



ESOPs For ‘S’ Corporations

**A New Opportunity For
Tax Planning**



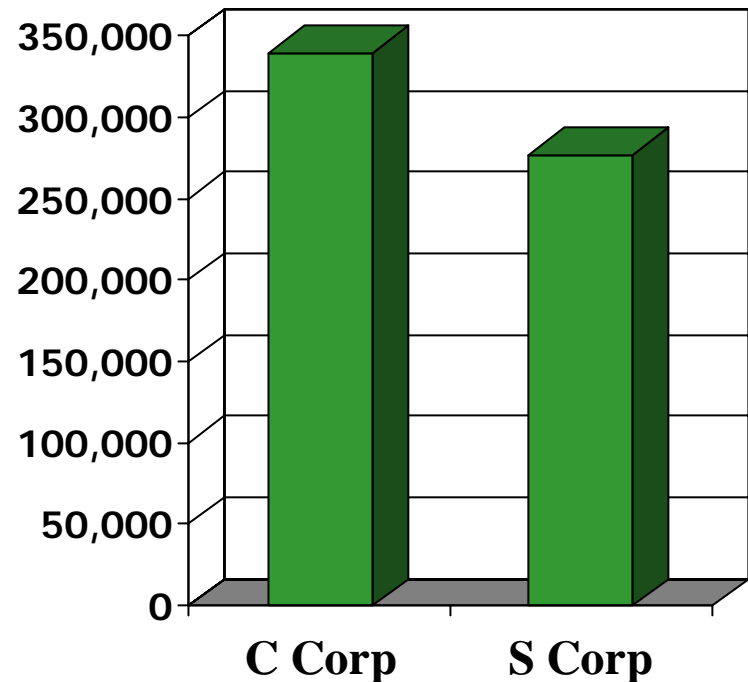
New Legislation New Opportunities

- UNDER THE TAXPAYERS RELIEF ACT OF 1997 (effective January 1, 1998)
- UBIT No longer imposed

**‘S’ CORPORATIONS CAN NOW UTILIZE
ESOPs**

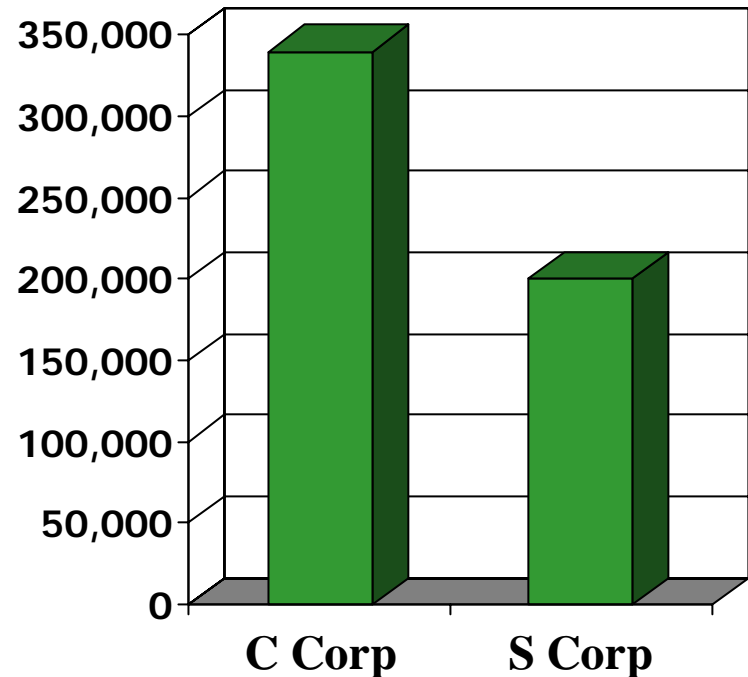
Tax Consequences

- Assumptions:
 - S Corp 30% owned by ESOP and 70% owned by individuals who pay tax at a 39.6% MTR
 - C Corp pays no dividends and pays tax at a 34% MRT
 - Both corporations earn \$1M taxable income
 - Earnings net of tax left in company



