under Section 1042 - Basic Elements

- Gain on the sale of qualified employer securities by a shareholder to an ESOP is indefinitely deferred
- ESOP must be sponsored by a non-public C corporation
- Within 15 months (3 before and 12 after) the sale proceeds must be rolled over into Qualified Replacement Property. Basis of QRP is reduced by the amount of deferred gain on qualified employer securities sold to ESOP, and
- The ESOP must own at least 30% of the ESOP sponsor's stock after the sale

EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs)

ESOP Facts

- Over 11,000 ESOP companies
- Over 12 million employee owners (roughly 10% of all non-public companies are owned by ESOPs)
- \$928B in ESOP Asset Value
- 60% of ESOP companies report productivity increases
- 80% of ESOP companies indicate the ESOP is a major benefit in recruiting new employees

Other Companies With ESOPs

- **Alion Science**
 - **Research and technology**
- **Andersen Corp.**
 - **Windows manufacturer**
- **Aspen Systems Corp**
 - **Computer services**
- **Command Technologies**
 - **Technical services**
- **DynCorp**
 - **Information technology**
- **Marine Hydraulics International, Inc.**
- **Técnico Corporation**

- **Herff Jones**
 - **Manufacturer of awards & gifts (Heismann trophy)**
- **Lifetouch**
 - **Photography studios**
- **Publix Supermarkets**
 - **Supermarkets**
- **Science Applications Intl.**
 - **R&D & computer systems**
- **Westat, Inc.**
 - **Research and Statistical Analysis**

Reasons For an ESOP – Survey

- Provide Employee Benefit 69%
- Improve Productivity 66%
- Purchase Stock From Major Owner 56%
- Turn Employees into Owners 45%
- Benefit From Tax Advantages 28%
- Reduce Employee Turnover 20%
- Prevent Corporate Takeover 4%
- Other 4%

Kaufman & Canoles, P.C.

ESOP Implementation Services

- ESOP feasibility analysis
- Valuation and financial consulting
- ESOP transaction design
- ESOP financing and funding
- Legal plan documents
- IRS and other regulatory filings

Questions & Answers