



Employee Stock Ownership Plans (ESOPs) **Continuing a Legacy**

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ESOPs: Continuing a Legacy

Presenters



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Agenda

1. Introductions
2. Definition of an ESOP
3. Benefits of an ESOP
4. ESOP Plan Design
5. Considerations
6. Closing



Forvis Mazars

- Successfully facilitated over 150 ESOPs (the majority of which were 100%) nationwide involving wide ranges of industries
- Transactions range in size from several million to several hundred million
- Not just a “deal team,” work with clients on a post-transaction basis, which gives us additional insight during implementation
- As part of Forvis Mazars, allows us to integrate financial and tax planning and explore other succession alternatives
- Provide ongoing ESOP consulting services to some of the largest 100% ESOPs in the U.S.
- Active in the ESOP community and closely monitor and evaluate ESOP regulatory environment and industry best practices

600+

- ESOP Clients

35+

- Years Serving ESOP Clients

A Top Provider of

- ESOP Audits in the United States*

*According to data from the ERISApedia database in April 2025.

Continue a Legacy

Benefits of an ESOP

1. Implement an ownership transition plan
2. Preserve culture, jobs, and community
3. Continue to manage the business and operations
4. Provide stockholder liquidity (generally over time) in a tax-efficient sale while possibly retaining some upside
5. Reduce or even eliminate corporate income tax
6. Reward long-term employees
7. Reward key management
8. Uniquely position company for growth via acquisitions

What Is an ESOP?

Qualified Retirement Plan

- Similar to profit-sharing plan, except
 - Designed to invest primarily in company stock
 - ESOP can borrow money (leveraged ESOP) to purchase company stock
- Stock is held by ESOP trust
 - ESOP trust is legal shareholder
 - Employees are beneficial (not actual) owners in value of stock allocated to their account
 - Employees do not receive stock
- Governed by the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA), with oversight by IRS & DOL

ESOP Statistics

6,600

ESOPs in U.S., majority privately owned.

\$2 Trillion

Plan Assets

Numerous studies have shown ESOP companies, on average, outperform non-ESOP companies and are more sustainable.

Statistics source: www.nceo.org

15M+

ESOP Participants

3,000

Estimated number of companies that are 100% ESOP owned. There were fewer than 100 in 1998.



Benefits to Owner

Continue to Manage the Company

- Receive reasonable compensation
- Participate in ESOP (unless Section 1042 is elected)
- Select and mentor next-generation management

Favorable Tax Treatment

- Treated as stock sale (vs. asset sale)
- IRC Section 1042 gain deferral
- Installment treatment available to the extent seller financed

Retain Upside

- Depending on financing structure, possibly retain some upside in company via warrants

Can the ESOP Pay Fair Market Value for My Stock?



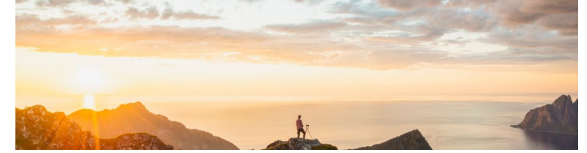
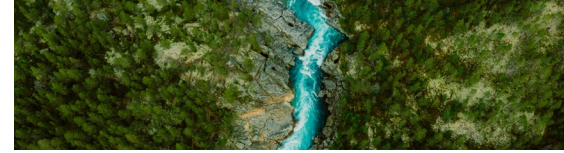
- ERISA required that the ESOP pay no more than fair market value
 - ESOP is viewed as a financial buyer
- ESOP trustee has own valuation performed by an independent appraiser to determine fair market value
 - That valuation is NOT shared by ESOP trustee with seller or any other parties
- Seller and ESOP trustee, through good faith negotiations, agree early in process on purchase price and other economic terms, pending due diligence and final negotiations
 - Seller will often engage Forvis Mazars to perform valuation on seller's behalf for purposes of negotiating with ESOP trustee

