

Selling Your Business To Your Employees

**An Overview Of Employee Ownership
Models and Strategies**

Michael Palmieri

Chris Cooper

and the staff of the Ohio Employee Ownership Center

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and the staff of the Ohio Employee Ownership Center
at Kent State University

AN **EOX** Special Edition

OUR MISSION

The **Employee Ownership Expansion Network (EOX)** expands employee ownership across the United States via a network of State Centers for employee ownership and national partnerships to increase community wealth, strengthen businesses and create a more vibrant, participatory economy.

We achieve our mission by:

- developing, convening, uniting, and supporting a network of State Centers
- engaging and collaborating with national entities and business owners to champion employee ownership
- amplifying the work of the State Center Network to increase education, awareness, and consideration of all forms of employee ownership

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The Ohio Employee Ownership Center of Kent State University is an outreach center that provides technical assistance, education and training, and carries out research and advocacy that supports the continued development of employee ownership.

Ohio Employee Ownership Center

321 Bowman Hall
Kent State University
Kent, Ohio, 44242

oeoc@kent.edu
www.oeockent.org
330-672-3028



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Table Of Contents

04	Acknowledgements
05	Foreward
06	Introduction: Why Employee Ownership?
08	An Overview of Employee Ownership
16	Employee Stock Ownership Plans (ESOPs)
28	Worker Owned Cooperatives
37	Employee Ownership Trusts (EOTs)
42	Direct Stock Ownership, and Hybrid Models
46	Additional Resources and Assistance
49	Contributors

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Since that first edition, the world of employee ownership has changed and expanded, and the legal and structural aspects of various models have continued to evolve. To address these changes, we have written substantial new material on each of the models covered in this edition. We have also drawn on the collective wisdom of many practitioners in the field. Their guidance and expertise, shared over many years, inform much of our writing even when uncredited. In addition, several of them have contributed what we call “sidebars” on specific topics within their areas of expertise, which you will find throughout the book. Special thanks as well goes to Davin Gustafson and Kim Blaugher for his important feedback in reviewing sections of the book.

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■ Forward

Steve Storkan

Employee Ownership Expansion Network (EOX)

At some point every business owner will face a succession moment. A crossroads where the future of the company, its people, and its legacy must be decided. In the United States it is estimated that almost three million businesses owned by baby boomers are approaching that transition, and the choices made will ripple across employees, families, and communities. Employee ownership offers a powerful and practical solution, and it is the only succession strategy that delivers a triple win: a win for the selling owner, a win for the employees, and a win for the community.

For owners, selling to employees through an Employee Stock Ownership Plan, a Worker Cooperative, or an Employee Ownership Trust offers a fair market exit, strong tax advantages, and the chance to preserve what they have built. For employees, it turns jobs into a real ownership stake, unlocking financial opportunity, voice, and a deeper connection to their work. For communities, it keeps thriving businesses anchored locally with good jobs left intact rather than sold off or closed by outside buyers.

That is why organizations like the Ohio Employee Ownership Center, along with a growing network of State Centers supported by the Employee Ownership Expansion Network, are working tirelessly to expand employee ownership across the country. For nearly 40 years, the OEOC has been a national leader in this space, helping hundreds of business owners navigate the journey to employee ownership by connecting them with the right tools, advisors, and financing.

Building on that long legacy, the Employee Ownership Expansion Network (EOX) was launched in 2019 to meet a simple need with transformative potential: every state should have a trusted, locally rooted unbiased hub to support business owners considering employee ownership. What began as a partnership with eight pioneering State Centers has grown into a cohesive national network of twenty-four centers, sixteen of which were launched between 2019 and 2024 with support from EOX (eoxnetwork.org/statecenters). We have focused on building a modern infrastructure for growth by providing shared services in marketing, accounting, fundraising, and HR so that State Centers can concentrate on what matters most, meeting owners where they are and guiding them through the transition process. This unified approach has transformed what was once a fragmented landscape into a coordinated national effort. Our vision for the future is clear. Every business owner in America should have access to reliable, non-partisan, locally grounded support when exploring employee ownership. By strengthening state level capacity and investing in long term systems and talent, EOX is working to ensure that employee ownership becomes a common, credible pathway for succession, not the exception.

