

Spring, 2024

CLEANING UP WITH AN ESOP

John was the majority owner of a New York-area commercial building cleaning company that he took over from his father. Under John's leadership, the company grew dramatically into a national market leader with contracts across the county. However, John and the company's other owners had a problem that is all too common among successful small business owners: too great a portion of their families' net worth was tied up in illiquid stock of a closely-held corporation. John's desire for liquidity, continued operational control, and a secure future for the company's valued employees seemed to present John with an unresolvable paradox.

With these objectives in mind, a traditional solution, such as a sale to a strategic or financial buyer, fell short. Fortunately, John was advised to consider a sale of the company's stock to an employee stock ownership plan ("ESOP"). An ESOP is a tax-qualified retirement plan that would be established by John's company. John's employees would be the beneficiaries of the ESOP.

With Danziger & Markhoff's representation and assistance, John and the other stockholders sold their stock to an ESOP established by the company. Not only did they receive significant cash payments at closing and sizeable note payments for many years, but they were also able to defer paying tax on their realized gains by making an election to invest their sale proceeds under Section 1042 of the Internal Revenue Code. Further, John received warrants exercisable for company stock in the future. In this manner, not only was John able to achieve his liquidity goal, but he was able to maintain operational control of the company, and the company's employees were given an opportunity to participate in the company's future growth through the ESOP. All this without paying federal income tax at the time of the transaction.

Needless to say, John is not the principal's real name. However, this is an otherwise accurate description of a real transaction that Danziger & Markhoff helped close last year. Utilizing our firm's multi-disciplinary skills and experience in, among other areas, pension, corporate and estate planning, we were able to guide the business owner in establishing an ESOP and closing a stock sale to that ESOP. Post-closing, we are now providing ongoing guidance to the company and third party administration services for the ESOP.

If you or your client confronts a situation similar to John's, please reach out to one of our partners to consider the possibility of an ESOP solution. In the right circumstances all stakeholders can really "clean up" with an ESOP.

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