IRC Section 1042 Gain Deferral

- Not heavily used in today's environment
 - Relatively low capital gain tax environment
 - Less attractive for existing S corporations
 - Used more frequently in states with high income tax rates
- Requirements include
 - Stock must have been held for three years
 - Company must be a C corporation on date of sale
 - ESOP must own 30% or more of company after sale
 - Must reinvest proceeds in qualified replacement property (QRP) within 12 months of sale
 - Proceeds include cash and seller notes
- Do not have to elect 1042 on total proceeds
- SECURE 2.0 allows S corporation shareholders to defer tax on 10% of gain – effective for sales after December 31, 2027

Qualified Replacement Property

How QRP Works



- QRP is generally stocks or bonds of domestic operating companies
- QRP receives “carryover basis” from stock sold to ESOP
- Sale of QRP during lifetime triggers income tax
- Under current tax law, if QRP is held until death, the QRP receives “step up” in tax basis & income tax is never paid
- ESOP Floating Rate Notes
 - Can margin up to 90% with carrying cost

Company Benefits

- Company repays acquisition debt with pre-tax dollars
 - Interest & principal on acquisition debt are tax deductible (subject to IRS limitations)
- If 100% ESOP owned S corporation, the company is exempt from federal & generally most state income tax
 - Maximum federal income tax rate of 37%
- Can result in a more productive workforce
 - More communication = better results



Leveraged ESOPs in General

- ESOP borrows money to purchase stock from selling stockholder(s)
- Similar to traditional leveraged buy-outs, except
 - Allows owner to continue to manage business
 - Tax benefits to seller & company
 - Over time, wealth is transferred to broad-based employees



