MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 51 Transcript

Announcer (4s):
Welcome to the Maximize the business value podcast. This podcast is brought to you by mastery partners, where our mission is to equip business owners, to maximize business value so they can transition their business on their terms. Our mission was born from the lessons we've done from over 100 business transactions, which fuels our desire to share our experiences and wisdom. So you can succeed. Now, here's your host CEO of mastery partners, Tom Bronson.

Tom Bronson (36s):
Hi this is Tom Bronson and welcome to maximize business value. A podcast for business owners who are passionate about building long-term sustainable value in their businesses. In this episode, I'd like to welcome our guest. Jason Luter. He's an attorney with Faegre drinker here in Dallas. Now Jason specializes in employee stock ownership plans, or esop's, there's been a great deal of interest in esop's recently. And I thought it would be a great time for us to have someone on the program who really understands them and can, can explain them better to our listening audience. So welcome to maximize business value.

Tom Bronson (1m 15s):
Jason, tell us about the firm Faegre drinker.

Jason Luter (1m 19s):
Thanks. Tom's pleasure to be here. I appreciate you having me. So about faegre drinker, we are a full service international law firm with about 1300, 1,350 lawyers. And that's primarily in the United States. And when I say full service, that means pretty much any type of law. You can envision. We have people who specialize in that and practice groups that do in my area. Of course, the corporate, transactional and esop space. We have one of the top practice groups in the country, and I know we'll be getting into that throughout this interview.

Tom Bronson (1m 58s):
Awesome. So what is your background? I know that faegre drinker does basically everything from litigation to probably do you guys do family law, even all of that kind of stuff as well?

Jason Luter (2m 8s):
We do. So the family law that that becomes when you get into family law becomes a smaller part, whereas because you're dealing with such a small group of the nation that would hire a full service firm to represent them in a family law matter. But in the, when you think in the corporate context, we have hundreds of lawyers who do corporate and transactional. They work with hundreds of lawyers who do commercial litigation and labor employment law. So those are kind of the big categories. And then of course you have specialties like family law or intellectual property, things like that. So

Tom Bronson (2m 48s):
Well-rounded law firm do they do lots and lots of things. So what is your background and why did you specialize in esop's and business transactions?

Jason Luter (2m 58s):
Well, so my pre law school background was finance and accounting and finance. And to add that, or, you know, when I got to law school, the, that transition finance and accounting transitioned nicely into tax law specialty. And then when you have a finance and accounting business background with tax law, the corporate transactions world are largely finance and, and tax driven. Those are very important structural issues for corporate transactions and esop specifically are they involve a, a tremendous amount of tax advantages for both the employees and selling shareholders, owners, transitioning employment.

Jason Luter (3m 49s):
So it creates a, a real win-win transaction structure for everyone involved really. And once I got into them many years ago, I got sucked into the, this, this really interesting world of ESOP transactions and transitioning corporate ownership from business owners to, to their employees through esop trusts.

Tom Bronson (4m 11s):
Well, I imagine that there's a lot of financial advantages there, but why don't we back up and just, we receive a lot of questions from clients about ESOP's and is this a good solution for them? So why don't we start by, by let's having you explain them what exactly is an esop?

Jason Luter (4m 29s):
Certainly. So ESOP's, as you mentioned earlier in the intro iesop, that stands for employee stock ownership plan, it's actually considered a qualified retirement plan. It's something like a 401k plan, but I don't want to, don't want to confuse the audience here. It's, it's very different from a 401k plan, but when you think of the, the concept of a tax qualified retirement plan, where employees are able to save on a pretax or tax deferred basis for retirement, and watch that grow on a pretax basis, it's very similar their individual accounts in the names of your employees, but the we'll get into the details as we continue the conversation on how they're structured.

Jason Luter (5m 16s):
But a in a nutshell, you have a tax qualified plan, which involves a tax exempt trust that trust becomes the buyer of the owner of a company's stock. So you have a selling owner who would sell to, well, any buyer, whether it's a family member or a third party buyer, whomever, a competitor, or you have an Aesop trust. And the buyer in that Esau transaction is the trust. So now you've sold your stock to a tax exempt trust where the stock is being held for the benefit of your employees and your employees are able to share in the value of the company over the next many years, decades.

