

# Employee Stock Ownership Plans: The Versatile Estate Planning Tool that is Good for Pennsylvania

Presented by:

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**Simple Purpose –**  
***Raise Awareness***  
***about the benefits of***  
***Employee Ownership***



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## Non Profit Volunteer Organization

- CEO's
- Industry Experts
- Foundations, Universities



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# Estate Planning

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## Silver Tsunami

**4.5 Million  
companies will  
transact in the next  
10 years**

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**Only 30% of  
business owners  
over 55 say they  
have a succession  
plan**

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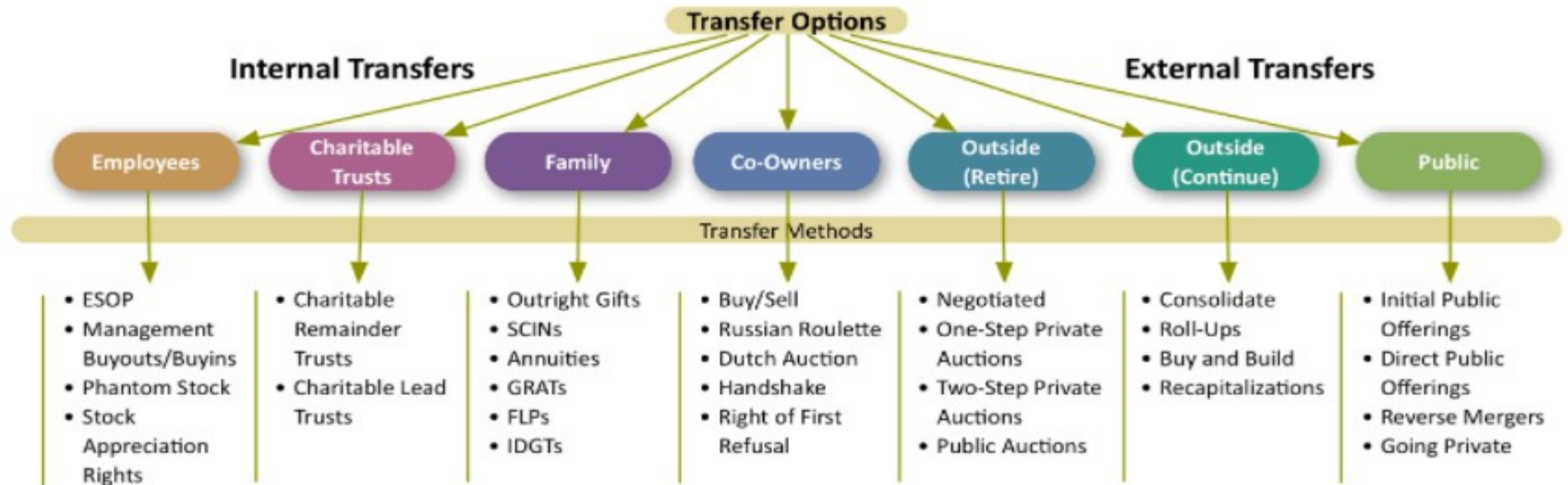
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## Transfer Options