Two Types of Leveraged ESOPs

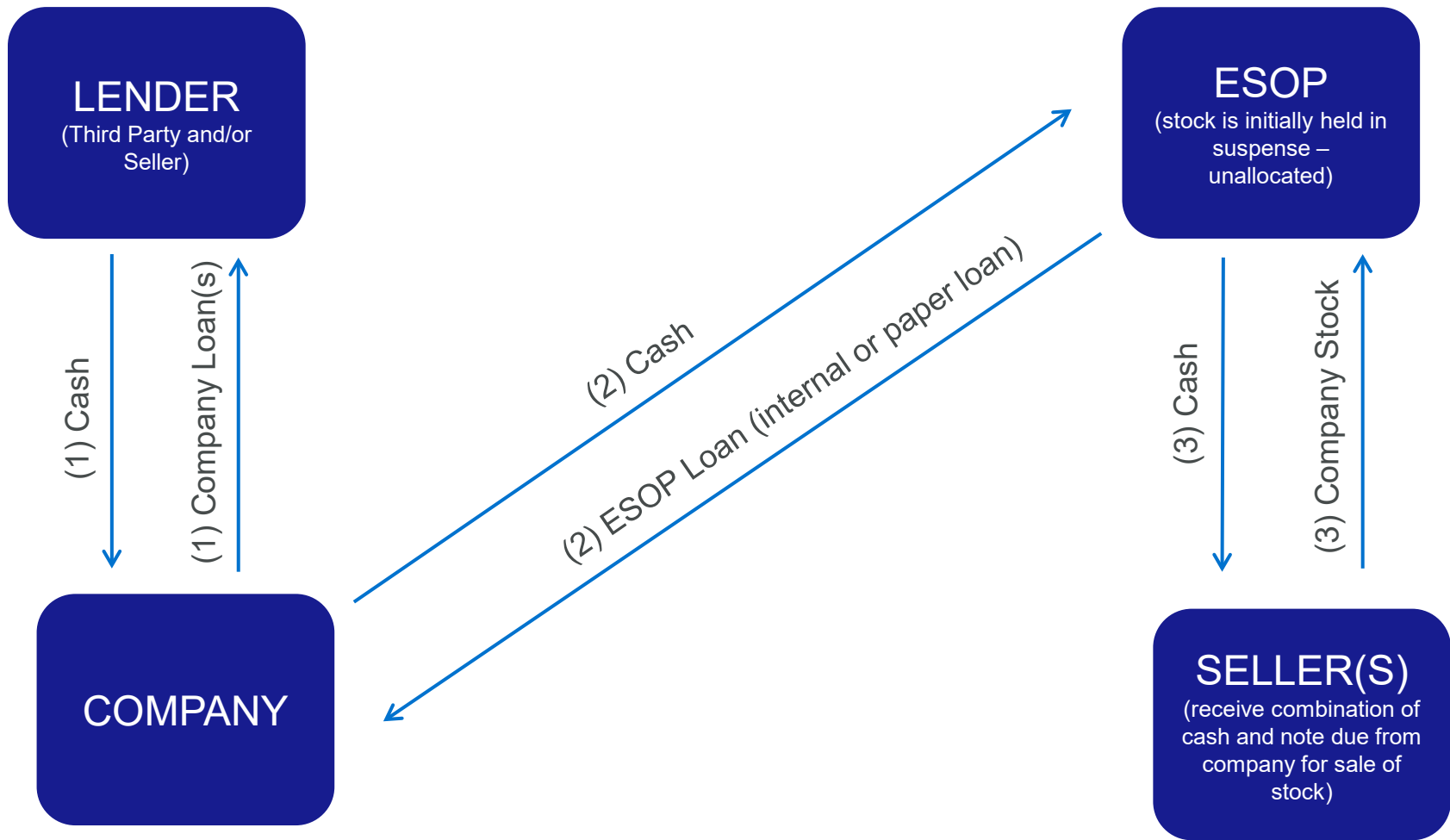
100% Sale

- Company's earnings completely exempt from federal income tax (if an S corporation)
- Seller can possibly retain some upside via synthetic equity
- No need for future stock transfers (complete and permanent liquidation)