Tom Bronson (6m 2s):
And as we, as I think about Aesop's, it's really for business owners who feel very strongly about their employees, right? So in the context of succession planning for companies and exit strategies for business owners, kind of what is the role and purpose does it matter?

Jason Luter (6m 24s):
So that yes, it is. It's very favorable to in place. I'll mention that as, as we talked about some of the alternatives I'll get into how it differs, but the let's let's start with what, what options do owners typically consider when they're, when they're evaluating or starting to mull over exit strategies and succession planning. You have somebody who's created a business first generation, second generation, whatever it is, and it's privately held company. And the owner a lot of times first thought is, what about errors? What about passing? You know, transitioning ownership from the current owner to his or her children or grandchildren or other relatives, many, many times, that's not a workable option for any number of reasons.

Jason Luter (7m 14s):

So once you get outside of that, just the, what about the, you know, other family members taking over, you start looking at transitioning or other options. We're transitioning who to whom could I sell my business? What I sell my assets of the business, what I sell the equity of the business. And when you start thinking of who your potential buyers are in that, in those structures, and you have a third party sale, you have, you could sell to a competitor, a strategic, a private equity fund, and Aesop is, becomes a potential buyer.

Jason Luter (7m 55s):
That a lot of, a lot of people, because they're not a lot of people are familiar with this. It's a specialized tax driven transaction. It doesn't always hit the radar with every, you know, business broker, investment banker. Who's out there talking to company owners. This topic doesn't always come up, but as a business owner, yeah. I strongly recommend that you ask the question and have this, have an Aesop, be part of the panoply of options that you consider. It may or may not be the right fit for you, for your company, for your employees for a variety of reasons. But it also might be a really excellent solution that, that you'll be thankful to have at least considered.

Tom Bronson (8m 39s):
We have a free ebook on our website. That kind of goes into all of the transition options, because it occurs to me that most business owners don't realize all the options that are available to them. And certainly we talked a little bit about esop's in that I would encourage you to go to our website, mastery partners.com, go to the free stuff tab and download the ebook on transition options. But so you started to mention a little bit about some of these other options. So how does company succession planning that utilizes an Aesop differ from what you would call maybe more traditional company, succession strategies, like a third-party sale, a management buyout, or, or corporate acquisition of stock, or a react position of stock?

Tom Bronson (9m 25s):
How does an Aesop kind of differ from those other things?

Jason Luter (9m 30s):
Excellent question that, well, at least first it differs in tremendous large ways, significant ways. And I'm happy to get into those. Let's start with the basics of simple, let's start with similarities, both in both selling your company. One difference is if you're considering as a business owner, selling your company to, to it, anything other than an esop, you can, again, as we mentioned earlier, you could sell the assets or you could sell the equity. You can sell your stock in the esop context, you can only sell the stock. So an

A\esop can only purchase corporation stocks. So if you're currently a partnership or an LLC, one difference between other forms of transactions is, is you would have to convert to either a C Corp or an escort prior to the transaction.

Jason Luter (10m 16s):
It's an easy process. We do it all the time, but so that's one difference. Then, as far as other differences between an esop transaction and the other transactions, you have a buyer in, in any of these instances, you know, assuming you're not donating business stock to a charitable foundation or somebody okay, but if there's a purchase and sale transaction, the esop is the buyer. And there are tremendous tax benefits that differ significantly from other forms of transactions, both for the selling shareholders, the business owner, as well as for the employees of that business.

Jason Luter (10m 57s):
Now as a sector, those are the first couple of issues. The next issue that, that differs just the throw this out here. It's not going to come as a surprise to, to anyone who has been, who's been in the business world for a while. You've seen, especially over the last decade or so. I mean, there's been a huge amount of private equity, M and a, and, and company, you know, you see roll-ups and, and a lot of corporate MNA transactions, strategic buyers, competitors buying each other. What is one theme that you see in those transactions consistently? And I don't say this because it's based on it's because of any nefarious intent or, or anything like that.

