



ESOP: THE CLIFFS NOTES' VERSION

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The Setting

- The Land of Qualified Retirement Plans
 - The landscape is constantly changing
 - The giant woods of the IRS Code
 - Seems dark and scary
 - If you know how to navigate, it can be a safe place
 - The swampy quagmire of ERISA
 - If you know how to navigate the land, you can have a great adventure



The Setting

- The Community of ESOP
 - What is an ESOP?
 - An ESOP is a qualified profit sharing plan designed to invest in Company stock
 - Employees become beneficial owners of stock in the Company
 - Exists in the Land of Qualified Retirement Plans
 - The rules of your ESOP community are laid out in your plan document
 - Everyone is allowed to read the rules
 - Everyone gets a summary of the rules (summary plan description)
 - Ignorance is no excuse for the law



The Setting

- The Company

- This is the business that is at the heart of the ESOP
- The wealth providing instrument for the ESOP community



The Setting

- Employee Benefits Associated with an ESOP:
 - Company contributions are deductible
 - Employee is not currently taxed on Company contributions
 - Plan assets grow tax free
 - Favorable tax treatment on distributions



The Setting

- Employee Benefits Associated with an ESOP (cont.):
 - Deferral of capital gains for “C” Corps and smaller or no tax for “S” Corps
 - Company remains in Michigan
 - Profitability of the Company reflected in the value of ESOP stock



Cast of Characters

- Board of Directors – Group of people responsible for running the Company
 - Decide to establish an ESOP community
 - Establish rules (plan document) for the ESOP community
 - Appoint Trustee
 - Must abide by Business Judgment Rule



Cast of Characters

- Selling Shareholder – An owner of the Company
 - Plays a major role in the beginning of the story as he or she provides the stock for the ESOP
 - Permitted to play major role even if all stock is sold



Cast of Characters

- The Trustee – The primary person responsible for enforcing the rules of the ESOP
 - Appointed by the Board of Directors
 - Responsible to act in the best interests of the ESOP community members
 - “Inside” or “Outside” Trustees



Cast of Characters

- Employees – people who work at the Company
 - May or may not be part of the ESOP community



Cast of Characters

- ESOP Participants – Employees who have become members of the ESOP community
 - Are beneficial owners of the Company, with a financial stake in the operations of the Company

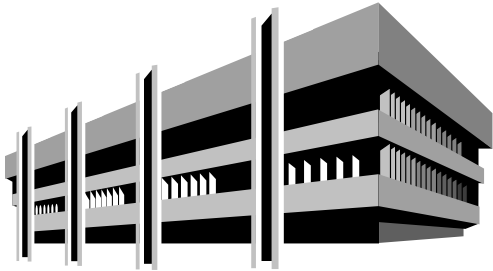


Cast of Characters

- Additional Characters:
 - Company Advisors: legal counsel, CPA, financial advisor
 - Selling Shareholder's Advisors: legal counsel, wealth advisors
 - Management team
 - Trustee's Advisors: legal counsel, valuation firm, appraiser, financial fairness advisor
 - Lending Financial Institution (bank)
 - Third Party Administrator

The Story

- Act One – The ESOP is Established
 - Scene 1 – Board of Directors decides to establish an ESOP. It secures the services of one of the local merchants in the Land called an ERISA attorney (who is knowledgeable about navigating the woods and swamp) to draft the rules for the ESOP (plan document)

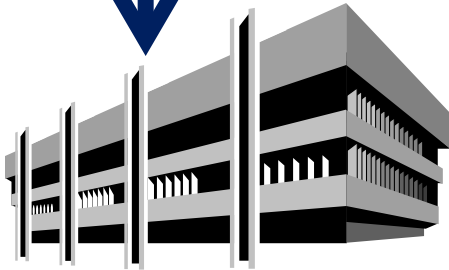
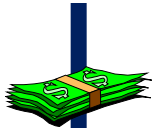
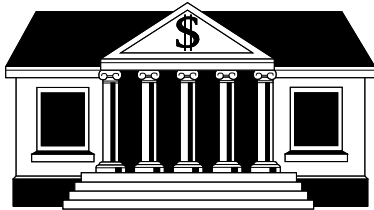


ESOP

- Scene 2 – Board of Directors appoints someone to enforce the rules: the Trustee

The Story

- Scene 3 – The Trustee looks for ways to acquire stock in the Company



- Trustee needs cash to buy the stock
- Nonleveraged ESOP- Company contributes stock (or cash to purchase stock) to the ESOP
- Leveraged ESOP- Bank lends money to Company, which lends money to the ESOP

