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IN BRIEFSM

Employee Stock Ownership Plans: An Overview *By Jim Vogl*



Since the mid-80s, I have been working on qualified retirement plans as a consultant, lawyer and CPA. In 1993, I began to focus on Employee Stock Ownership Plans.

What is an ESOP?

In general, an ESOP is a special kind of qualified retirement plan that can borrow money to buy company stock. There are many reasons an ESOP is used by a business but the most common reasons for adopting an ESOP are: (1) buy shares of a current shareholder; (2) create an ownership culture; and/or (3) set up an organization in which a business does not have to pay taxes on profits.

Buy Shares of a Current Shareholder

A common use of an ESOP is to buy out a current owner. Typically this is a situation where the owner has started a business and is now looking for an exit strategy. The current owner could sell his or her business to an outsider or a competitor however such a sale will not guarantee that the business will continue in its present form. The owner typically wants the business to continue and the employees to retain their jobs. Selling to an outsider could result in many unexpected or unwanted changes and it might even result in the business being liquidated. Selling directly to the employees of the business is generally not feasible since the employees do not have the money. Selling to an ESOP that benefits employees is another option.

If the owner uses an ESOP, the owner's shares can be sold to the ESOP and paid for with the earnings of the Company. There can be tax benefits to the selling owner (e.g. if the Company is a C corporation, the selling shareholder might be able to defer the tax on the sale or in some cases avoid the tax altogether). There are tax benefits to the Company in using an ESOP since the Company gets to deduct the purchase of the shares by the ESOP. A stock redemption on the other hand is not deductible, typically the selling shareholder continues to work at the company for some time after the sale to the ESOP and may even

get some of the sold shares allocated to his/her ESOP account.

Create an Ownership Culture

An ESOP can be used to create an employee ownership culture. As an ESOP acquires shares, such shares are allocated to employees' ESOP accounts. Even though an employee is not a direct owner of the stock, an employee's retirement value is directly impacted by the value of the company. Much like an owner this gives employees an interest in the business. The added benefit to the employee is that this "ownership interest" is given to the employee as part of his or her retirement benefit. The employee gets benefits of employee ownership without having to buy stock. The theory is that once employees realize that the performance of the Company directly affects the value of their retirement those employees generally care more about positively affecting the Company's overall results.

Stop Paying Tax on Profits

Many companies set up ESOPs to avoid paying taxes on profits. If an ESOP owns 100% of the stock of an S corporation, no taxes are paid on the profits currently. In other words, a profitable business does not pay corporate tax and the shareholder, the ESOP, does not pay tax on the S corporation's earnings since the ESOP is a tax-exempt retirement plan. The only taxes that are paid are by the employee when he/she takes a distribution from the ESOP. The retiree pays ordinary income tax on the value of the benefit paid. Businesses like the idea that there are no current taxes and such a cash windfall can be used for such items as growing the business, paying higher compensation to attract top employees, being more competitive by keeping product prices low, etc.

There are many other strategies that involve using ESOPs but the above three reasons are the most common. ESOPs aren't for every company. Only companies that are organized as a corporation can adopt an ESOP. Other factors such as profitability, size of the workforce, ESOP expenses, etc. are important factors to weigh in deciding whether or not an ESOP is right for a company.

Barna, Guzy and Steffen welcomes Attorney W. James Vogl, Jr. who will practice "of counsel" in the area of Employee Benefits Law with an emphasis on Employee Stock Ownership Plans (ESOPs). Jim has worked with medium sized closely-held companies in designing, implementing and maintaining ESOPs. Jim also provides additional legal services related to retirement plans and general corporate legal work. For questions regarding this article or for more information about ESOPs contact Jim directly at 763-783-5163 or jvogl@bgs.com.

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IN BRIEFSM

Recent Developments in Estate Taxes By William F. Huefner



On December 17, 2010, President Obama signed a long-awaited tax relief act into law. The tax relief act affects the Estate Tax for the next two years. Prior to the enactment of the law, there was no Estate Tax for anyone dying in 2010. This was the result of legislation that was passed back in 2000. That law also gradually increased the Estate Tax exemption from \$1,000,000 in 2001 to \$3,500,000 in 2009. The Estate Tax expired in 2010 which meant that for anyone dying in 2010, there was no Estate Tax. However, the Estate Tax was scheduled to come back into place in 2011 with a \$1,000,000 exemption and a 55 percent maximum tax rate.

Under the new law, the Estate Tax provisions were made retroactive to January 1, 2010. For individuals dying in 2010, 2011 or 2012, the Estate Tax exemption is \$5,000,000. The maximum tax rate has been reduced to 35 percent. Individuals who die between January 1, 2010, and December 17, 2010 (the day the law was signed into place) have the option of electing out of the Estate Tax and using the laws that were in existence at the time of their death.

In addition to increasing the Estate Tax exemption to \$5,000,000 for the next two years, Congress also increased the Gift Tax exemption to \$5,000,000 for the next two years. This means that individuals can pass \$5,000,000 at their death and pay no Estate Tax or they may gift up to \$5,000,000 during their lifetime and pay no Gift Tax. This provides individuals with wealth with significant planning opportunities for the next two years.

In addition to providing planning opportunities for individuals, it also removes many people from the federal Estate Tax roles. Unfortunately, it does not mean that individuals no longer need to plan for Estate Taxes. For anyone who is a resident of the State of Minnesota or owns property in Minnesota, you should be aware that we have a two-tiered tax system. We have the federal Estate Tax system, but we also have a Minnesota Estate Tax system. Minnesota only allows an individual to pass \$1,000,000 free of Minnesota tax to anyone besides the surviving spouse. You are always allowed to leave an unlimited amount of money to your spouse. For individuals who have more than \$1,000,000 if they leave everything to their spouse, there is no tax on the first death. However, on the second death is where the tax is paid. Minnesota has a graduated tax rate that has a maximum rate of 16 percent.