This book captures the hard-earned lessons from the OEOC's experience. It will guide you through the process of succession planning with intention and show why selling to your employees can be one of the most enduring and generous legacies you can leave behind. Along the way, you will learn about the different models that exist, the benefits and challenges associated with each and hear from professionals who have firsthand experience with employee ownership transitions and are driving this movement forward.

The results are clear: employee-owned companies are more resilient, more inclusive, and more likely to stay locally rooted for the long haul. The triple win is real and within reach.

■ Introduction:

Why Employee Ownership?

For the purposes of this book, employee ownership refers to specific types or models designed for broad participation. While the models discussed here all share some features with equity strategies typically reserved for senior leaders or select employees, our focus is on broad-based employee ownership structures—those that enable the widest possible participation and give employees at all levels a meaningful opportunity to share in the company’s financial success.

A sale to employees can have many appealing aspects as a succession strategy. If you don’t have a child waiting to take over the business, or an outside buyer willing to make a bona fide offer, employee ownership may be the answer. If you feel strongly about maintaining the legacy and history of what you’ve built—and rewarding those who helped you build it—then employee ownership may be the answer. If you are interested in keeping the business anchored in your local community, employee ownership may be the answer. If you want to receive a fair price for the company while meeting the other goals you may have, employee ownership may be the answer.

Flexible Models

Employee ownership is also flexible, with multiple models that can meet your specific situation and goals. Depending on the model you choose, you can sell 100% of the business in one transaction—or you can sell portions of it over time. You can stay involved in the business or work your way out over a few years.

Even with this flexibility, each employee ownership model has its own rules and requirements—legal, administrative,

and cultural. Depending on the size of the business, your goals and objectives, your financial position and liquidity needs, and other factors, some employee ownership models may fit while others may not. As will become clear in the following pages, different models provide different kinds of financial and governance rights to employee owners. Understanding what those rights are and how they operate is key to selecting the model that is right for you. Further, each will require specialists in their respective fields. An ESOP specialist may not know how to structure an effective worker cooperative, and vice versa. Given the uniqueness of the employee ownership strategies discussed here, the importance of using specialists is high.

Employee ownership may also require a culture shift inside the business, and perhaps a mindset shift for you. If your organization currently operates under a highly centralized, top-down model, consider gradually delegating authority as part of your succession planning. This need not be disruptive or scary: the goal is to establish reliable leadership and decision-making processes, so the business continues to thrive. All employee ownership models do not automatically require broad, consensus-based decision-making—but it is a route that you can choose if you prefer.

Tax Breaks

Certain employee ownership models can also offer appealing tax breaks—for you and your family when you sell the business; for the business as an operating employee-owned company; and for employee owners build wealth in helping grow the business. Available tax breaks for each model will be discussed in the following Overview, as well as in their respective sections.

What It Means for the Company

Over the last 5 decades, a large and growing body of research has examined how employee ownership affects companies. To summarize the findings in short, it works. Employee ownership is not related to negative business performance. If any relationship exists, it is that businesses that become employee-owned usually see improved performance—higher sales, better productivity, faster job growth, and lower turnover. They also tend to be more stable as firms and are less likely to shut down for any reason, especially during economic downturns, including the 2008 financial collapse and the COVID-19 pandemic. Reviews of the research—covering more than 100 studies—arrive at the same conclusion: employee-owned companies generally perform better across sales, profit, and long-term value.

What It Means for Employees

Employee-owned companies are also good for your employees. Research also finds that employee-owners benefit from:

- **Increased wealth:** employees have higher wealth and retirement savings—for example, ESOP participants have 2-3× more retirement assets than workers at traditional companies.
- **Tax Benefits:** Many plans can provide favorable tax treatment for employees in addition to those provided to the company and a selling owner.
- **Employment stability:** employee-owners are laid off less often, especially during economic downturns
- **Improved economic well-being:** employee-owners have better benefits, including health, vision, and parental leave, and often receive better pay.
- **Increased participation:** employee owners are more likely to participate in company-led teams, committees, and task forces focused on solving issues related to their day-to-day work.