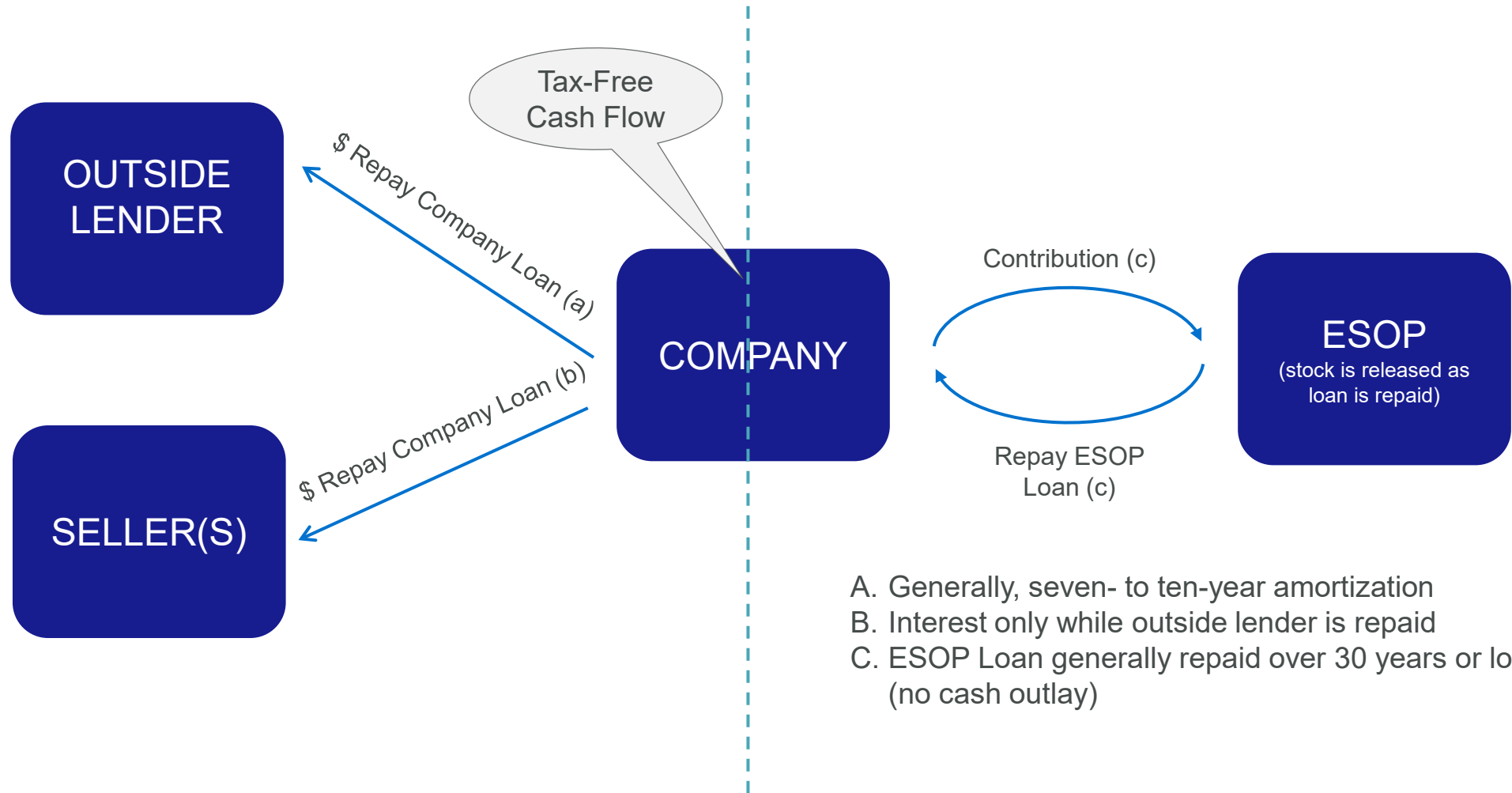
Partial Sale, e.g., 30% to 49%

- Company has partial tax benefit via deduction of principal on ESOP loan
- Seller retains upside in remaining stock ownership
- Future transaction necessary to liquidate seller's remaining stock ownership

How Does a 100% Leveraged ESOP Work?



How Does Repayment of a 100% Leveraged S Corporation ESOP Work?



Company Loan Options

Traditional Bank Financing

- Lender consideration of collateral, existing leverage, working capital needs, cash flow, & strength of management
- Covenant compliance

Seller Financing

- Transaction can be 100% seller financed, if desired
- Subordinated to bank, if bank financing is obtained
- Increased repayment flexibility
- Interest rate generally between 7% to 10%
 - Straight interest
 - PIK
 - Warrants

ESOP Loan Considerations

- Has no cash flow impact!
- Contributions and dividends can be used to repay ESOP loan
 - Contributions generally limited to 25% of compensation
- Contributions to repay loan are tax deductible
 - Possible tax planning opportunity in initial year of 100% ESOP
- Shares are released and allocated to employees annually as loan is repaid
- ESOP loan in 100% ESOP is generally minimum of 30 years

How Employees Benefit



- Retirement benefit invested in company stock
- Employees incentivized to improve stock value and, as a result, their retirement benefits
 - Communication!
- The longer an employee stays, the more stock they should receive
- Once employees receive their retirement benefit, generally can continue to defer taxes by rolling to an IRA

