



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

ESOP Consulting

- 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 unique insight during implementation
- As part of Forvis Mazars, allows us to integrate financial & tax planning & 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 & closely monitor & evaluate ESOP regulatory environment & 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, & community
3. Continue to manage the business & 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 IRC & ERISA, with oversight by IRS & DOL

ESOP Statistics

6,500

ESOPs in U.S., majority privately owned.

2,500

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

14M+

Employees of ESOP Companies

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

Statistics source: www.nceo.org



Benefits to Owner

Continue to Manage the Company

- Receive reasonable compensation
- Participate in ESOP (unless Section 1042 is elected)
- Select & 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 requirement is that ESOP not pay 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 & ESOP trustee, through good faith negotiations, agree early in process on purchase price & 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

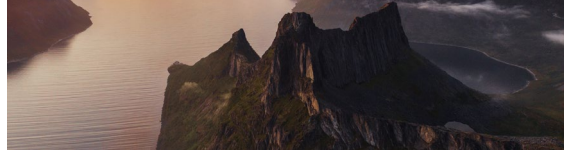
- Not heavily used in today's environment
 - Relatively low capital gain tax environment
 - Less attractive for existing S corporations
 - Used more frequently in states with high income tax rates
- Requirements include
 - Stock must have been held for three years
 - Company must be a C corporation on 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 includes cash & 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

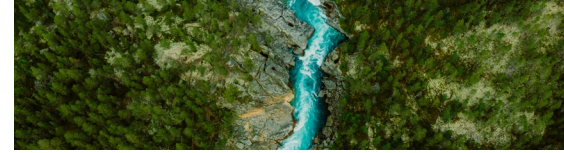
How QRP Works



- 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, receive “step up” in tax basis of QRP & 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
- 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