The Bottom Line

These advantages make employee-owned companies easier to staff, easier to retain talent in, and stronger overall.

Employee ownership isn't just a succession strategy. It's a proven way to strengthen company performance; build a committed workforce; improve retention and recruitment; and create long-term value and stability.

How To Get There

But there's one catch: providing a stake in the company by itself is typically not enough. The companies that see the biggest gains pair ownership with a culture where employees understand the business, get involved, and have a real voice. When employees think and act like owners, performance improves faster and stays strong.

That kind of culture doesn't happen by accident. It takes leadership, communication, and training so employees know what ownership means and how they can contribute.

Employee ownership is not a magic bullet. However, if you are a business owner for whom legacy, independence, community, a fair price for the business—and some possible tax breaks—are essential, then employee ownership is an option worth considering.

Done right, it can make a company more competitive and more resilient—ensuring your legacy—while giving employees a real stake in its success.

A Few More Words....

This book provides an overview of the the most common employee ownership models – at a 20,000 foot level. It is not intended to be an in-depth exploration of all the aspects and facets of each employee ownership model. Doing so would require many hundreds of pages of text—and probably monthly updates!

Our goal is to provide enough detail for you, the business owner, to determine which employee ownership model makes sense to explore further. To help with this, the last section includes a list of resources and organizations that can assist your continued exploration.

■ Part One:

An Overview of Employee Ownership

There are several primary models of broad-based employee ownership, each with its own structure, governance, and financing approach. The most common in the United States is the Employee Stock Ownership Plan (ESOP), a qualified retirement plan through which employees accumulate shares over time, typically funded by the company itself. Worker cooperatives represent a more democratic model, where employees directly own and govern the business on a one-member-one-vote basis. Employee ownership trusts (EOTs)—more widely used in the United Kingdom and now emerging in the U.S.—hold shares collectively on behalf of employees, offering a long-term, stewardship-oriented form of ownership. Other variations, such as direct stock purchase programs or various hybrid models, provide other ownership opportunities. Each model carries its own regulatory, financial, and cultural considerations, but all share the goal of broad-based participation in the company's success.

Each of these models will be explored in detail in the pages that follow, where their distinctions will become clear. Before diving into them individually, we'll begin with a broader look at the fundamental components that define employee ownership as a whole.

In most cases, the transactions for each of the models are financed via the cash flow of the business itself. The company takes out a loan to purchase the stock from the selling owner—with the company being the collateral for the loan—and the loan is paid back by the business over the next 3-10 years. The seller may need to provide some guarantees on any bank financing; there will likely also be some seller financing, especially when selling 100% of the business. If desired, the seller can choose to finance the entire transaction. What this

means is that the company (as collateral) must be profitable; have significant debt capacity; and have an owner that is willing to either delay getting all of their money at one time or become the bank “of record”—sometimes both.

An important thing to understand about employee ownership, and it's an issue at top of mind for the average business owner, is its relation to business (or sale) value. There are a lot of good reasons to choose employee ownership, but maximizing the sale price is probably not one of them. A sale to employees will not get you the strategic or financial premiums you might get from certain types of outside buyers. It won't provide a lower book value or liquidation value. And you most certainly won't be giving the business away! In most cases the Fair Market Value (FMV) standard is used – as determined by an independent outside valuation expert.

Fair Market Value (FMV) is defined by law: willing seller, willing buyer; both in possession of all relevant facts; with neither under compulsion to either buy or sell. In practice, FMV is determined by looking at the specific facts about the business. These include past performance, future projections, financial position, assets, debt, and the overall industry and economic outlook. This method for determining the sale price is what we consider as best practice, and in the case of ESOPs it's required by law. The rule of thumb we use is, unless there are significant issues with the business, you should expect to get a fair price for the business.