Jason Luter (11m 40s):
But a lot of employees do lose their jobs. Typically from the selling entity. That's a that again, it's not nefarious. It's just, there are employee redundancies that, that exists. You know, a competitor buys you do. We need, you know, multiple people in the same role of accounting and HR and administrative personnel and all that there's that. But then there's also a strategic changes. You'll have a buyer or private equity fund. They put in their new management team, they want to assemble their own group. You're there ends up being a good bit of employee turnover. In most of these third-party sales, would you call it now? That's where another tremendous difference with the esop exists is because we're not in this, in the esop context, selling to a, a stranger or a competitor or someone who's going to put in their own man, a new management team you're selling to an esop trust that you create now.

Jason Luter (12m 36s):
And for the benefit of your employees, they're the beneficiaries of that trust as a result, there does not, there's typically no employee loss or turnover associated with the ESOP

transaction. The, the last thing I'll mention aside from the big tax benefits and differences that we'll dig into, as we get into to tax structure and C Corp versus S four, you don't have to find a buyer when you're doing an ESOP transaction. If you think of a typical, okay, I don't have family members to try and transition this to a management buyout is not an option. How do I find a third party buyer?

Jason Luter (13m 17s):
Typically you go through the process of marketing, your company, your you package it, this, this package, here's what we are, what we do. And you try to find a buyer and negotiate a deal. In the esop context, we create the ESOP, create these trust. That becomes the buyer. So there's no, there's no searching for a buyer. Now you have to pick a, you have to select a trustee and find someone who is suitable for that role to the trustee of the, of the ESOP that you create. But there's no roadshow. So to speak, to, to try and find a buyer, of course, can, can expedite the timeline if that's important.

Tom Bronson (13m 58s):
Yeah, and I, I was not aware that an esop really only is a stock purchase. I was not aware of that. And so for business owners that are thinking about their transitions many, many times, I don't even know what the percentage is, but it's a very high percentage of transactions are asset purchases, right? Because of the tax benefit

Jason Luter (14m 17s):
Tax and liability liability reasons, you have a third-party purchaser who says, okay, yeah, I'm going to buy this company. I like the idea for whatever strategic reason, but I, I liked the idea of buying your equipment, your, your employees, your real estate, your Goodwill, you know, operations customer lists, not so interested in a potential liability that you have out there. So I'm, I'll just buy the assets and exclude any liability that may exist. That's connected to your, in an equity purchase. It's harder to exclude liability, right?

Jason Luter (14m 57s):
Again, in the esop context, since you're, you're transitioning, it's the same people before and after the transaction, generally, who are owning and running and operating the business. So you're, it's not the same as going out and buying a stranger's car and wanting to wondering what skeletons may be in the closet and wanting to disclaim and not take on any liability. That's unknown. You pretty much know what your business is.

Tom Bronson (15m 25s):
Yeah. I'll tell you if you, if you haven't been through a business transaction before selling it to a third party is incredibly disruptive, right? I mean, because of, for all the reasons

that you brought up here, the, you know, potentially new management coming in, some employees may be terminated or offloaded, you know, post-transaction, it's, it's the whole sale process, very disruptive business owners. Don't really think about that. Many times. It takes a year or more to sell a business. And while you're trying to run that process, you're also trying to run the business, which sometimes devalues the business. I think one of perhaps the biggest benefits to an esop is that it's an internal transaction and that you don't have to go out and you don't, you won't be eliminating people to the, to the extent that they don't need to be eliminated anyway, right.

Tom Bronson (16m 17s):
In the business. And, and it is, it is significantly less disruptive to the business to have that insider transaction, to already have management in place. And it's a very smooth transition. So I, I really like those benefits. And so, so we need to take a break. We're talking with Jay. Oh, good.

Jason Luter (16m 41s):
If I could make one comment about that. There's one thing related to exactly what you said. That's specific to the business owner in this context. So we've talked about employee turnover and replacement, and you know, new management team comes in in a third party sale. You think about the business that you, as a business owner have created and you sell it to a third party. They are many times, and I'm sure Tom, you've seen this a million times. The third party buyer is saying, okay, we, we need the business owner. You're the, you are the, the brains behind the operation. You're the backbone of this company. It's your relationships with customers and vendors and everything that, that are so significant.