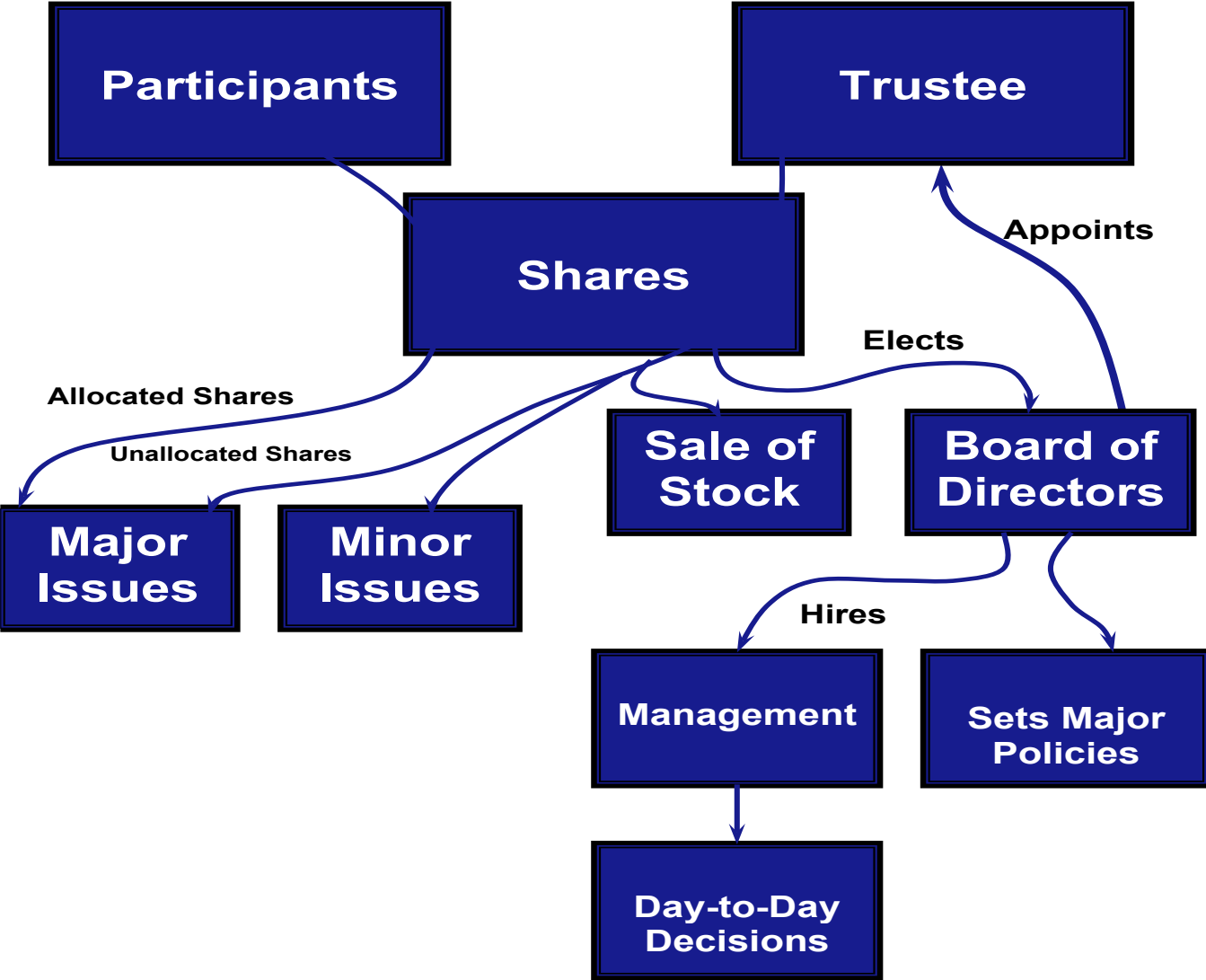
ESOP Plan Design

- Eligible employees participate subject to age and service requirements
- Shares typically allocated annually based on compensation (subject to IRS limits)
- Annual statement of ESOP account balance
 - Do not have to share company financial information
- Six-year graded or three-year cliff vesting
- Repurchase liability
 - Receive benefit in cash at retirement, disability, or death
 - Delay in receiving cash benefit if employees leave for normal termination
 - Wait longer of five years or repayment of ESOP loan
 - Paid in installments over five years