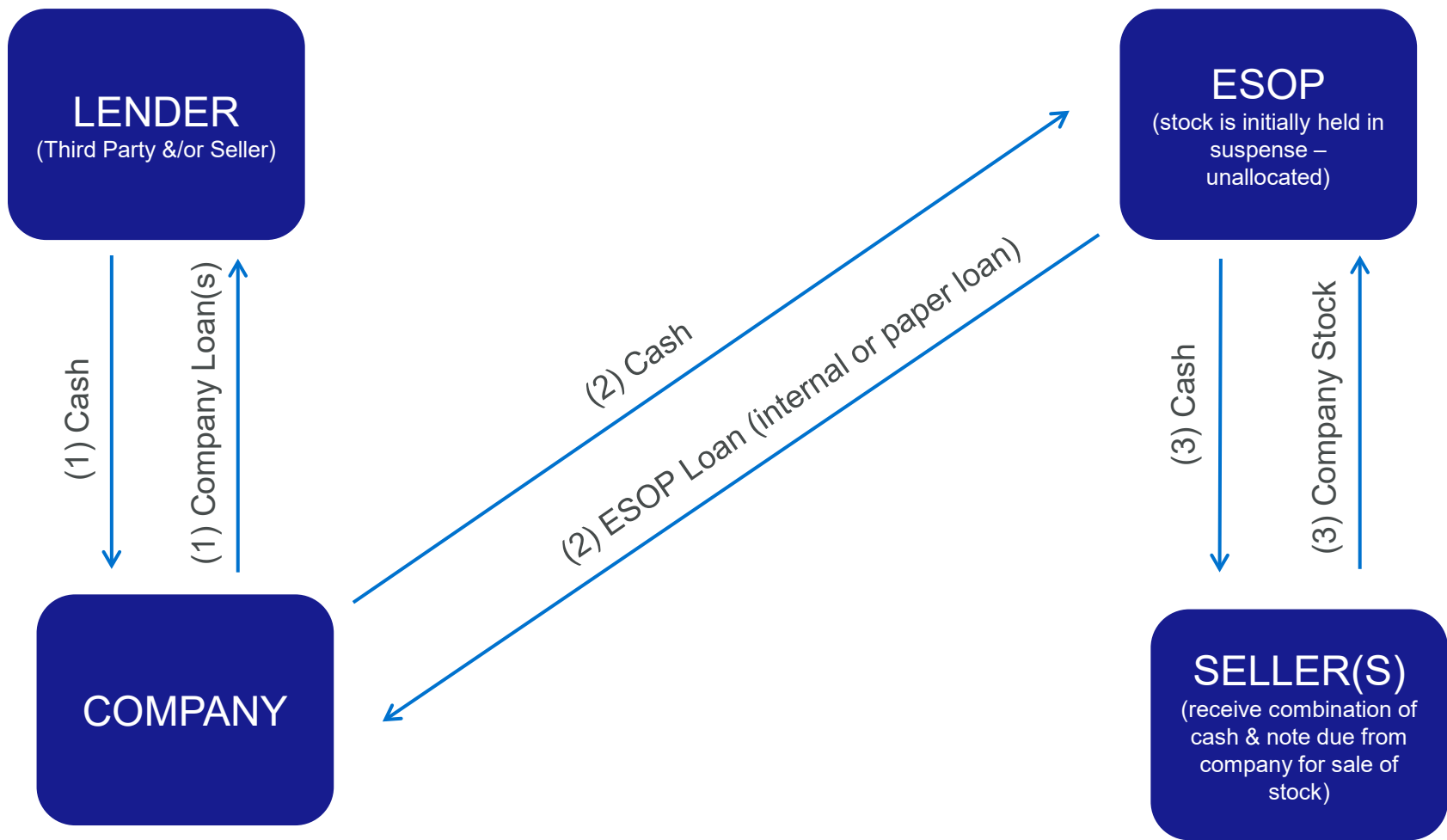
100% Sale

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

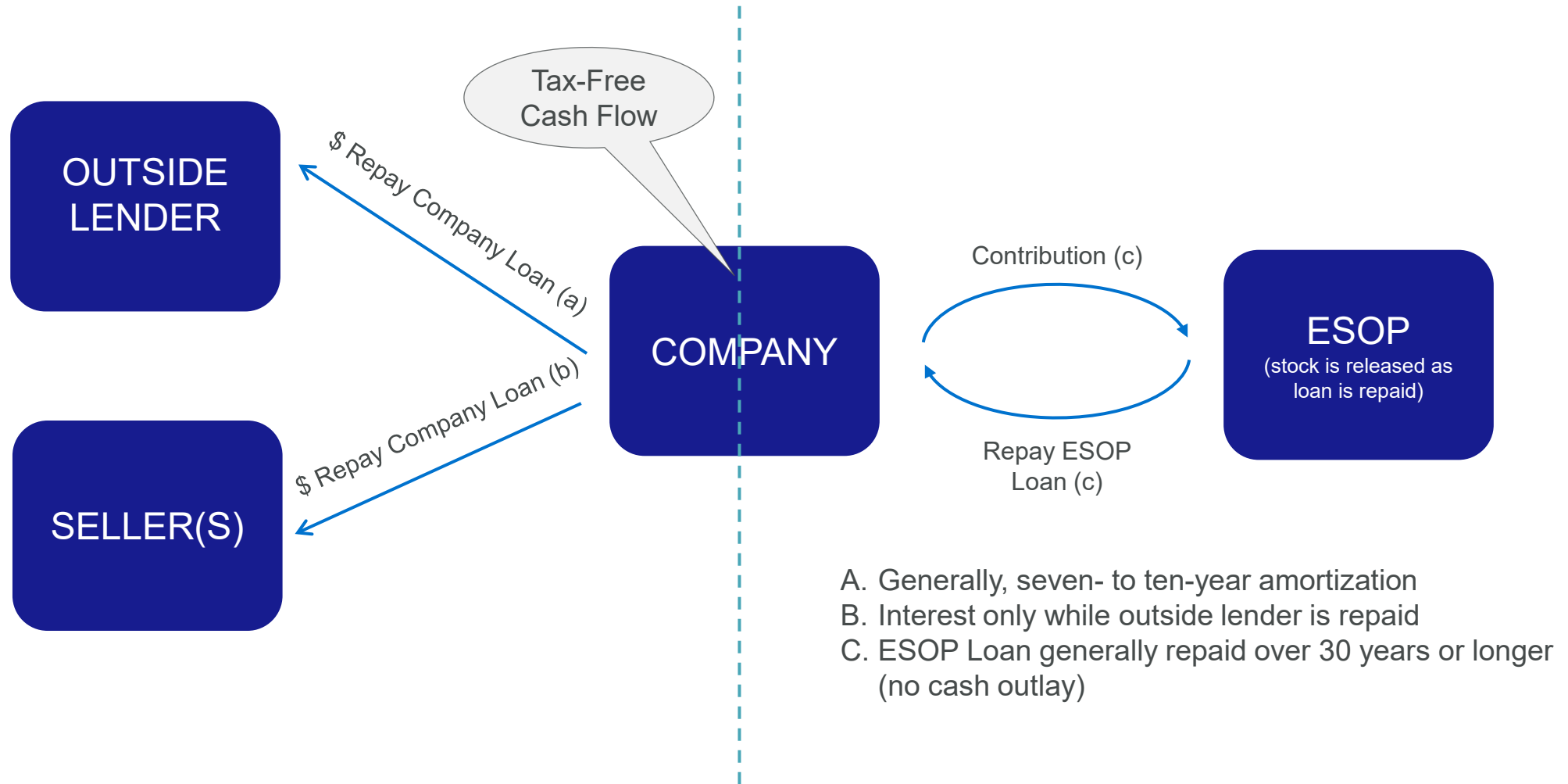
Partial Sale, e.g., 30% to 49%

- 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 ESOP Work?