Jason Luter (17m 23s):
We have to have some time post-purchase, we're not just buying and then kicking everybody out the door. We need you specifically business owner who created and built this company to stay on for some period of time, a year, two years, four years. And how are we going to get you to do that? They use earnouts and other structures to try and incentivize the business, the selling business owner to stick around and ensure that the buyer at the end of that period of time has a company that they feel comfortable is, is going to be able to run profitably without the presence and contributions of the business owner. Now, what do we see in, in practice?

Jason Luter (18m 4s):
Or, you know, what actually happens? You've been running the company, you built the company it's yours. It's, you know, say it's founded in 1982 or, or what are you okay? You

haven't been answering to anybody. And then everybody's, it's one big happy family. You just got a big paycheck from a strategic buyer and they want you to stick around. But all of a sudden you're answering to someone else who's running your business because now they own it. And we, I see many, many times that business owners walk away, they leave money on the table. They walk away from earn-outs that part of their purchase price, because they say, you know what? I just, I cannot stand going into my own business anymore. It's just breaking their heart and they leave money on the table.

Jason Luter (18m 47s):
In an esop context, you can stick around as long as you want. I mean, it's, it's still your, you know, it's still your company in the sense that the equity is owned by the ESOP for the benefit of your employees. And, but you're still running it. So if your succession plan, you're, you're, you know, you're thinking about getting out of the business. I want to transition towards retirement. I want to do other things travel. Whatever's on your agenda for the next 20 years. You, you may, in most of the time I hear business owners say, well, I mean, I don't want to just sell and, and be done in in six weeks or six months. I think I'd probably have to five years, four years now, three years, whatever it is, 10 more years, I'd like to keep working, but I want to take some chips off the table.

Jason Luter (19m 32s):
Now I want to monetize some of my investment. Well, this is one of the best ways, if not the best structure that allows you to monetize your ownership, you know, take some chips off of the table while you continue to run the company, the equity is owned by the trust, but you're the management of the company you continue to pay. You're still the boss. So in timeline,

Tom Bronson (19m 56s):
That's huge. I will tell you that, you know, the, the, there's a, there's an enormous dissatisfaction. When I forget what the number is. It's some high percentage, like 59% of business owners are dissatisfied with the transaction a year later, partly of that is driven by, they now have a new boss right there. They sold the business and they're working for somebody else. So that, that leads to the average tenure of a CEO who sells to a third party to be less than two years. And even though their agreement may be longer than that, like you said, they may be walking away from things because it's hard. If you've been running your business for a long time now taking direction from somebody else, the new owner in the business, that's a very difficult thing.

Tom Bronson (20m 41s):

And it can be extremely disruptive. I love this, that, that you can basically the business and An exit strategy and stay. If you want to or go, if you want to, right, then you're still calling the shots until that time that you hand over the reins to your handpicked successor. Right?

Jason Luter (20m 59s):
That's right. So you can, you can do this transition on your terms and your timeline.

Tom Bronson (21m 4s):
I love that. So we're talking with Jason luter, let's take a quick break. We'll be back in 30 seconds.

Announcer (21m 10s):
Like it or not, eventually you'll have to come to a point when it's time for your business to transition. Will you be ready? Will you be able to get the maximum value for your business? Brought to you by mastery partners, MasterYclass is a 12 month program designed specifically for business owners. We meet once a month as a group to work through our transition readiness assessment, expand your business. Toolbox through leadership presentations have live interaction with other business owners. This program determines vulnerabilities and your business will affect business value and your ability to transition in the future. Whether that transition is in two or 15 years, what you do now has long-term effects on the future value of your business.

Announcer (21m 57s):
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Tom Bronson (22m 19s):
We're back with Jason Luter an attorney at Faegre drinker, and we're talking about esop. So Jason, let's get into some of the details. How is succession planning using an esop? How is that funded?

Jason Luter (22m 35s):
Sure. Yeah. An important, important point, right? Cause we've, we've mentioned earlier in the interview that we've created an esop with a tax exempt trust. That's going to buy your stock as a business owner. So the logical next question is where does the stuff that you created get that money, the funding to purchase your stock? The quick answer is

debt, but I don't, but before anybody gets scared away from the idea of a business or in the trust borrowing money to buy out your soul, let's, let's get into exactly how this works. I want to start with a simple example, because again, typically an esop transaction would be funded between by combination of lender, debt, like a traditional third-party lender data bank, a bank gives a loan and seller debt.