Executive Compensation

- Attract and retain quality management team
- Align ESOP and management interests
- Employment contracts
 - Salary and bonus structure
 - Non-solicitation and possible non-compete
- Synthetic equity
 - Incentive stock options
 - Stock appreciation rights
- Approval by independent ESOP trustee during the initial transaction and by independent board members post-transaction
 - Reasonable compensation
 - Dilution and overall fairness

Corporate Governance – 100% ESOP



ESOP Transaction Consulting



Forvis Mazars

- Design and facilitate transaction
- Assist with obtaining financing
- Perform separate valuation on behalf of seller(s)
- Assist with negotiations



Corporate/ERISA Counsel

- Draft documents
- Assist with negotiations



ESOP Trustee

- Independent professional ESOP trustee
- Negotiates purchase price and transaction terms
- Hires own counsel
- Hires independent appraisal firm



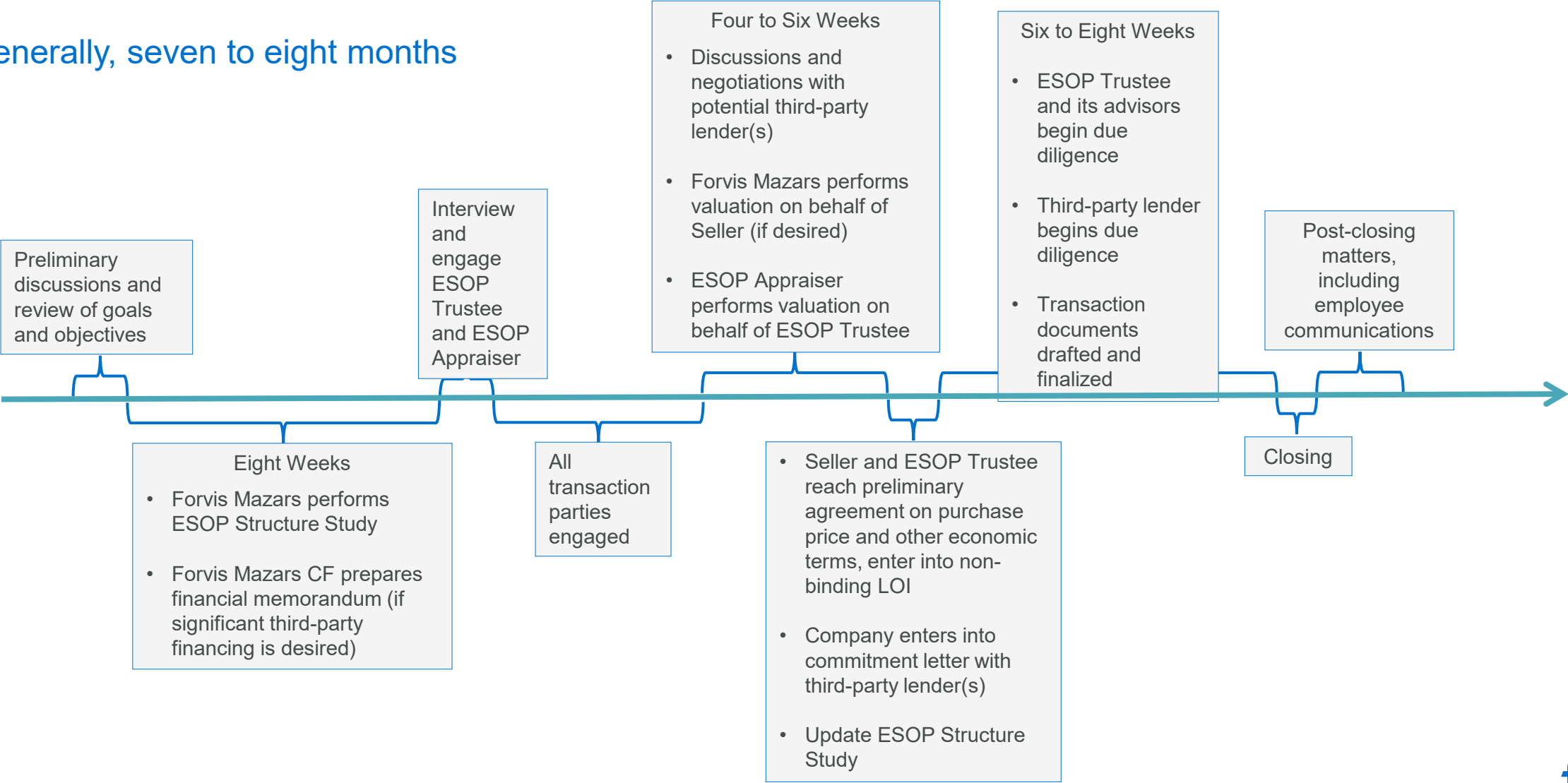
Bank & Bank Counsel

- Funding of the transaction
- Drafting of bank documents

ESOP Transaction

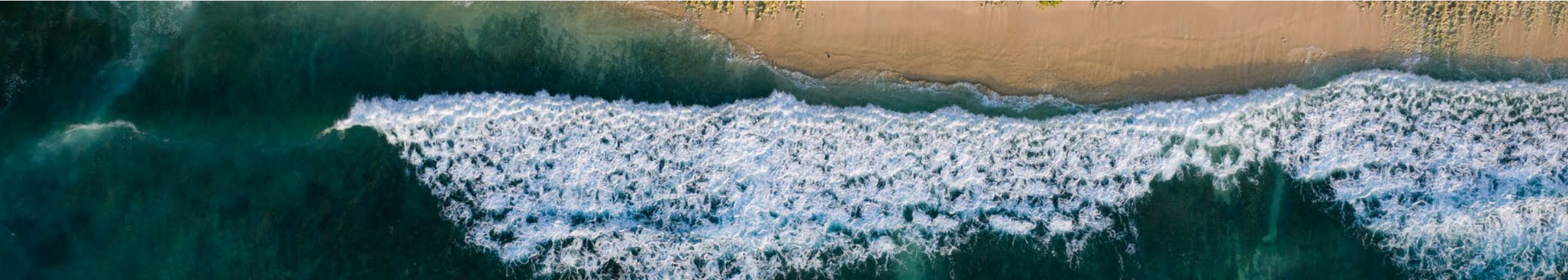
Illustrative Transaction Timeline

Generally, seven to eight months



ESOP Transaction

Current Environment



- DOL regulatory climate
- Interest rate environment and financing impacts
- Continuing impacts of inflation and tariffs

ESOP Transaction

Potential Cons

Financial Terms

- Opportunity to run parallel paths which involve exploring ESOP transaction while simultaneously testing the market (Forvis Mazars CF)
- Generally, does not involve seller(s) completely cashing out at time of transaction, as seller financing is typically involved

Regulations

- ESOPs are regulated by DOL and IRS
- DOL and/or IRS have right to investigate the transaction after it has occurred
- DOL or IRS could claim ESOP paid more than fair market value, which could result in a prohibited transaction

A Few Other Considerations

- Should be coordinated with individual estate tax, charitable, and wealth planning
- Abuse of S corporation ESOPs
 - Must provide broad-based employee ownership
- Key executive life insurance
 - Seller note
- Fiduciary risk
 - Insurance
 - Independent institutional trustee

When an ESOP May Be Right!

- Owner wants to preserve company legacy, but is thinking about retirement
- ESOP culture is a good fit
- Owner is willing to carry some of financial risk, *i.e.*, seller notes, for a period of time
- Generally fair value of equity of \$5 million or more
- Generally, 30 employees or more
- Stable cash flow
- Potential for significant corporate income tax savings
- Looking for long-term growth platform



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