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Strategic Value Enhancement Consulting (SVEC)

## VALOREM PRINCIPIA

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### New SP&H Website

[www.sphvalue.com](http://www.sphvalue.com)

### Astrum Investment Management

[www.astruminvest.com](http://www.astruminvest.com)

### Dubnoff Center

[www.dubnoffcenter.org](http://www.dubnoffcenter.org)

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## ESOPs: Not Just an Employee Benefit Plan

By: Ellwood L. Jones, President  
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Even though the Employee Stock Ownership Plan (ESOP) has been around since the late 1950s, not many were formed because of confusing legal issues. That changed with the advent of ERISA, the Employee Retirement Income Security Act of 1974. ERISA, which governs employee benefit plans, established the statutory framework for ESOPs. Since then, the number of ESOPs has grown almost every year. There are now more than 11,500 ESOPs covering over 10 million participants, according to the ESOP Association. While many of these ESOPs were created as an employee benefit plan, there are many more reasons why an ESOP may be the best interest of a business owner as well as the business' long-term longevity and success strategy.

#### Employee Benefit or Incentive

Whether the benefit aspect of an ESOP plan is the driving factor in establishing an ESOP or not, most ESOP companies hope that by making employees owners they will increase their dedication to the firm, improve work effort, reduce turnover, and generally bring a more harmonious atmosphere to the company. Research has shown that giving workers a significant stake in their companies can improve employees' attitudes toward their companies, and that these improved

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attitudes can translate into bottom line improvements.

To get shares into employees' hands within an ESOP, many companies will make discretionary contributions to employee accounts each year; these contributions are made up of cash and shares of company stock. Additionally, some companies will match a participant's 401(k) contributions with shares of ESOP stock. Either way, participants are getting more shares of stock in their company each year.

#### Funding a Business Transfer

Many closely held companies have no plans, or incomplete plans, for business continuity after the departure or retirement of the founder. Finding a buyer is not always easy or desirable; in fact, a retiring owner may face an unpleasant choice between selling to a competitor and liquidating assets. As an alternative, an ESOP can provide a market for the shares of an owner looking to retire or as a way to gain access to the current value of the company they have built while providing a benefit and job security for employees in the process. With a C-corporation, retiring owners may incur no taxable gain on a sale of stock to an ESOP, provided that the ESOP owns at least 30 percent of the company immediately after the sale, and that the sale's proceeds are reinvested in qualified securities within a 15-month period beginning three months before the date of the sale. This tax-deferred rollover is the most tax-favored way for an owner of a closely held company to sell his or her stock.

Selling shares of a closely held S-Corp is a different animal, but not one without benefits. ESOP plans for S-Corporations have been in place for over 10 years but not surprisingly, few have used it. Why? There are three reasons:

1. A lack of understanding on the part of advisers;
2. Confusion regarding the C-Corporation version of the ESOP, which is generally less attractive; and
3. Lack of proactive exit planning on the part of business owners.

Two of the major benefits of S-Corp ESOPs, when done properly, are: 1) It allows owners of businesses to create a market for the shares they own and gain access to the value of the companies they have built; and 2) If the S-ESOP owns 100 percent of the company's shares, the company can operate without paying federal income taxes. This is because an ESOP is a non-taxpaying entity, when the ESOP owns 100 percent of the stock, there are no federal income taxes paid.

This is obviously a very quick overview of the advantages of ESOPs. The first step in determining if an ESOP is appropriate for the selling shareholder and the company is to talk to qualified advisers who specialize in ESOP planning. A qualified business appraisal, among

many other factors, is one of the foundational tools in assessing the viability of an ESOP for each business considering an ESOP.

The ESOP continues to be a valuable tool for creating a market for closely held stock, transferring business ownership and giving ESOP sponsoring companies a competitive advantage in their market place. The growth of the ESOP market has been influenced by federal legislation but has remained fairly steady in the recent past with new plans replacing terminated ones.

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The following are summaries of two ESOP updates highlighted in the June 2011 National Center for Employee Ownership (NCEO) e-mail bulletin.

#### **DOL Obtains \$10 Million Settlement in Suit Against ESOP Company**

A lawsuit filed by the U.S. Department of Labor against the DirecTECH Holding Co. Inc. Employee Stock Ownership Plan resulted in six consent judgments requiring payment of \$10,454,545 in restitution to plan participants and \$1,045,454 in civil penalties to the federal government. The plan covered 5,799 participants employed by businesses in Kentucky, Michigan, and Louisiana. According to the DOL's suit, plan fiduciaries allegedly retained appraisers with insufficient qualifications, used inadequate valuation methods for stock transactions, and provided inaccurate information to the appraiser. Litigation against remaining defendants is ongoing.

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#### **Senate Bill Addresses Proposed Fiduciary Status of ESOP Appraisal Firms**

Three New England Republican senators (Kelly Ayotte of New Hampshire, Olympia Snowe of Maine, and Scott Brown of Massachusetts) introduced a bill that would prevent the Department of Labor from implementing regulations that would make ESOP appraisers fiduciaries of those plans. The DOL has not yet finalized its proposed new regulations, but comments by Phyllis C. Borzi, assistant secretary of labor for the Employee Benefits Security Administration suggest an ongoing interest in making ESOP appraisers plan fiduciaries.

She said, "We knew [the proposed] regulation was going to be controversial, but there has been even more intensity than we expected."

*For more information, please click the link below for access to The Employee Ownership Bulletin and Updates:*

[NCEO: The Employee Ownership Update Bulletin](#)

## **Nevin Sanli Starts A New Business: Astrum Investment Management**

Founded by Nevin Sanli in October 2009, Astrum I. M., LLC ("AIM"), dba Astrum Investment Management, is a Los Angeles, California, based privately-owned fund Management Company.

AIM's first fund, Astrum Fund I, LLC, invests in solidly performing office and medical buildings, warehouse facilities, and multi-unit apartment buildings. The fund term is 5 years. Astrum Fund I is a great vehicle to add a real estate component to your portfolio. It provides diversification and balance. The minimum investment in the U.S. is \$100K. IRA/401k rollovers accepted.

On May 11, 2011, Astrum hosted a successful meeting at the Montage Hotel, Beverly Hills to introduce Astrum. For a copy of the presentation, please click below.

[Astrum - Beverly Hills Presentation](#)

*For more information regarding Astrum and/or investment opportunities in Astrum, please contact Jacqueline Jones at 310/571-3400, or via email at [jjones@sphvalue.com](mailto:jjones@sphvalue.com) to arrange a meeting with Nevin Sanli.*



Visit Astrum's website at [www.astruminvest.com](http://www.astruminvest.com)

## New SP&H Website

SP&H is excited to announce the launch of our new and improved website! Please take a moment to check it out at [www.sphvalue.com](http://www.sphvalue.com).

## The Word Origin

moot \* If you committed a crime in Anglo-Saxon times, you would be taken to a *gemot*, a court of law where the fact of that crime would be established and the trial referred to another kind of court. A "moot court," therefore, was all talk and no action, which gives us the modern sense of something that is theoretical or not open to further discussion, as in a "moot point."

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