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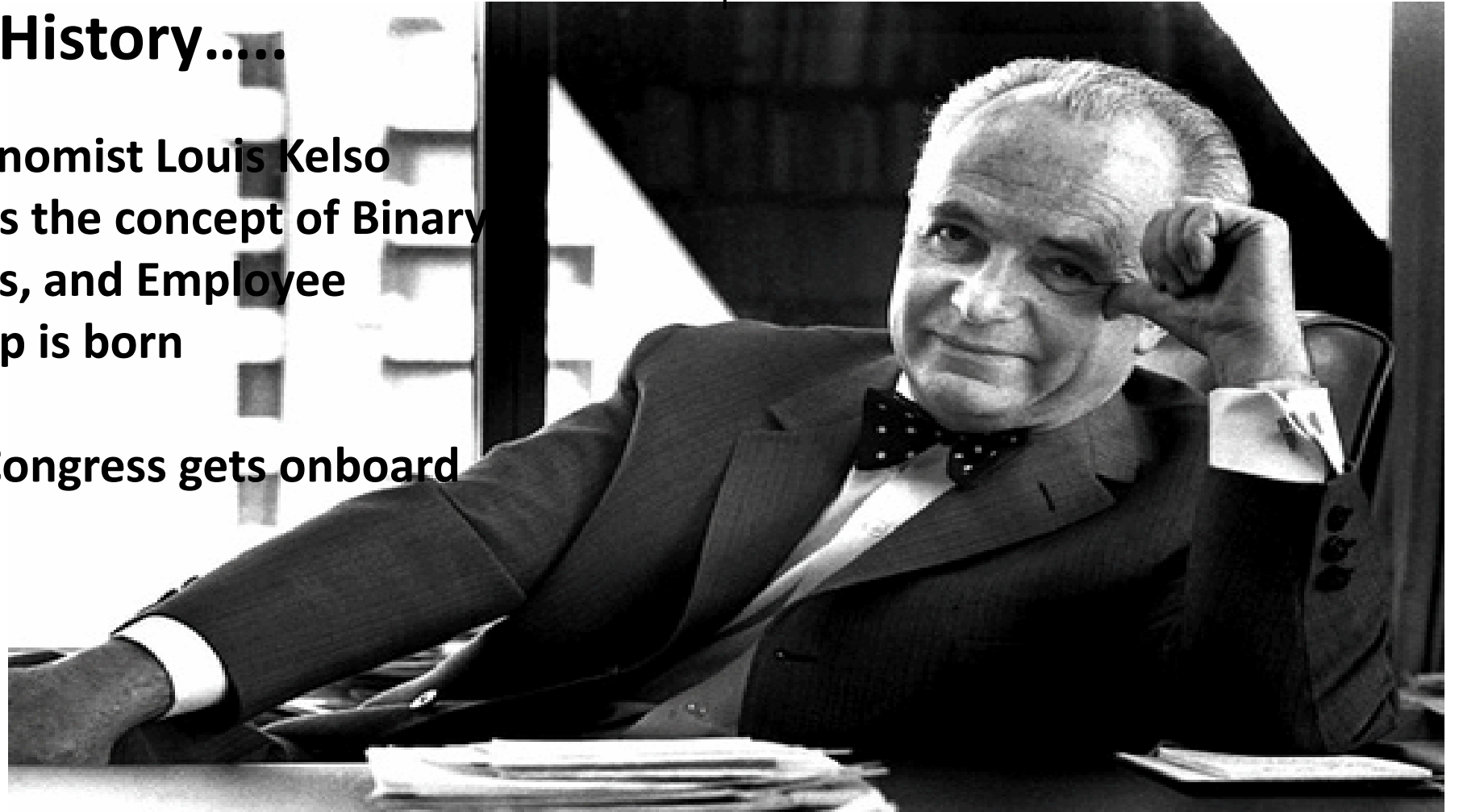
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## A little History.....

1956, Economist Louis Kelso introduces the concept of Binary Economics, and Employee Ownership is born

In 1974, Congress gets onboard



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In 1974,  
Congress passed  
a law.....

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And nobody  
knows  
about it.....

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**Only 3-6% of  
business owners say  
they considered an  
ESOP when selling**

***92% of ESOP  
Sellers say they  
are happy they  
did so***





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- Employee Owned Companies are 5% more productive than non-Employee Owned Companies.
- Employee Owned Companies keep businesses and jobs in the US.
- Employee Owners have 2.5 times more retirement savings than Non Employee Owners.

*\* NCEO/ESCA White Paper*





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## What Do ESOPs Do?

- Liquidity for Owners
- Legacy
- Keep Companies Here
- Succession Planning
- Productivity Improvements
- Bolsters Local Economy
- Reduce Burden on Government



Restek Corp, Bellefonte, PA  
(new employee facility)

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## Pittsburgh Area Employee Owned Companies



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## Pennsylvania/National Employee Ownership



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# WHAT IS AN ESOP?