Company Loan Options

Traditional Bank Financing

- 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 & 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 & 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 &, as a result, their retirement benefits
 - Communication!
- The longer an employee stays, the more stock they should receive
- Once receive retirement benefit, generally can continue to defer taxes by using IRA

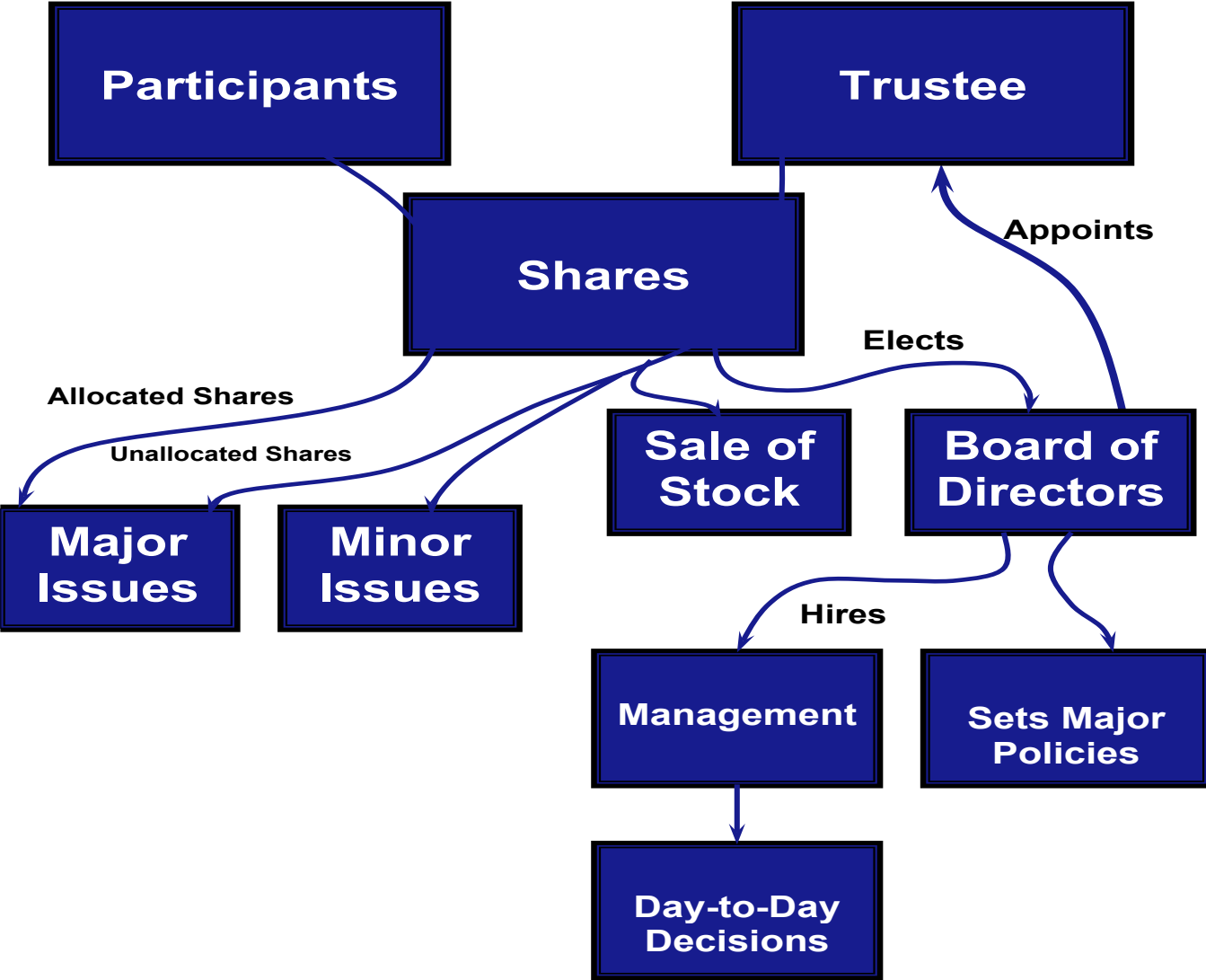
ESOP Plan Design

- Eligible employees participate subject to age & 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 leave for normal termination
 - Wait longer of five years or repayment of ESOP loan
 - Paid in installments over five years

Executive Compensation

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

Corporate Governance – 100% ESOP?

