

# ESOP Overview

## WHAT IS AN ESOP?

An ESOP is a tax-qualified, defined contribution retirement plan invested in employer securities. The ESOP is regulated by the IRS and the Department of Labor under ERISA. The ESOP is not interested in running the operations of the business.

## WHO IS THE TRUST?

An ESOP is represented by a trust and operates as a passive buyer of equity at any interest (one percent to 100 percent). An ESOP trustee is almost always independent in nature but range in size. As a flexible buyer, the ESOP can accommodate long-term exit strategies for owners with differing time horizons.

## HOW IS AN ESOP CREATED?

The ESOP transaction is typically structured as leveraged buyout. The company establishes the ESOP trust, which is represented by the trustee. The ESOP acquires an equity interest from the selling shareholders (typically, the majority is funded with seller financing).

## WHO DOES THE ESOP BENEFIT?

**Sellers:** Sellers can elect to defer capital gains taxes and can limit future liability. **The Company:** Contributions are tax-deductible; a 100 percent S-Corp ESOP is federally tax-exempt. **Employees:** Employees become beneficial owners and receive benefits over time.

## HISTORY OF THE ESOP

### 1956

Louis Kelso closes the first ESOP, Peninsula Newspapers, after securing necessary exemptions for tax-qualified plan.

### 1964

IRS revises review process allowing regional offices to issue determination letters further enhancing closing efficiencies.

### 1986

Tax Reform Act of 1986 expands benefits to compel corporations to establish ESOPs.

### Today

6,482 ESOPs covering more than 10 million employee participants.



### 1958

Louis Kelso publishes "Capitalist Manifesto," establishing groundwork for broad worker compensation.

### 1974

Congress passes ERISA establishing framework for ESOPs.

### 1997

Taxpayer Relief Act of 1997 expands benefits and allows S-Corporations to establish ESOPs.

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