Each model creates its own unique balance between: financial benefit and how that benefit is provided; between governance, control, and decision-making; and with the legal and regulatory framework under which it operates. Briefly, the differences are:

3 Things to Prepare For When Transitioning to Employee Ownership

Mike Frommelt, Strategic Talent Partners



Transitioning your company to employee ownership is an exciting prospect. It provides a solid return on the business you've built, allows employees to share in its ongoing success, and, if done right, preserves your legacy by ensuring the company will continue to thrive after you're gone.

However, there are three key things to prepare for to ensure the transition goes smoothly.

1. Prepare Yourself for a Different Manner of Decision Making

For years—perhaps decades—you've likely been the final or even sole decision maker for your business. You may have resembled the Wizard of Oz: employees brought you problems, you disappeared behind the curtain, and the issues magically disappeared. That approach served the company well before the sale.

But once you transition to employee ownership, decision-making changes. You'll now have a Board of Directors and a governing body representing employee interests—whether a Trustee (in an ESOP or EOT) or a member-elected Board (in a worker cooperative). Decisions become more collaborative: leadership works with these groups to ensure actions align with the company's mission, financial health, and the interests of its employee-owners.

While that may sound daunting, it's actually ideal for most owners. Employee ownership is often part of a broader succession plan—a way to step back from day-to-day management. With the right people on the Board and in leadership, sound decisions will continue to be made while you enjoy your next chapter.

Lastly, don't underestimate the emotional challenge of this change. After running a company for much of your career, stepping away is not easy. Give yourself grace as you go through the transition, and don't hesitate to reach out to others who have done it—Board directors, advisors, or members of your leadership team. Each transition is slightly different, and everyone involved wants it to go as smoothly as possible.

2. Prepare Your Team to Lead (and Act) Without You

Ideally, this starts well before you decide to sell or transfer ownership—and it applies whether you choose an ESOP, worker cooperative, or employee ownership trust.

The value of your business, and the ease of financing a transition, depend largely on the strength of your leadership team. If the business is too reliant on you for sales, decision-making, or growth, buyers, lenders, or investors may hesitate to finance the transaction or offer less favorable terms. They don't want a "project"; they want a company that runs well without the owner.

The same principle applies to any employee-ownership model. If financing partners or advisors believe your business depends too much on you, they may hesitate to proceed or require you to carry more of the financing yourself. If the company underperforms, your payout could be delayed or reduced. Building a capable, independent leadership team before the transition is therefore critical.

3. Prepare to Spend Money on Consultants, Service Providers, and Other Professionals

If you've always been frugal about outside help, now is the time to change that mindset. Transferring ownership to employees requires strong advisors—and it's worth every dollar.

You'll need a valuation firm, accounting firm, legal counsel, and other advisors experienced in employee-ownership transactions—whether ESOPs, worker cooperatives, or EOTs. Afterward, a capable and objective Board of Directors becomes essential.

A strong Board helps guide strategy, oversee leadership, and ensure the company operates in the best interests of employee-owners and creditors (including you, if you provided seller financing). The best Directors are experienced executives—CEOs, CFOs, and other leaders—with employee-ownership experience if possible. Yes, they'll need to be compensated, but quality board members and advisors will pay for themselves in stability, performance, and peace of mind.

Every transition is unique, but the goal remains the same: to leave the company stronger than you found it, with employees who feel ownership not only in their roles but in the future you've built together.

- **Employee Stock Ownership Plans (ESOPs)** – ESOPs tend to provide a higher level of financial benefit, for employee owners and the company, and make fewer governance and control demands on the company. Much of the added financial benefit is due to the tax breaks designed to encourage their use, and ESOPs have the

flexibility to provide broader governance rights if desired. As a qualified retirement plan trust that "sits on top of" a C-corp or S-corp, ESOPs are regulated by both the Department of Labor (DOL) and Internal Revenue Service (IRS).