Jason Luter (23m 30s):
So the business owner takes seller notes for a portion of the purchase price as well. Let's use a simple example to illustrate and say $20 million. Okay. The valuation of your business is $20 million, and we're going to fund that, that price. So you sell a hundred percent of your stock at $20 million funded, 50, 50, 50% bank debt and 50% seller notes. Of course, there's no magic number or percentage split there it's whatever deal makes sense for your company. And, and of course, what a bank will agree to, but pretty much a bank is always going to require that the seller has some skin in the game. They're not going to give you a hundred percent of your purchase price, but right in that 50 50 sample in a $20 million deal, you have $10 million of bank debt at closing that's cash.

Jason Luter (24m 19s):
Okay? So at closing you as the selling shareholder take $10 million, that has to be paid back over a, and it's paid by the company through the esop through company. And so it's debt effectively on the company because that's the only operating entity. The trust doesn't have operations. So the funds would flow through for the tax benefits, but really it's, it's the company buying, you know, company earnings is paying off this debt bank. That's going to have a typical bank debt terms or term loan. So think four or five years, six years, something like that at a market rate of interest or 5%, something like that today and level amortization over that period, you can make those payments once that gets paid off and there there's also, there's some big tax benefits here as well.

Jason Luter (25m 7s):
But before I get to that, let's turn to the bank. Debt gets paid off. Now there's the seller debt. They both exist at closing, but the bank is going to require that your seller notes be subordinate to the bank debt. They want to get paid back and prioritized first, understandably, they put up the cash. You as the seller. Now, once the bank debt's paid off, start getting paid. You can get interest payments on your seller debt for those four years or whatever it is to pay off the bank debt. But then once the bank debt's paid off, you start receiving principal and interest payments on your seller debt. The solid seller is going to have a higher rate of interest than traditional bank debt, because the seller, you as a business owner are not a professional lender.

Jason Luter (25m 47s):
That's not your business and you're not. And you're able to command a higher rate of return for loaning money as a non-professional financial institution. So you're going to get a higher rate of return that we get paid out over the next several years. Now let's start with the, the tax benefit. Why, because a lot of times, business owner, especially conservative business owners, who've built a business conservatively. They look at the same way, man. I'm not going to take a hundred percent debt on this company. Like how can we sustain that? And that's a very reasonable concern, but there's a fundamental difference between the way that the treatment of your business debt outside of the esop context and inside the ESOP context, outside of the sub context, you take out a loan, say it's a term loan, $2 million a your business.

Jason Luter (26m 41s):
You're going to make payments as a business to the bank. And what do you deduct from tax perspective? You deduct the interest, but not the principal in the esop context, you're going to deduct a hundred percent of both. So really? Yes, that's exactly right. So it's a, a tremendous tax benefit that lightens the burden dramatically that the debt burden, the weight of that debt on the business is lightened dramatically because every payment that you're making say it's in that $20 million example, if we were to say a million dollars a year paid back over 20 years, just to make easy math, you're paying a million dollars plus interest and deducting all of it, the million plus interest every year, every payment that that really lightens the load, obviously.

Jason Luter (27m 30s):
And additionally, you'll, you have the opportunity if you're an s-corp, w we're getting into this structure that you can see an estimate second, but there there's an additional way to lighten the burden of the debt on the company, which is effectively. If you're an S-corp, you're an S-corp, that's now owned by a tax exempt entity. How are escorts taxed on business earnings? Well, there is no tax at the corporate level and an escort. There isn't a C Corp. They pay C-corp tax and an S-corp. It gets passed through and pushed down to the owners, you, and in that simple example, a single owner, the profits of the business that aren't paid out as compensation and expenses that gets taxed to you, whether you take a distribution or not the Phantom income concept and the S-corp ESOP context, that same exact number say it's $2 million worth of profit at the end of the year, that will be taxable to you is now tax exempt.