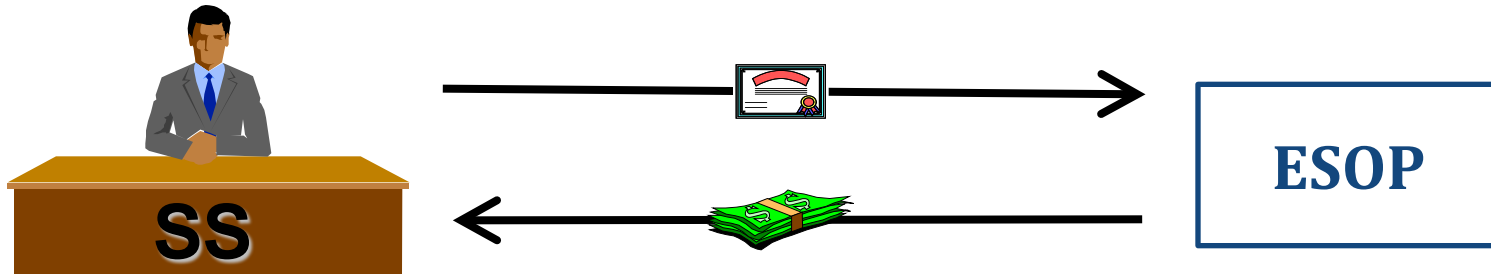


Cash contributions/Loan



The Story

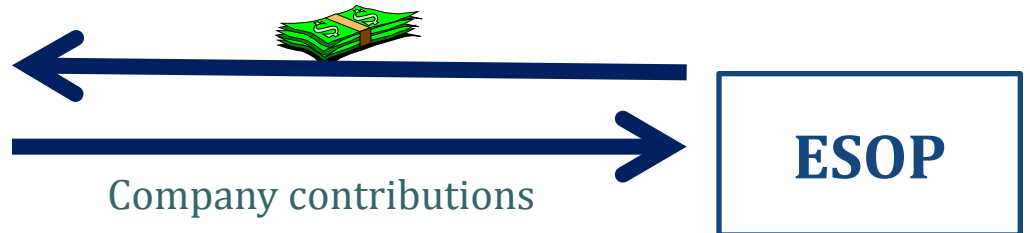
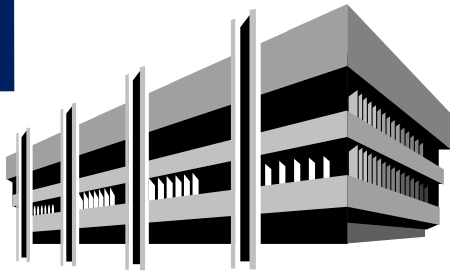
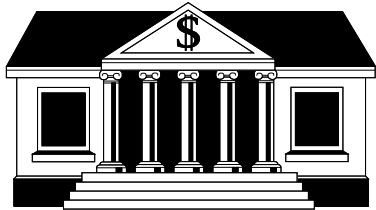
- Scene 4 – The Trustee acquires the Stock
 - Trustee purchases stock from Selling Shareholder or
 - Trustee purchases stock from Company



- Independent Appraiser very important

The Story

- Leveraged ESOP Financing:
 - Stock is used to collateralize the loan from the Company
 - Company contributes funds to ESOP
 - Trustee repays Company
 - Company repays Bank





The Story

- Act 2 – Employees become part of the ESOP Community and begin to acquire wealth
 - Scene 1 – Employees become ESOP participants
 - Become participants based on the rules of the ESOP
 - ESOP participants have certain rights
 - Vesting disclosure
 - Not “Shareholders”



The Story

- Scene 2 - Board of Directors makes a contribution to the ESOP, and the ESOP participants receive allocations of stock
 - Contribution is used to repay loan
 - As the loan is repaid, collateralized shares are released for allocation to participant accounts
 - e.g. - 10% of loan repaid...10% of shares are released
 - Participants receive allocations to their accounts based on the rules
 - Participants pay no tax on the stock while it is in the ESOP

The Story

- Scene 3- ESOP participants receive distributions as they retire or otherwise separate from the Company

- For retirement, death or disability, distributions begin within 1 year
- For other reasons, distributions may be delayed for up to 5 years
- Payments must be completed in 5 years





The Moral

- Why an ESOP?
 - Nondisruptive and positive method to transfer ownership
 - Other options include:
 - Sale to competitor
 - Merger
 - ESOP designed to be a win/win for Employees, Company and Selling Shareholders



The Moral

- Benefits to Employees:
 - Employees receive their share of increase or decrease in value of Company
 - Company not sold to “outsiders”
 - Company generally operates “business as usual”
 - Favorable tax treatment of distributions
 - Diversification of Company stock account at age 55 and 10 years of participation
 - Employee distributions generally made upon termination of employment subject to Company’s ability to wait five years and payout over five years



The Moral

- Benefits to Company:
 - Business management decisions remain unchanged
 - Additional benefit for Employees
 - Tax deductible contributions to ESOP Trust
 - Tax deductible principal repayment of loans
 - Stock is allocated to ESOP participants each year
 - Company remains in Michigan



The Moral

- Benefits to Selling Shareholders:
 - Designed ESOP to benefit employees
 - Created buyer for stock without liquidating or selling Company to outsider
 - Business succession strategy
 - Potential tax-free rollover on sales of stock to ESOPs



Questions?