- Employee Stock Ownership Plan
- A tax qualified defined contribution employee retirement plan
- No employee contributions; 100% employer paid
- Overseen by the IRS and the Department of Labor like 401(k) plans
- Qualified Plan under IRC Sections 401(a) and 4975(e)(7)
- ESOPs must invest primarily in stock of the sponsoring company

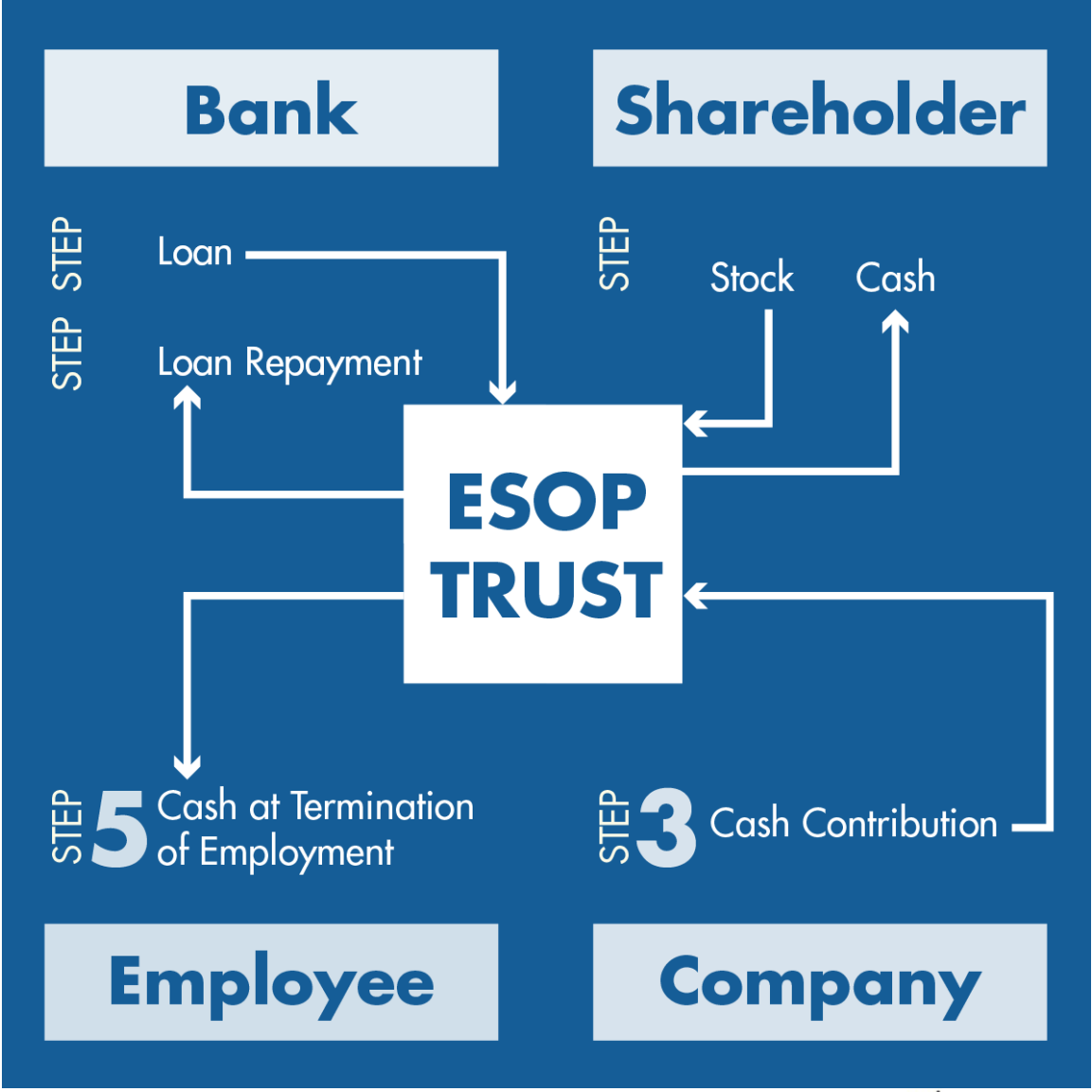
# MAJOR TAX INCENTIVES

1. Indefinite Deferral/Elimination of capital gains taxes normally due on a sale of a business
2. Dollar for dollar corporate deduction on every dollars' worth of stock sold to the ESOP
3. Profits of an ESOP company may become 100% federal and state income tax exempt
4. Significant estate planning transfer discounts



# ESOP CANDIDATE PROFILE

- Owner wishing to cash out all or portion of business
- Payroll of \$1,500,000 or greater (minimum \$1,000,000)
- Strong succession management
- \$10,000,000 or more business value (minimum \$5,000,000)
- 25 + Employees (minimum 20)
- Works well when family or management want to stay involved but cannot or unwilling to obtain financing

