Wright Ford Young & Co.
Certified Public Accountants and Consultants, Inc.

EMPLOYEE STOCK OWNERSHIP PLANS

Dear Clients and Friends:

Employee stock ownership plans (ESOPs) are gaining popularity as a vehicle to motivate employees while providing tax benefits to the company and an exit strategy for its shareholders.

An ESOP is a qualified defined contribution plan that invests primarily in employer securities.

An ESOP gives employees the opportunity to share in productivity through appreciation of the employer stock held in their accounts, and so encourage job performance.

An ESOP offers differing benefits to both S corporation and C corporation companies and their shareholders.

S corporation benefits:
An S corporation can transfer corporate stock to an ESOP and the ESOP's share of the S corporation's income will not be taxed. Since the ESOP is not subject to tax, the portion of the S corporation's income allocated to the ESOP escapes from tax entirely.

Assume that the ESOP owns 40% of the S corporation's stock and that the S corporation has taxable income of $100,000. The ESOP's $40,000 income allocation is tax free. Assuming that the S corporation distributes 45% of its taxable income to its shareholders to cover their income tax on their allocation of S corporation income, the ESOP will receive a tax-free dividend of $18,000, which it can use to buy additional shares of the S corporation. There are limitations on how much stock ownership a shareholder can have and still be able to accrue benefits in the ESOP.

C corporation benefits:
A C corporation shareholder who sells stock to an ESOP may elect to defer the recognition of gain on the sale by reinvesting the proceeds in certain other qualified securities.

Assume that an individual owning stock of a C corporation wishes to retire. An ESOP can borrow debt from a financial institution guaranteed by the Corporation to purchase the stock from the individual owner. The Corporation can make annual tax deductible contributions to the ESOP that is used to pay off the debt. The individual owner's proceeds can be reinvested in other qualified securities and defer taxation.

I hope you find this brief discussion useful. Using an ESOP to hold employer stock involves many complicated fiduciary, legal and tax issues that will have to be addressed further. If you wish to discuss your specific needs in greater detail, please give us a call.

Very truly yours,

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