Case Study:

S-Corp ESOP

Concept: A company sponsored employee benefit program. It is a defined contribution plan designed to invest primarily in the sponsoring company's stock. It is a plan that shares rewards and risks of capital ownership. Employees own a piece of the company.

Key: In 1998, Congress passed a law allowing an S Corporation to be owned by an ESOP. Once it's owned by an ESOP, a S Corporation can elect to pay only some or No Federal income taxes on its profits.

Client Profile: John and Pam, both 55 years old, owned a company valued at $5 million. They wanted to divest their equity in the company, which constituted 50% of their investment assets, into a more diversified investment portfolio. However, there were no interested 3rd party cash buyers.

Collaborative Design: With help of their tax advisors and legal counsel, John and Pam decided to sell their company to their employees. They established an ESOP Trust and sold 100% of their S-Corp stock to the Trust, in exchange for a promissory note. John and Pam maintain control of the company until the note is retired. John and Pam also become participants in the ESOP.

Result: The company, 100% owned by the ESOP, becomes a tax exempt entity. It pays no income tax on its profits. The tax savings allow the ESOP Trust to make payments to retire the note owed to John and Pam. The payments are treated as gain, subject to capital gain taxes. Employees of the company become "owners" of the company as contributions are made in their behalf. Corporate owned life insurance policies, paid with "tax free" premiums, are set up on the lives of John and Pam to secure the note in the event of a pre-mature death.

Revenue: $ 120,000