Jason Luter (28m 24s):
So what's the result and impact of that result and impact is you now have a tax exempt entity effectively where that $2 million that would be taxable at the end of the year. So

say six, 800 grand. Well, whatever the, whatever the tax amount would be paid on, those earnings and profits stay in the company is returned retained earnings. What can you use that for servicing debt? You have all this extra free cashflow you can grow. You can expand, give people raises, you know, acquire competitors. We see that a lot. There's the provides a, a huge financial opportunity for the company, as well as the business owner

Tom Bronson (29m 8s):
Now. So we've talked a lot about some of these taxes. I mean, you're blowing my mind here with all of these different implications here and the advantages of it. Is there a difference with respect to post-closing implications? We talked about escorts and kind of how the tax flow, but is there a difference between s-corps and C-corps?

Jason Luter (29m 26s):
Yes, yes. There and, and important differences. So the let's start with, because there's that the tax considerations for both the selling shareholder, the business owner, and in this simple example of a single owner owns all the stock. Yeah. As we said earlier, it has to be at the time of the stock transaction has to be a C Corp or an S Corp. So what does it matter to the selling shareholder? And then I'll get to the, what, how it matters to the company selling shareholder. Cause you can sell C-corp or S-corp stock. If it's C Corp stock, you have the opportunity on all the, on the funds that you receive in this $20 million example, you get a $20 million payday for your, for the sale of your business.

Jason Luter (30m 15s):
If it's a strategic buyer, a third-party purchaser comes in and buys your assets or your equity and gives you $20 million in this simple example, that is a taxable event this year. Okay. So if it's in 2021 and you get paid $20 million, you have taxable income of $20 million in 2021. It's pretty simple. Then the only thing that you are playing with at that point is a cost basis and accounting issues, as far as your tax considerations go, but you got the money this year and it's a taxable event in the Aesop context, if you're selling C Corp stock. So your secret at the time of the transaction, you have the opportunity as the business owner, but not the obligation to take advantage of what's called a 10 42 exchange at 10 42 exchange is I think the closest analogy, but it's not the same.

Jason Luter (31m 11s):
The closest analogy would be, if you think about a tax-free rollover from a 401k, into an IRA, you hear the commercials online. Did you leave a 401k plan at your old employer? Why don't you, or you see the commercials on TV? You know, why don't you roll it over tax-free to an IRA and continue to let it grow tax deferred? You know, it's that same concept, but again, it's, you know, don't get confused. I'm not saying it is. They rollover to

an IRA. It's not, but they, the tax implications were about the same, where if you choose to exchange that money, the $20 million in this example in to what's called 10 42 exchange qualified replacement property, which is generally, and you can, you can Google it and see what 10 42 qualified replacement property is.

Jason Luter (32m 0s):
It's effectively know mutual funds, U S investments. No foreign stuff, but standard investments that you would think about having as, you know, what, what you would take your $20 million and put it into, if you do that within a certain time period, after the transaction closes, that differs the taxable event until some later date, when you actually start monetizing it. So back to that IRA analogy, you roll it into an IRA, your 401k plan into an IRA. There's no taxable event today, but eventually when you start taking money out, you know, liquidating those investments within the IRA, you're going to be taxed on it.

Jason Luter (32m 42s):
Let's let's same concept for the business center, no taxable event today. Now why is that significant will snip significant for a huge number of reasons, but the first is $20 million in one year. I mean, if it's just a taxable event this year then it is what it is, there's, there's not a lot of manipulation or really any that can be done, or I shouldn't say manipulation, but more a strategy tax planning. If instead you put all of that money at $20 million into qualified replacement property and you defer taxes on it, then you can strategize over time with your, a wealth advisors and your estate planning advisors on how best to take out money over time to maintain your standard of living.

Jason Luter (33m 26s):
Go ahead and spend my, whatever it is you want to spend money on, but also estate planning. Should we contribute something to trust somebody after your children or to charitable foundations? If you have a charitable giving desires, there's you just have a basically unlimited amount of flexibility to structure and design your future from a tax planning perspective that is not available outside of this, this unique 10 42 qualified exchange scenario. That's again, in the c-corp context, in the s-corp context, under current law, 10 42 exchanges not available, there is a proposal under the new Biden administration to allow S-corp sales, to also be made to also have 10 42 exchange as a, an available opportunity there hasn't been passed yet.