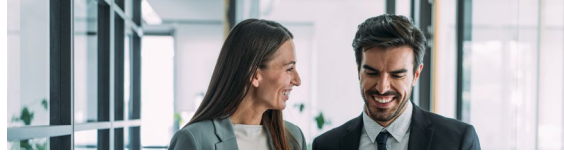


ESOP Transaction Consulting



Forvis Mazars

- Design & 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 & transaction terms
- Hires own counsel
- Hires independent appraisal firm



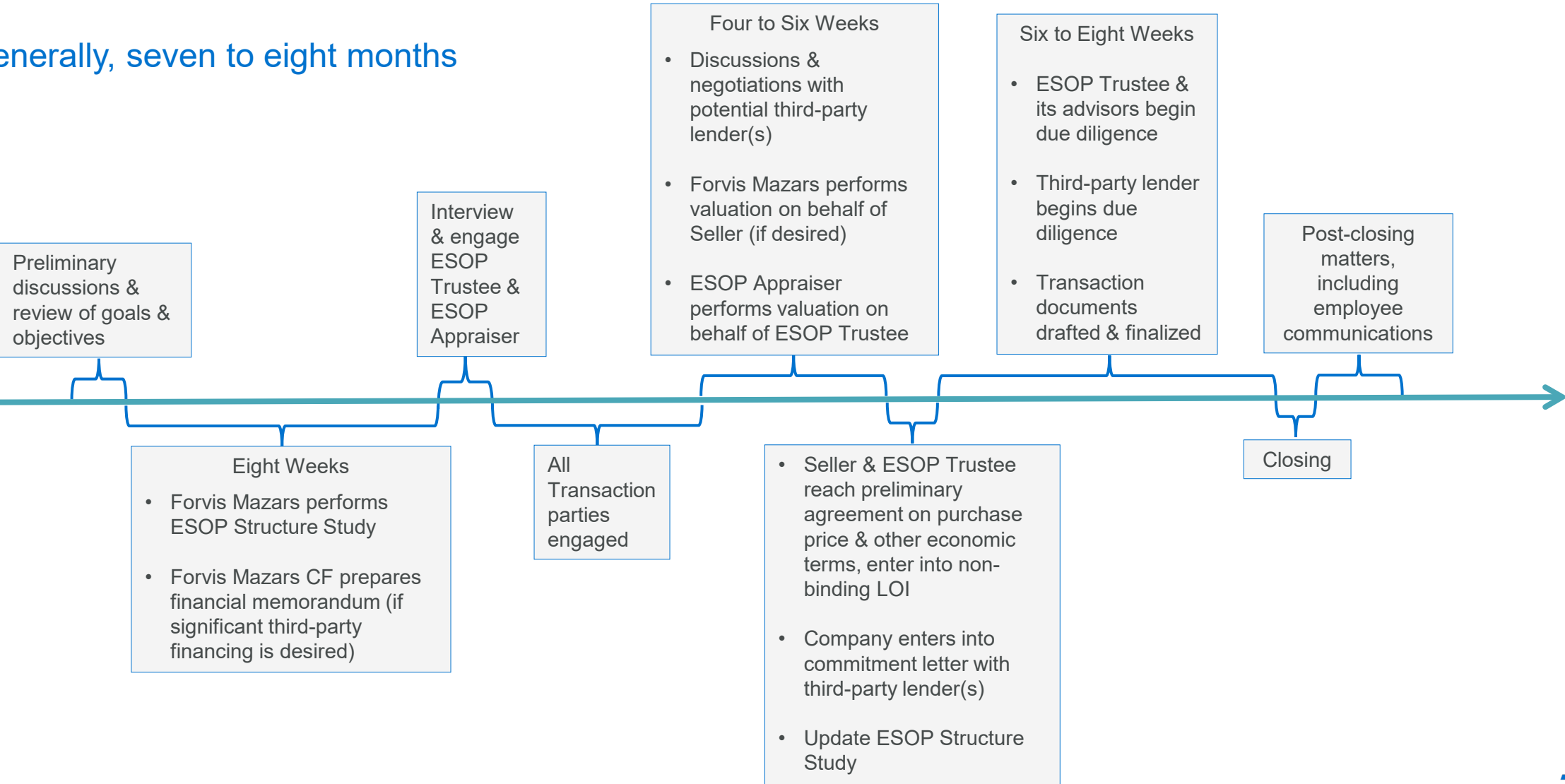
Bank & Bank Counsel

- Funding of the transaction
- Drafting of bank documents

ESOP Transaction

Typical Transaction Timeline

Generally, seven to eight months



ESOP Transaction

Current Environment



- Interest rate environment & financing impacts
- Continuing impacts of inflation & tariffs
- Overall political & economic uncertainty

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 & IRS
- DOL &/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, & wealth planning
- Abuse of S corporation ESOPs
 - Must provide broad-based employee ownership
- Key man 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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