# An ESOP can benefit a business owner's retirement and estate plans

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Employee stock ownership plans ("ESOPs") offer closely held business owners an exit strategy and a tax-efficient technique for sharing equity with employees. But did you know that an ESOP can be a powerful estate planning tool? It can help you address several planning challenges, including lack of liquidity and the need to provide for children outside the business.

## An ESOP in action

An ESOP is a qualified retirement plan, similar to a 401(k) plan. But instead of investing in a selection of stocks, bonds and mutual funds, an ESOP invests primarily in the company's own stock. ESOPs are subject to the same rules and restrictions as qualified plans, including contribution limits and minimum coverage requirements.

Typically, companies make tax-deductible cash contributions to the ESOP, which uses the funds to acquire stock from the current owners. This doesn't necessarily mean giving up control, though. The owners' shares are held in a trust, and the trustees vote the shares.

An ESOP's earnings are tax-deferred: Participants don't recognize taxable income until they receive benefits — in the form of stock or cash — when they leave the company, die or become disabled.

## Retirement and estate planning benefits

If a large portion of your wealth is tied up in a closely held business, lack of liquidity can create challenges as you approach retirement. Short of selling the business, how do you fund your retirement and provide for your family?

An ESOP may provide a solution. By selling some or all of your shares to an ESOP, you convert your shares into liquid assets. Plus, if the ESOP owns 30% or more of the company's outstanding common stock immediately after the sale, and certain other requirements are met, you can defer or even eliminate capital gains taxes. How? By reinvesting the proceeds in qualified replacement property ("QRP") — which includes most securities issued by U.S. public companies — within one year.

QRP provides a source of retirement income and allows you to defer your gain until you sell or otherwise dispose of the QRP. From an estate planning perspective, a simple but effective strategy is to hold the QRP for life. Your heirs receive a stepped-up basis in the assets, eliminating capital gains permanently.

If you want more investment flexibility, you can pay the capital gains tax upfront and invest the proceeds as you see fit. Or you can invest the proceeds in qualifying floating-rate long-term bonds as QRP. You avoid capital gains, but can borrow against the bonds and invest the loan proceeds in other assets.

If estate taxes are a concern, you can remove QRP from your estate, without triggering capital gains, by giving it to your children or other family members. These gifts may be subject to gift and generation-skipping transfer taxes, but you can minimize those taxes using traditional estate planning tools.

**Weigh the pros and cons**

ESOPs offer significant benefits, but they aren't without their disadvantages. Please contact us to help determine if an ESOP is right for you.



The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com