Jason Luter (34m 22s):
It's just a proposal. We'll see what happens, but under current law and traditionally it, if you sell S-corp stock, it hasn't been eligible for 10 42 exchange. So why would

somebody sell as an S Corp? Well, there's a full, first of all, some, some selling shareholders are not that interested in, in 10 42 exchange for any number of reasons. Second of all, there's that immediate. If you are an S-corp and the date of sale, then immediately after the sale to the ESOP, what we were talking about earlier, you have a tax exempt entity effectively now where all of that extra money, that $2 million of profits every year, that would normally be taxable.

Jason Luter (35m 3s):
It's not taxed at the secret level because you're not a C Corp it's not passed through to you. It's passed through to a tax exempt trust, which means it stays in the company. That might be a structure that's really helpful in getting you as the selling shareholder paid out faster and more aggressively, depending on the timeline of how you want to get paid out, because you have all this extra cashflow that would otherwise be going to taxes. It does not mean that you can't do both. You just need a longer time horizon. So if you were to be, for example, a C Corp on the date of sale, then you advantage of the 10 42 exchange opportunity and then immediately convert, or you start the process of converting to an escort.

Jason Luter (35m 47s):
If you were a partnership or an LLC that converted to a Corp before, before the transaction, or you were an S-corp that revokes your S selection before the transaction. So now you're a C and can take advantage of the 10 42 exchange. There's a five-year five taxable year waiting period. So you can't, you can't just flip back and forth that IRS. Isn't going to allow that. So if you want to take advantage of 10 42, you got to keep that in mind as well. You might have to need a longer time horizon.

Tom Bronson (36m 18s):
That's important. I was going to ask you if there was a look back on that in an ESOP transaction, and you just answered that question. So that, that, that makes a lot of sense. So you need to plan and strategize about this in advance, just like you would any other type of exit strategy. It sounds like so excellent. So for the sake of time here, we're going to run out of time in a few minutes, but so in esop it sounds like is a highly specialized exit strategy. Can business owners do this on their own or do they need help?

Jason Luter (36m 53s):
The quick answer is that you really should not do this on your own for a variety of reasons. It is technical, you know, tax based exit strategy, but there's also liability associated with it both from a tax liability perspective, as well as fiduciary liability,

because the concept is you're transitioning ownership to your employees for their benefit. And so it's not just the IRS that would scrutinize this. It's the United States department of labor saying, Oh, wait a minute, did you try and structure something for your own benefit at the expense of your employees? Or did you do something where everybody benefited? And it's, it's really important to have advisers in this world who really work with this, this type of transaction, understand it, and have, have considered carefully the legal implications, the governmental scrutiny that's applied to, to them.

Jason Luter (37m 51s):
So everything from your advisors, your trustees, the valuation professionals, the lenders need to understand esop lending. You need people that have experienced in this space for a successful transaction that minimizes the liability to you.

Tom Bronson (38m 6s):
I agree kids, don't try this at home. Find a specialist that can help you do this. You know, frankly, I can't imagine even being possible to do it on your own. Perhaps if you're an attorney and a CPA and you're on the business, maybe you can figure that out. But this is a highly complicated and specialized type of a transaction that has many, many benefits to business owners and employees alike. And so you really need to get the right help. So speaking the right help, what sets you apart from other Aesop attorneys?

Jason Luter (38m 43s):
Oh, well, I'd like to say my, my trauma and personality and how everyone here, you're going to have a great experience working with me. Well, the honest answer, the, because this is a specialized type of transaction. There's not, there's not a ton of people who specialize in this type of, in this type of work in this type of transaction nationally. So you're, you're already limited to a specialized group of practitioners in this space then among those specialized practitioners, my team is among the top teams in the country in terms of breadth and depth of experience in these deals as well as a number of transactions a year.

Jason Luter (39m 24s):
So I feel like you'd be in really good hands working with us. We have among our team includes the former deputy deputy secretary of labor nationally. So you have that department of labor oversight in advice and input, if, and where needed the same on the IRS side as, and then of course the, the corporate MNA, you know, hundreds of corporate MNA attorneys, which these are ultimately corporate M and a transactions.

