

## ESOP as a corporate finance tool.

Adapted from V&E.

An ESOP may serve as a financing technique to expand the business or purchase capital assets in a tax-advantaged manner. Under conventional (non-ESOP) financing, a corporation that needs to raise money for working capital or expansion purposes borrows the funds from a financial institution and repays the loan principal with after-tax dollars. Although the interest component of each loan payment is a deductible expense to the corporation, the loan principal payment is not. While conventional loans require repayment of principal with after-tax dollars, ESOP financing enhances the ability of the borrowing corporation to meet debt-service requirements with pre-tax dollars. By using the ESOP as a corporate finance vehicle, the repayment of both the principal and interest are tax-deductible by the company. The increased cash flow available for additional debt service should either enhance the creditworthiness of the borrowing company or increase the amount of money that a financial institution is willing to lend.

For example, assume a C corporation wishes to obtain financing (for whatever reason) in today's tough borrowing climate. Under an ESOP structure, (i) either the ESOP borrows money or, more commonly, the corporation borrows money from the lending institution and the corporation then loans the proceeds to the ESOP, and (ii) the ESOP purchases newly-issued stock from the corporation. As a result, the proceeds from the sale of the newly-issued stock are then used by the corporation to finance the acquisition of capital assets, the expansion of the business, or to refinance existing corporate debt. As loan payments become due to the financial institution, the corporation makes a tax deductible contribution to the ESOP consisting of: (i) an amount of up to 25 percent of covered payroll for the purpose of repaying the loan principal; plus (ii) an unlimited amount used to pay interest on the loan. Cash dividends paid on the stock are also tax deductible if they are used to repay the loan, are distributed in cash to the participants, or are voluntarily reinvested by the employee participant in company stock.

Contact the professionals at ESI to discuss how your company might benefit from this strategy. ■

## ESOP legislative bulletin.

Adapted from The ESOP Association.

On October 22, 2009, Congressman Maurice Hinchey (D-NY-22) introduced **House Concurrent Resolution 204** which expresses continued support for employee stock ownership plans. It cites the Congressional history of ESOPs and references the 35 years of data showing that the vast majority of ESOP companies are high performing companies with better benefits than non-employee owned companies.

Concurrent resolutions have no force of law but can be useful tools in showing support for a concept. The text of the resolution can be found at <http://thomas.loc.gov/> (search for H. Con. Res. 204).

If you have questions about how to contact your member of Congress about co-sponsoring this Resolution, please visit, [www.esopassociation.org/](http://www.esopassociation.org/), and download a copy of the Advocacy Kit, [www.esopassociation.org/pdfs/Advocacy\\_Kit.pdf](http://www.esopassociation.org/pdfs/Advocacy_Kit.pdf), and a copy of the Congressional Company Visit Kit, [www.esopassociation.org/pdfs/Congressional\\_Visit\\_Kit.pdf](http://www.esopassociation.org/pdfs/Congressional_Visit_Kit.pdf), for more information.

On September 16, 2009, Representative Ron Kind (D-WI-3) introduced H.R. 3586, **The S Corporation ESOP Promotion and Expansion Act of 2009**, to improve and promote S ESOP laws.

On August 6, 2009, Senator Blanche Lincoln (D-AR) introduced S. 1612, the **ESOP Promotion and Improvement Act of 2009**. Senator Lincoln has long been a proponent of ESOPs and continues to be the "go-to" Senator for employee ownership organizations.

To find your Senator and/or congressional representative to express your support of these proposals, go to: [www.house.gov/zip/ZIP2Rep.html](http://www.house.gov/zip/ZIP2Rep.html) or [www.senate.gov/](http://www.senate.gov/). ■



### Check out ESI's updated website!

If you haven't been there in a while, please visit ESI's website. It has a fresh new look and feel and we hope that you'll find it useful and informative.

[www.esi-enterprise.com](http://www.esi-enterprise.com)

## New and improved.

When you receive your annual valuation report this year, you will notice that the ESI team has revised the format. We have found this streamlined report to be an improvement as it allows for greater understanding and readability. In addition to maintaining compliance with all regulations and standards, this new treatment helps us minimize our paper use while maximizing “green” sustainable business principles. We are confident that you will find the new look easy to follow and will be happy to answer any questions you may have. ■

## Hello Denise!

ESI is pleased to announce the addition of **Denise Waller** to our team! A Certified Public Accountant, she is our newest Assistant Financial Analyst and her focus is on preparing annual valuation updates for our clients.



With more than fifteen years experience as a CPA in a public firm, Denise has worked with companies of all sizes in various industries. Our clients will benefit from her unique perspective as she uses her past familiarity with financial statement and tax returns preparation and review. She earned her BS degree in accounting from St. Cloud State University.

With the addition of Denise, ESI now boasts a staff of thirteen. We are one of the largest valuation groups focused on ESOPs in the country, backed by our professional credentials and industry experience.

We're happy to have Denise join our group and are certain that you will enjoy working with her. ■

## Team spirit.

In the spirit of community, ESI has made a conscious decision to lend its support to a variety of charitable endeavors. ESI Team members donate their time and funds to purchase holiday gifts in support of disadvantaged families. Below is a picture of team members putting the finishing touches on items for La Casa de Esperanza. ■



## Fiduciary awareness.

Adapted from SeeTheBenefits.

The uncertain economy puts pressure on the dynamics of the ESOP appraisal process and company stock values. It is not simply an issue of the fair market value, but how fluctuations in company stock values are handled. Fiduciary and management issues, including employee communications, benefits calculations, procedural prudence, and strategic planning are all important aspects of the stock value process. Therefore, make sure that you:

### Look closely and communicate clearly

Projections prepared by management may need closer examination and documentation of those assumptions. Assumptions about growth that were realistic for some industries in the near past may be viewed in hindsight as overly optimistic or pessimistic. This and other factors affecting value may create difficult employee communication issues. Consider having ESI be more involved in supporting your efforts to communicate to employees.

### Think “demonstrable prudence”

Potential significant shifts in annual valuations or strategic transactions may call for a scrutiny of procedures to ensure that fiduciaries are demonstrating thorough procedural prudence.

### Know your corporate duties too

With all the talk of corporate governance, are the right parties doing the planning? Consider, for example, ESOP repurchase liability. Is it being handled by ESOP fiduciaries, or the board's finance committee? Are you changing the terms of the ESOPs distribution provisions in response to this liability? Be sure all parties, the process, and the plan document optimally protect the company and the ESOP fiduciaries.

### Don't wait until the last minute

Overall, ESOPs fiduciaries must be careful and even more vigilant throughout the valuation process. Delays due to uncertainties or in producing company financial statements may cause issues with participant communication. Boards of directors should examine the inter-relationship of company financial reporting and the ESOP valuation process. If there are significant accounting anomalies, get them resolved. Consider keeping your valuation firm more proactively in the loop with your other advisors in order to streamline the process.

ESOP fiduciaries should be aware as they handle their routine annual compliance and fiduciary matters and periodic plan amendments to assess their entire ESOP situation and look to their future plans. ■