RUTGERS–NEW BRUNSWICK
Institute for the Study of Employee Ownership and Profit Sharing
School of Management and Labor Relations

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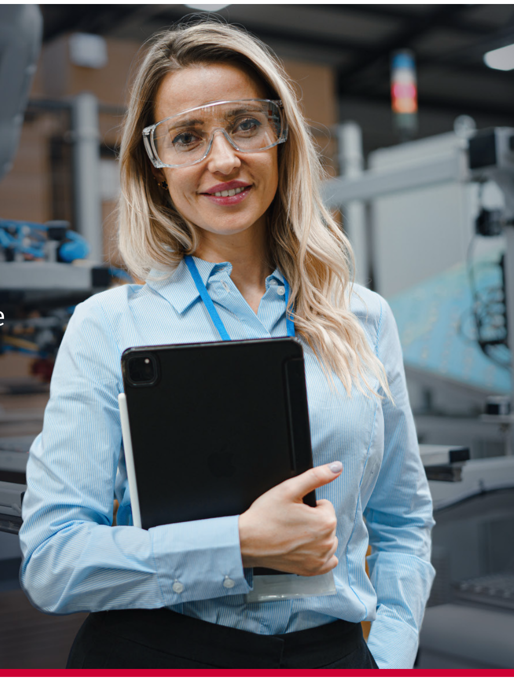
Transitioning to Employee Ownership
How New Jersey Business Owners Benefit



If you are a business owner planning for retirement or considering selling part of your equity stake, transitioning to employee ownership can provide an alternative to selling to outside buyers or private equity. This option can **help preserve your business' legacy and culture while providing a pathway for succession**.

The most common form of employee ownership is an Employee Stock Ownership Plan (ESOP). ESOPs offer business owners a practical succession solution, a way to achieve liquidity, plus additional benefits.

5 *Reasons* to Transition Ownership of Your Business to Employees through an ESOP

1 Liquidity on Your Terms

ESOPs are a tool for liquidity that can provide business owners a way to convert some or all of their equity stake into cash for a competitive price by selling their equity internally, to employees, instead of an outside buyer. The sale may be financed through lender financing, where the owner receives cash immediately, or owner financing, where the owner receives a promissory note for gradual repayment, or some combination. Shares may be sold to the ESOP gradually over time or all at once. **The flexibility can allow owners to sell, or exit, on their own terms.**

2 Tax Advantages

Selling to an ESOP provides significant tax benefits for both the selling owner and the company.

Business owners who sell their shares to an Employee Stock Ownership Plan (ESOP) may defer capital gains taxes on the sale. To qualify for this tax deferral under IRS Section 1042, the owner must reinvest the proceeds from the sale into qualified replacement property, typically stocks or bonds of U.S. companies. This special tax advantage was designed to encourage more business owners to sell to their employees in order to expand ownership opportunities more broadly. Companies also benefit from substantial ESOP tax advantages. For example, in S Corporations, the portion of the company owned by an ESOP is wholly exempt from federal income tax. For example, **if the ESOP owns 100% of the company, the entire income of the company is exempt from federal income tax**. This can be a major cash flow advantage allowing more funds to be reinvested in the business, used for expansion, or to pay down debt. In C Corporations, ESOPs offer the ability to deduct contributions used to repay both principal and interest on loans, unlike non-ESOP companies that can only deduct interest.

3 Continuity of Leadership, Company Name & Culture

ESOPs allow business owners to sell their ownership stake—but retain their executive role if they wish. With an ESOP sale, **the original owners can remain in leadership even after selling their equity stake**, or they can step back, depending on preference and need.

Unlike with a sale to an outside buyer, the company's name, identity and culture can continue. This is particularly valuable for companies with strong or close company cultures that they wish to preserve.

4 Employee Engagement and Retention

Research suggests that employee ownership through an ESOP can increase employee engagement, productivity, and retention, particularly when implemented in high trust workplaces or in environments that encourage employee voice. **When employees have a financial stake in the company's success, and a voice, they may be more motivated, aligned, and focused on quality**.

5 Legacy, Jobs & Community

Selling to an ESOP allows business owners to **protect employee jobs, share future successes with employees, and maintain local ownership**. For many business owners, transitioning business ownership to employees, in addition to offering a tax advantaged pathway to exit or liquidity, aligns with their values and their commitment to their workforce and community.

NOTES: *Companies considering ESOPs should be profitable and financially stable, with reliable cash flow and revenue. While there is no strict minimum size requirement for an ESOP, generally companies with at least 25 employees and annual revenues of several million dollars are best suited for the model. In smaller companies, a worker cooperative, employee ownership trust or another transition should be considered.*

The information above is intended as a general introduction. Any ownership transition requires expert guidance from legal and financial advisors.

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