Tom Bronson (39m 51s):

Yeah. And it doesn't cost anything to have a conversation, right. To, to at least have a consult with you to, to, to discover whether or not this is something that might make sense for your business. So I would strongly advise business owners who are thinking about this to get in touch with Jason. We'll talk about how to do that in just a second one last business question. This podcast is all about maximizing business value. Of course. So Jason, what's the one most important thing you would recommend business owners do to build value in their businesses?

Jason Luter (40m 23s):
Oh, good question. I guess it I'll answer it a couple of different ways. I mean first, how did, how do you maximize business value as an owner who's selling your business? Well, it's not just the dollar figure of the purchase price. It's also, what are the terms of payout? Are you going to be able to stick around? Like we talked about earlier and, and transition working your, your working years on your own terms and on your own timeline and what are the tax implications? Is it just a single payday or do I have the opportunity as a business owner to maximize the value of this business that I've created on a post-tax basis?

Jason Luter (41m 2s):
Esop's provided great opportunity there from the employees side and you as a business owner should be considering that. How do you maximize the value to your employees? In addition to the tremendous benefit that that dollar value that's created and built in the ESOP accounts for your employees over time, your employees get to keep their jobs. That's, that's a significant value. I mean, are you creating and adding value with your business? These people, your employees have been with you for a long time and helped you build this successful business, become successful on your own. You get to leave a, leave, something to them, a business behind that survives your tenure with the company that you built for the benefit of, and not at the expense of employees who helped you get there.

Tom Bronson (41m 49s):
I love it. I love it. Now our listeners know that I always ask a bonus question, you know, after all the business questions and they listen all the way to this point, cause everybody wants to know the answer to this question, Jason, what personality trait has gotten you into the most trouble through the years?

Jason Luter (42m 7s):
Gosh, I was wondering where you're going with this. Okay. Well, I guess the first thing that comes to mind, I think probably a lot of people can relate to this would be, I'm a, I'm

a people person. I love being around other people. And when I'm working with business owners, I like, I really enjoy getting out of web or historically done as you go out and you see the business owner at their business, what, they've, what they do, what they've built, what they've created and work with them in person learn about what their desires, dreams, objectives are personally, financially, and for their business, for their employees. And over the last year, not being able to see, you know, because of, COVID not being able to see people in person and having to do all of these transactions and meetings remotely.

Jason Luter (42m 55s):
We're all, we're all making it work. But I feel like that personality trait is it's been uncomfortable for me. You know, really wanting to, to be with people in person. I look forward to being able to do that again really soon.

Tom Bronson (43m 9s):
That's, that's a great answer. I agree. I, I, we like to touch people, right? I want to be around. I'm a big hugger, you know, I want to be around people that do that. So how can our viewers and listeners get into,

Jason Luter (43m 21s):
Oh, thanks. Well, you can Google my name. Jason Luter J a S O N L U T as in Tom, E R. And if you, that, that should bring up my firm website and LinkedIn as the top couple of results. If you need an additional keyword to put in, you can say Jason Luter, faegre, affirm Fae, G R E. And I should take you right to me. Okay.

Tom Bronson (43m 44s):
Thank you for being our guest and taking some of the mystery out of esop's. Okay.

Jason Luter (43m 50s):
Thanks for having me. You can find

Tom Bronson (43m 52s):
Jason Luter L U T E R. Ed fakery drinker, F a E G R E drinker.com or on LinkedIn, of course. And of course you can always reach out to me and I will be happy to make a warm introduction to my new best friend and esop specialist. Jason Luter. This is the maximize business value podcast, where we give practical advice to business owners on how to build long-term sustainable value in your business. Be sure to tune in each week and follow us wherever you found this podcast. Be sure to comment. We love your

comments and we respond to all of them. So until next time, I'm Tom Bronson, reminding you to consider all

Announcer (44m 34s):
Of your options for your exit strategy, including esop's while you maximize business value. Thank you for tuning into the maximize business value podcast with Tom Bronson. This podcast is brought to you by mastery partners, where our mission is to equip business owners to maximize business value so they can transition on their terms on how to build long-term sustainable business value and get free value building tools by visiting our website, www.masterypartners.com that's master with a Y mastery partners.com.

Announcer (45m 12s):
Check it out. <inaudible> that was perfect. I wouldn't make any changes on that.