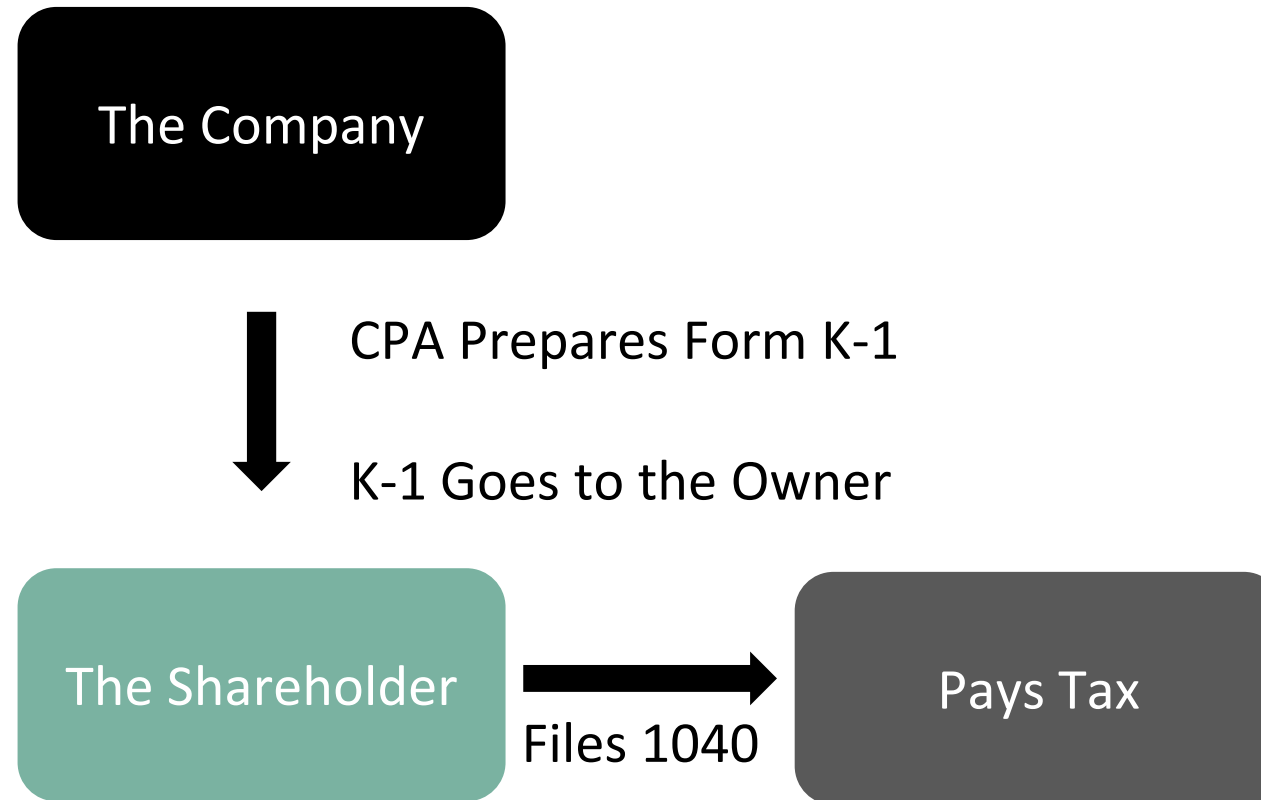


BTA proprietary graphic

# C Corp: IRC § 1042/Capital Gains Tax Deferral

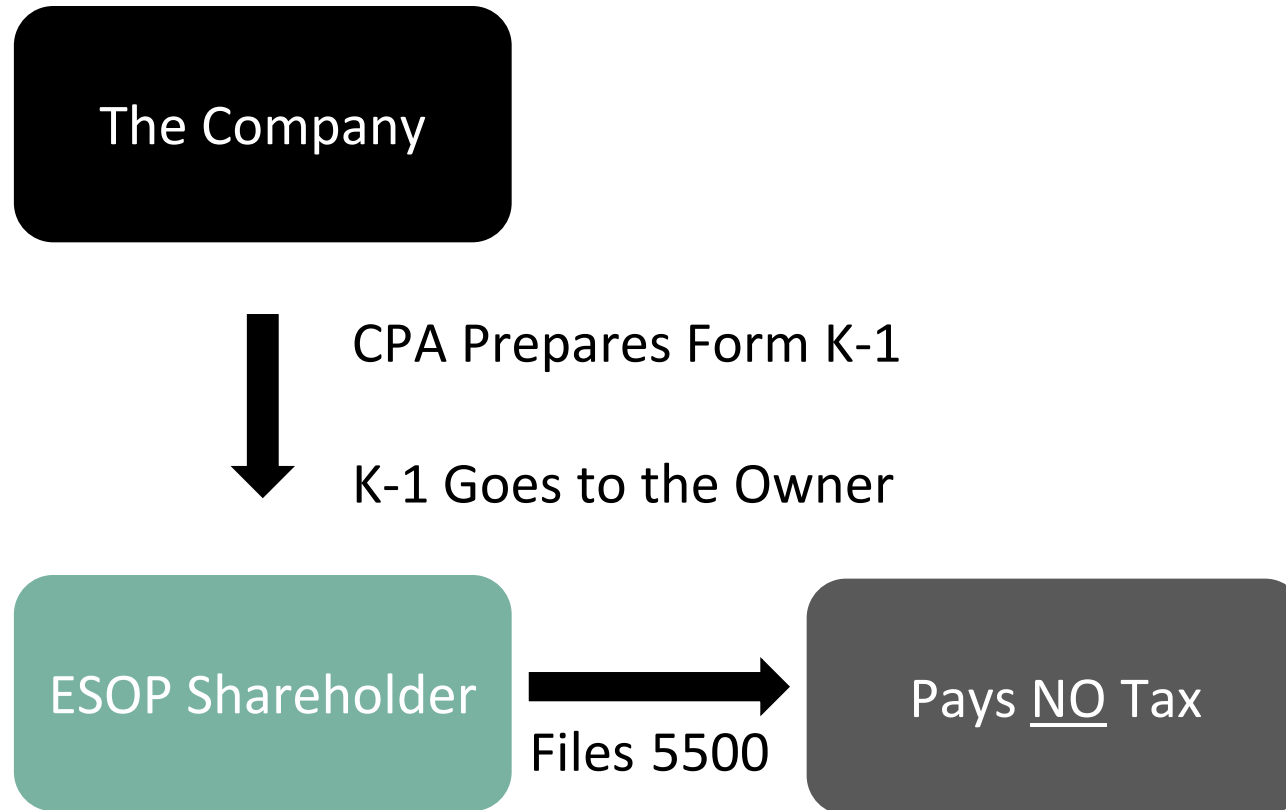
- Selling shareholder may elect to indefinitely defer federal capital gains on sale proceeds regardless of basis
- Similar to real estate provision IRC § 1031 and life insurance IRC § 1035
- Must reinvest proceeds into “Qualified Replacement Property” (U.S. stocks and bonds subject to restrictions)
- Special ESOP financial vehicles are available to facilitate deferral and access to cash

# S CORP TAXATION w/o ESOP



**Note: Distributions are made to shareholders to pay income tax**

# S CORP TAXATION w ESOP



**Note: No distributions needed, cash stays in the company**

# CONTROL

- Employees never actually own stock
- Employees only have a beneficial interest in ESOP
- No minority shareholder rights
- Trustee votes shares on behalf of employees
- Trustee can be “Directed” (by the board) or “Independent”



# VALUATION

- Seller has personal valuator
- Trustee will hire independent valuator
- Seller's team and Trustee negotiate price and sale terms
- ESOP is a financial buyer
- Rev. Rul. 59-60 fair market value, willing seller and willing buyer standards apply
- ESOP has specific discounts (generally positive)

# FINANCING THE SALE

- Employees do NOT contribute; Free benefit
- Bank financing
- Secondary lender (mezzanine)
- Seller financing
- Combination

# MODERN FINANCING STRUCTURE

- Seller may take an installment note for everything not covered by bank senior debt
- Seller is entitled to a market rate of Interest
- Market rate of Interest is NOT what the senior lender (bank) charges
- Market Rate IS what a secondary lender (mezzanine) would charge
- Seller has several options to realize total return including P.I.K.s

# TOTAL OUTCOME EXAMPLE

**Company Value \$20,000,000**

|                               |                     |
|-------------------------------|---------------------|
| Bank Down Payment             | 8,000,000           |
| Seller Note - Principal       | 12,000,000          |
| Seller Note – 4.5% Interest   | 4,524,000           |
| P.I.K. *                      | 7,790,000           |
| <b>Approx. Total Proceeds</b> | <b>\$32,314,000</b> |