- **Worker Cooperatives** – In practice, worker cooperatives typically provide a lower level of financial benefit for employee owners and the company than ESOPs, but they can still be meaningful. They have the highest level of “baked-in” governance rights of any of the models, which is built on a one member-one vote structure. As a type of corporation, worker cooperatives are subject to a unique segment of the tax code, called Subchapter T of the Internal Revenue Code, and which will be discussed later.
- **Employee Ownership Trusts (EOTs)** – EOTs have no defined structure for either financial benefit or governance rights for employee owners. Instead, both aspects are defined at the time of creation to fit with the vision and purpose of the trust. There are best practices for the level and type of rights provided, but considerable variation exists in how an EOT can be structured. The Employee Ownership Trust owns company stock but makes no demands on the type of corporate entity, though C-corps are the most common entity choice.
- **Direct Stock Ownership and Hybrids** – Similar to EOTs, the structures for governance and financial benefit are defined at the time of creation of the plan. As with EOTs, there are best practices, but considerable variation for how each company implements the model. Because of the level of variation, it is hard to make generalized statements about what they entail; they are discussed in greater detail in their respective section.

Tax Breaks

Each model also has a unique approach to tax breaks that are designed to encourage their creation and benefit their operations. Briefly, they are:

Employee Stock Ownership Plans (ESOPs) – ESOPs provide the largest set of available tax-breaks including:

- §1042 Rollover capital gains tax deferral on sale proceeds (at least 30% of stock must be sold, C-corporations only)
- Tax deduction for the ESOP note principal and interest
- ESOP S-Corporation Income Tax Exemption, after transaction

Worker Cooperatives

- §1042 Rollover capital gains tax deferral on sale proceeds
- Subchapter T tax deduction for profits shared with worker members

Employee Ownership Trusts (EOTs)

- Potential Estate Tax benefits for seller and family
- Potential to deduct profits shared with employee-owners

Direct Stock Ownership and Hybrids

- Depends on model, but likely no significant seller tax breaks
- Potential to deduct profits shared with employee owners

Relevant tax breaks for each model will be discussed in greater detail in the model specific sections that follow.

Transaction Costs

Transaction costs can vary quite a bit with (and within) each model, but its important to state at the outset that in most (if not all) cases, a sale to any of the employee ownership models will be less expensive than an average outside sale transaction. One of the big differences between a typical outside sale and employee ownership transition is when those costs will be incurred. It's not uncommon in an outside sale to have all of the transaction costs rolled into the overall deal, thus deferring them until the end of the process. With a sale to employees, some of the costs will be incurred (and paid) more at the front end.

One of the biggest drivers of cost is the complexity of the transaction, with the biggest being the size, and value of the business. But there are others. Are there multiple owners each with their own set of goals and objectives, and operating or shareholder agreements? Is there a more complex than usual corporate structure (perhaps with real estate) that requires some up front legal work? Any number of things can add complexity, and cost. Most importantly, there are expensive, and less expensive, ways to implement any one of these models. Talking with someone from an employee ownership support organization (listed in Section 6 of this book) can help you navigate this important issue.

Generally speaking, ESOPs will have the highest transaction costs, mostly due to the complexities of the model itself. As a Qualified Retirement Plan - with the regulatory framework that comes with it - ESOPs have a higher level of due diligence and require a broader set of advisors. It's important to note that the many associated ESOP tax breaks can typically - and intentionally - offset much or even most of the added cost. For the other models (and to a degree also with ESOPs if done a certain way) costs will be lower, sometimes much lower. One of the keys is to not let corners be cut in order to save a small

How Valuations Work in ESOP Transactions

Nick Sypniewski, Comstock Advisors



Valuations serve as the foundation for major ownership transitions, whether the goal is to sell to employees through an ESOP, transfer shares within a family, or sell to an outside or strategic buyer.

ESOP valuations and family gifting/estate planning valuations are based on the fair market value (“FMV”) of the stock, which represents the price at which the stock would change hands between a hypothetical willing buyer and willing seller, with neither under compulsion and both having reasonable knowledge of the relevant facts. Although sales to third parties are not strictly governed by the FMV standard, there is still the question: “Would the valuation of a company be different just because of the succession strategy?”