Was Your New Car "Totaled?" By Steven G. Thorson



If you did not have "new car replacement" coverage, you will have a loss for the difference between what you paid for the car and the amount of the insurance settlement. You might be able to recover that loss either through restitution or through conciliation court.

- Reckless Driver had: no license or insurance; no current vehicle registration; no job; no assets.
- Innocent Driver's vehicle insurance issued a settlement check for the "current value" of the totaled vehicle less the deductible.
- The settlement check for the vehicle (less the policy deductible) was \$3,200 less than the cost of the vehicle.
- Innocent Driver petitioned the court in the criminal proceedings against Reckless Driver for restitution to be paid by Reckless Driver.
- There was no charge to Innocent Driver for submitting the petition.
- Judge ordered a \$3,200 restitution payment (a discretionary call for the judge).

- Innocent Driver's vehicle was struck by Reckless Driver.
- Innocent Driver's vehicle was almost new (10 weeks old), but was declared a total loss by the insurance company.

- Reckless Driver was charged with several crimes for the accident.

- Innocent Driver has received varying restitution payments through the court in the four years following the accident.
- Roughly half of the restitution payment has been made.

Successful recovery through restitution in criminal court depends upon the Reckless Driver's need to rehabilitate himself, by his need to drive again and by

his ability to remain a taxpayer in Minnesota: the restitution payments are deducted from his paychecks periodically.

Unfortunately, it is also a regressive tax rate. This means that the highest tax percentage is paid at the lowest amount over \$1,000,000. The maximum amount that will be paid on a percentage basis is 40 percent.

The change in the tax laws provides some unique planning opportunities for larger estates in the next couple of years, but it also requires individuals with more modest estates to plan to minimize the Minnesota Estate Tax. A simple example of this is a couple with \$2,000,000 worth of assets. If the estate is not properly planned and everything passes to the surviving spouse on the death of the first spouse, there is no tax. However, on the death of the surviving spouse, assuming the estate is still worth \$2,000,000, there will be a tax liability of \$99,000. With proper planning, this amount can be reduced to zero.

Bill Huefner is a shareholder in Estate/Tax Planning, Probate/Trust Administration. If you have questions regarding this article or the recent developments in Estate Tax law, please contact Bill directly at 763-783-5160 or whuefner@bgs.com.

his ability to remain a taxpayer in Minnesota: the restitution payments are deducted from his paychecks periodically.

Recovery through Conciliation Court

For those accidents where no criminal charges are brought against the other driver, you might still be able to recover the loss through Conciliation Court. If the total loss you have incurred for your vehicle does not exceed the jurisdictional limit of \$7,500, you may sue the defendant in Conciliation Court. You do not need an attorney to use Conciliation Court.

Innocent Driver's personal injury case was handled separately from the restitution case. For more information on your rights in an accident, contact one of our personal injury attorneys: Russell Crowder, John Buchman or Adriel Villarreal.

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What is Intestate Succession? By Douglas J. Dehn



It is dying without a Will or Trust, with the Decedent owning property in his or her own name alone. We do not recommend it. Be ready to have your heirs deal with many pages of state statutes that govern intestate succession.

In this brief article, I would like to give our readers a sampling of some of the statutes that deal with intestate succession, using simplified wording and, in some cases, generalizing the result.

For starters, if there is a spouse but no children, or if the only children are common to the Decedent and the spouse, the spouse gets the estate in full. If there are "other" children, the spouse gets the first \$150,000, plus one-half of any balance. Under a different statute, the spouse gets the homestead if there are no children, but only a life estate if the Decedent has any children. A life estate is a partial real estate interest and gives the spouse the right to use and be responsible for the property for his or her lifetime. The fee title/future interest goes to the Decedent's children, subject to the life estate.

If not already receiving the entire estate, another statute gives the spouse up to \$10,000 in value of the Decedent's personal property and one automobile, without regard to value. The spouse is also allowed family maintenance for up to \$1,500 per month for up to 18 months, if the estate is solvent.

If there is no spouse, but there are children, the children take the estate in equal shares. If there is a deceased child, his or her children, if any, divide that share equally.

It gets trickier if the Decedent had no surviving spouse and no children. You have to create the family tree by going up the line to the Decedent's parents or grandparents and down to the heirs. There are exceptions to these rules that are not intuitive.

If you die intestate, you have no control over who your personal representative will be. A surviving spouse does have priority; but, with no spouse, all of your other heirs have equal priority. That group of heirs has to locate a volunteer to petition the court for appointment, with the rest of the heirs needing to sign off and file Nominations with the Probate Court. The likelihood of the probate being "formal" (more work) vs. the more typical "informal," increases without a Will. A Will could simply have nominated your personal representative.

Authorizing the leaving of a "List" for your tangible personal property, naming which individual gets what item, is another benefit of a Will. This list can then be updated anytime without updating a Will.

This article could go on for pages, but I hope you get the idea that you should have a Will, a Trust, Will with a Trust, or other procedures such as Transfer on Death Deeds, pay and transfer-on-death accounts, and other beneficiary-driven assets. At the very top of the "needy" list are single parents or couples without children.

Doug Dehn is a shareholder in Estate Planning and Probate and Trust Administration. Give him a call if you are ready to do your Will or Trust at 763-783-5128 or ddehn@bgs.com.

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