\*Assumes equity PIK with company value growth of 3% annually over 15 years

# ESOP OBJECTIONS

- **ESOPs are complicated:** Yes, but so are many worthwhile techniques
- **ESOPs are expensive:** It's relative. Consider costs of business broker/private equity fees as well as the potential elimination of capital gains tax on proceeds and income taxes on profits
- **Employees will run the business:** Not true
- **Difficult to finance:** ESOPs are financed like any other corporate loan or could be 100% seller financed. Banks like the cash flow enhancement of tax-free profits



*Quality and Integrity Since 1949*



# 1947 - The KTA test panel



# 1961 – KTA pioneers coatings inspection



# 1965 and 1973 - Laboratory Services





# 1999 - KTA enters steel inspection





# 2000 - The Search for Liquidity Begins

## Sale to Insiders

- Management Buy Out Offer
- Memorandum of Understanding
- The first failed attempt



# 2006/2007 Securing Key Management

- *Go to War* Plan
- Restricted Stock Agreements



# 2008/2009 Parallel Paths

## Sale to Outsiders

- Financial Buyer
- Strategic Buyer

## Sale to Insider

- ESOP Feasibility Study
- ESOP Trust Established



# 2010 – Start of a New Legacy

- Performance Goals Established
- ESOP Team Assembled
- Financing Secured
- December 20, 2010
  - 70% Employee-Owned
  - Business Succession Secured





# Sustainability

- Strategic Planning
- Ownership Culture
- Repurchase Obligation



# Our Core Purpose

*Building Meaningful Careers*

*Worthwhile Businesses*

*Fulfilling Lives*



# Our Vision

*We are recognized experts in protecting the world's infrastructure, offering engaged employee-owners challenges and opportunities throughout their careers, and security in retirement.*

# The Journey Continues

- 2<sup>nd</sup> Stage Transaction – December 17, 2015
  - 100% S-Corp ESOP
- Leadership Development
- Succession Planning
- Repurchase Obligation



# Total Value of the ESOP Trust

December 31, 2010

2,748 Shares @ \$62.79/Share = \$172,547

December 31, 2016

15,992 Shares @ \$330.06/Share = \$ 5.278 million

**The value of all of the shares held in the Trust have increased by 2,959%, in 6 years!**

# ESOPS & FAMILY ESTATE PLANNING

- Gift P.I.K.s and seller notes to future generations via generational transfer vehicles while highly leveraged and worth very little
- Grantor Retained Annuity Trusts (GRAT) and Grantor Retained Unitrusts (GRUT) may “zero-out” gift value (if PV of gift equals the retained interest)
- Family Limited Partnership can sell stock to ESOP and elect IRC 1042 capital gains tax deferral/elimination
- Family Offices may desire to liquidate existing privately held stock to an ESOP for income producing assets

# ESOPS & CHARITABLE PLANNING

- Gift appreciated stock to charity, university or foundation (C/U/F) with FMV income tax deduction, no cap gains tax with immediate sale to ESOP
- Gift QRP (IRC 1042) to C/U/F with FMV income tax deduction for immediate liquidation for investable cash
- Charitable Remainder Annuity Trusts (CRAT) and Charitable Remainder Unitrusts (CRUT) for income stream and FMV deduction
- C/U/F may desire to liquidate existing privately held stock to an ESOP for income producing assets
- The *Tax Cuts and Jobs Act* is beneficial to S Corporation donors

# PLANNING NEEDS



**BUSINESS  
SUCCESSION  
PLANNING**



**CHARITABLE  
PLANNING**



**CORPORATE  
REPURCHASE  
LIABILITY**



**ESTATE  
PLANNING**



**EXECUTIVE  
BENEFITS NQDC**



**FINANCIAL  
PLANNING**



**FINANCING**



**QUALIFIED PLANS**



**WEALTH  
MANAGEMENT**



# PROCESS

1. Review client/prospect files
2. Contact Kevin McPhillips or Dan Zugell to discuss
3. Complimentary client financial review/consultation
4. Feasibility Study
5. Implementation

# NCC Video

<https://www.youtube.com/watch?v=uwJEiqtti8E>



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