Value is not affected by the ownership succession plan, but rather by the impact on the features of the company and the stock that are expected to result from the succession plan. For example:

Will the block of stock have control over the company?

A control interest may warrant a higher valuation, but the ESOP trustee must still ensure the price aligns with FMV, free from excessive premiums. In family transfers, gifting and estate planning often involve minority or nonvoting interests with explicit restrictions on control and marketability, which lowers value. In strategic sales, the buyer may be willing to pay a premium for control if it believes it can extract a greater return.

Will the future performance of the company change as a result of the succession strategy?

ESOP valuations are based on how the company is expected to perform without regard to synergies that a strategic buyer could implement. Strategic buyers may be willing to pay a premium above FMV due to anticipated synergies, competitive positioning, or market share objectives.

An ESOP valuation assumes a hypothetical financial buyer and disregards the potential synergies that a specific buyer might bring. The analysis focuses on the company’s stand-alone value, not its value to a particular acquirer. In a family transfer, the same hypothetical buyer assumption applies, though discounts may be applied to reflect the specific nature of minority interests or illiquidity. In a strategic sale, the actual buyer is known, and the valuation (or transaction price) reflects the buyer’s unique motivations, cost savings, or revenue opportunities, often resulting in a “control premium” above the stand-alone FMV.

Will there be restrictions on the transfer of stock?

In a transaction involving 100% of the company stock, discounts for lack of marketability are minimal. In family transfers, which often involve minority interests, corporate documents often impose restrictions on the transfer of shares, resulting in larger discounts for lack of marketability.

Will the stock have a put right?

ESOP shares are subject to a put option, which requires the ESOP company to repurchase shares held in the ESOP upon certain events such as retirement, death, or disability. This establishes a quasi-market for participant shares and reduces the discount for lack of marketability.

Regardless of the transition strategy, the underlying valuation principles—assessing financial performance, market conditions, and risk—remain consistent. What drives the difference in value is not the methods being used, but the premise of the valuation and actual features of the stock under each succession strategy.

amount of cost. Even though it can cost more, it truly pays to hire the right people for the job and do it right the first time.

Total transaction costs for ESOPs can range from \$200,000-\$500,000, or sometimes even more. For worker cooperatives, \$20,000-75,000; for EOTs costs can range from \$30,000-\$100,000. Keep in mind that these ranges are very fluid; further specifics on costs will be discussed for each model in their own section.

Advisors

Even though it’s a growing field, transfers to some form of employee ownership are still a unique and specialized field that require specialized assistance. Not every business

attorney will be an expert in ESOPs, worker cooperatives, or any other form. You may find that your current set of business advisors and professionals (and/or their firm) are proficient in one or more employee ownership models. If so, it’s prudent to probably use them— it will likely save you the time and expense of educating a new advisor about your business.

If your current advisors aren’t employee ownership specialists, you will need to augment what you have with the right experts. A good source of referrals for experts are other business owners that you know; your current advisors; your local state employee ownership center; and others. You will also find in most cases that ESOP experts are not necessarily worker cooperative experts, and so on. Here is a basic overview

of required and recommended advisors, and which will be covered further in each of their respective sections:

Employee Stock Ownership Plans (ESOPs) – ESOPs typically require the broadest range of advisors to get the deal done. Because of the uniqueness of the ESOP structure, this means that there will be both Sell and Buy side advisors.

Selling Owner/Sell Side

- ESOP/ERISA Attorney
- CPA familiar with ESOP tax issues and benefits
- “Quarterback” (or Investment Banker for larger or more complex situations) – Not Required but can be useful
- Banker/Investment Banker
- Investment Planner – §1042 Rollover specialist

“Buy” Side

- Trustee – hired by company but represents the ESOP
- Independent Valuation Advisor – hired by Trustee

Company

- Third Party Administrator (TPA) – assists with recordkeeping post-transaction
- Culture/Communication Experts

Even though it's a growing field, transfers to some form of employee ownership are still a unique and specialized field that requires specialized assistance.