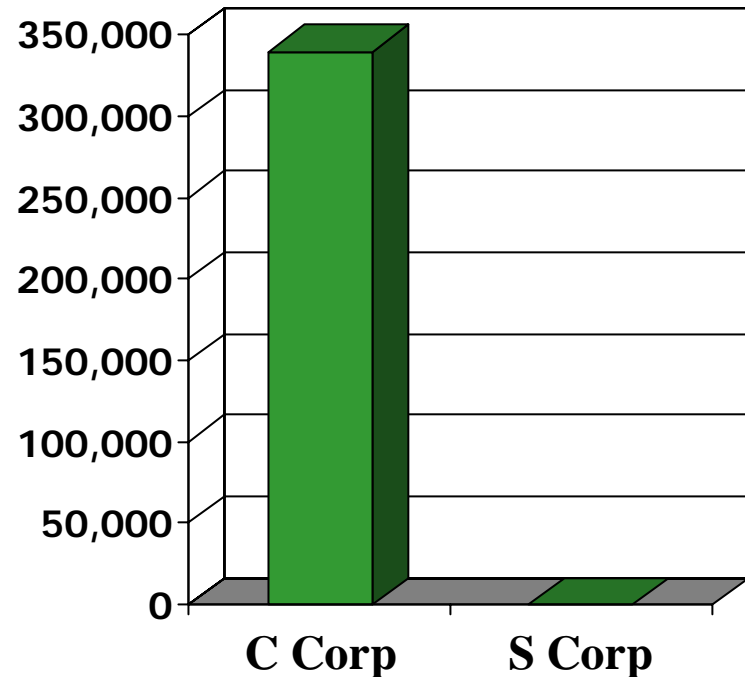
Tax Consequences

- Assumptions:
 - S Corp 50% owned by ESOP and 50% owned by individuals who pay tax at a 39.6% MTR
 - C Corp pays no dividends and pays tax at a 34% MRT
 - Both corporations earn \$1M taxable income
 - Earnings net of tax left in company



Tax Consequences

- Assumptions:
 - S Corp 100% owned by ESOP and 0% owned by individuals who pay tax at a 39.6% MTR
 - C Corp pays no dividends and pays tax at a 34% MRT
 - Both corporations earn \$1M taxable income
 - Earnings net of tax left in company





The Power & The Reality of 'S' Corporation ESOPs

*You can have a “For Profit”
corporation that is
“NOT”
subject to Federal Income
Tax on any level!!*

Where Do ESOP Distributions Go??

So, where do the ESOP distributions go??



Into the ESOP Trust

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What Can I Do With the Distributions??

- **Fund repurchase liability**
- **Repay ESOP debt**
- **Buy stock from another shareholder**
- **Buy treasury stock (recap company)**
- **Distribute cash to ESOP participants**





What Are the Differences??

- ***‘C’ Corp. ESOPs***
 - Seller **can** take advantage of Sec. 1042
 - 25% of qualified payroll is deductible if leveraged; 15% if not leveraged
 - Earnings of Corp. **ARE** fully taxable
- ***‘S’ Corp. ESOPs***
 - Seller **cannot** take advantage of Sec. 1042
 - 25% of qualified payroll is deductible
 - Earnings of Corp. **are not** subject to Federal Income Tax, to extent company is owned by ESOP



What Are the Differences??

- ***‘C’ Corp. ESOPs***

- Seller, family of Seller, & 25% S/H are excluded from ESOP for 10 years and 1 day.
- Corporation can have multiple classes of stock provided certain ERISA rules are followed (ESOP must have highest common voting or convertible by the trustee).
- Can have dividend preference.

- ***‘S’ Corp. ESOPs***

- Extensive exclusions for family members and 10% or greater S/Hs under anti-abuse rules under IRC 490(p)
- Second class of stock not allowed (can have common non-voting ESOP must own voting stock)
- Pro-rata distributions required –no dividend preference.