Worker Cooperatives

- Worker Cooperative Attorney
- Valuation Advisor
- Cooperative CPA – for Subchapter T Issues
- Investment or Wealth Advisor
- Culture/Communication Experts

Employee Ownership Trusts (EOTs)

- EOT Attorney
- Valuation Advisor

- CPA familiar with EOTs
- Investment or Wealth Advisor
- Culture/Communication Experts

Direct Stock Ownership and Hybrids – Can vary quite a bit depending on how deal is structured.

- Attorney
- CPA
- Investment or Wealth Advisor
- Culture/Communication Experts

Timeline

The timeline, from start to finish, to implement a sale to employees can (not surprisingly) vary quite a bit, and all of the factors discussed above can impact it, including which employee ownership model you choose. From a technical perspective, you will need 6-9 months from beginning the process to getting to signing day. However, you may need time, and may need to do many things, to get you to that beginning point. This can include building up your advisory team, building up your management team to take over for you when you leave, obtaining or developing the finance for the deal, getting personal and financial planning in place, growing the value of the business so you get what you need from it when it is sold, and others.

Another component impacting the timeline is where you are in the process—financially, mentally, and emotionally. It's not uncommon for a business owner to get cold feet as they get closer to “signing day”. It can be either temporary or permanent. Whether its because you are having second thoughts, or you realize the numbers don't work, or anything else, this can push things back further. If you are unsure about where you are at in the process, we recommend reviewing our companion book, **Business Succession Planning: An Owner's Manual** for more information. With all of this taken into account, a good rule of thumb on a start to finish timeline is 12-24 months.

Preparing Your Business for a Transition to Employee Ownership

Transitioning to employee ownership isn't just about the sale itself—it's about setting the business up for long-term success under a new model of ownership. That means thinking not only about the financial and legal details, but also about the people and culture that will carry the company forward. The process begins with preparing the next generation of leaders who can run the business and extends to fostering a sense of ownership

among the employees who will make it thrive. Together, these steps help ensure that what you've built doesn't just continue, but grows stronger under employee ownership.

Replacing Yourself

Assuming you are likely planning to use employee ownership to exit the business, there are some key questions to ask yourself. Can the business run without you? Who will be taking over your current duties and responsibilities? How about your relationships with key employees, customers, suppliers, and advisors?

A question we typically ask business owners is - what happens when you go on vacation? Perhaps a better question is, can you even go on vacation? If you are constantly on the phone with customers (or continually answering emails from employees) while waiting in line at the amusement park or at dinner with the family, then you clearly have some planning to do.

Figuring this out will go a long way to informing you on whether the business is truly ready to go on without you.

Leadership Transition

When your business was in the start-up or growth phase, your company was very dependent on your skills, knowledge, and expertise - that's probably a good thing too, since you've succeeded in growing a successful company. Now, a key component will be how you develop the next generation of leadership in (and for) the business. It makes sense too - after all, you are likely planning to use employee ownership to exit the business. Can the business run without you? Who will perform the tasks that you currently perform? Who has the strategic vision to take the company to its next phase?

Understanding what the company needs to continue be successful is an important step in a sale to employees. In a sale to an outside buyer, they might be planning to bring a management team with them that are capable of running the business. Clearly, this won't be the case with a sale to employees. You will need to ensure that a new team is in place (or in process of being built) that can continue to run the business without interruption.

In an ideal world, that person (or persons) will be there already, but in some cases, you may need to bring in someone from the outside. Either way, this may take time to accomplish, and an important factor in the ultimate success of your transition will be performing this task. New leaders will need to understand

the business; be able to maintain current relations with clients, customers, and others— and also to build new ones. It's not enough for them to be good operators - they should have a strategic vision for the business too.

As importantly, leaders in employer-owned businesses will likely need a unique set of skills specific to employee ownership. In addition to "merely" running the business effectively, they will have additional challenges - running an employee-owned business and creating a strong ownership culture.

Employee research has consistently shown that providing an ownership stake in a business doesn't automatically create a sense of ownership. What does is combining the new ownership stake with education and training programs, along with opportunities to engage in decision making.

“

Transitioning to employee ownership isn't just about the sale itself—it's about setting the business up for long-term success under a new model of ownership.

”

The shape and form this takes in your company will be unique, and it won't happen without deliberate choices and deliberate actions. If you've previously operated the company with these principles, then you are well on your way to creating that culture—but your successors in leadership need to continue to follow through. If this type of culture is a change for your company, your successors in leadership will need to begin the process of creating that change.

These choices and actions start at (and come from) the top. And the fact is, not everyone is a good fit for this type of collaborative management.

Developing an Ownership Culture

As mentioned in the previous section, an ownership culture likely won't magically manifest itself because you've provided a financial stake to your employees. That takes effort, and time. What exactly do we mean by ownership culture? That can be a tricky, question, probably with a very unique answer.

Why Leadership Matters

Ginny Vanderslice, Praxis Consulting Group



Leadership Matters When Employees Own the Business

Selling your business to employees can be a powerful legacy decision, providing financial liquidity, offering long-term wealth-building for employees, and driving the company's continued growth. However, the ongoing success of an employee-owned company depends less on the legal structure and more on leadership that can make employee ownership a meaningful factor in driving the business forward.

Leadership is Different in Employee-owned Companies

Employee-owned company leaders need to act less like multi-knowledgeable experts and more like catalysts and enablers – supporting a culture where shared ownership results in every worker taking responsibility for the company's success. Employee owners' expectations of leaders are high. They expect more transparent communication, education including business literacy and professional development, and opportunities for involvement in improving the company. These processes are in addition to developing growth strategies, aligning operations, and overseeing financials. Effective leaders are humble, share responsibility for achievements, courageous, and put benefiting employee owners and the company ahead of their self-interest.

Develop Leaders Internally

Developing leaders internally, whenever possible, has clear benefits. You are more likely to know their strengths and can work with them on areas needing development. You also will be aware of whether they care only about themselves, maximizing short-term profits or building a company that will last and that is good for everyone. Developing internal leaders also responds to one of the expectations workers bring to shared ownership.

Hire with Leadership Potential in Mind

Deepening a company's leadership capacity begins with hiring the right people. Hire for both today and tomorrow: someone with the functional skills, experience, and culture alignment you need now who also has the potential to grow professionally.

Develop Your Middle Managers First

Middle managers' behavior and relationships with workers are the most important determinant of employees' day-to-day experience. For workers to find shared ownership meaningful, managers need skills to listen and communicate openly, set expectations without micromanaging, educate workers about the results that will make their department successful, delegate for development, and continually engage workers in generating ideas for improvement.

Make Developing Potential Successors a Requirement of All Managers

Developing potential successors as a required job responsibility of all managers builds a systematic professional development process. This involves annually articulating the skills needed to lead now and in the future, assessing employees' strengths and gaps relative to those skills, creating development plans for top candidates, and tracking their progress. Only when there is a job requirement and a structured process for developing people will managers make the time to focus on it.

Provide Ongoing Leadership Development at All Levels

To build and maintain a culture where shared ownership can be exercised meaningfully, leaders need the skills to build an ownership culture. Committing to develop everyone's ability to lead results in deeper leadership capacity and increases the likelihood of long-term success. It also demonstrates the company's determination to develop people professionally.

The Leadership Choice

Leaders aren't required to embrace these practices in all models of employee ownership. For example, in ESOPs, leaders may choose to treat it as a simple retirement benefit. But doing so misses the opportunity to fully unlock the potential of employee ownership.

One of the best ways to think about it might be to look inside yourself. What were the aspects of ownership that appealed to you when you first decided to take the plunge into entrepreneurship? What were your expectations of what came with being an owner? Whatever your answers, you can be sure that some (or even all) of the new employee owners at the business are probably thinking the same thing.

In addition, the model of employee ownership you choose

will impact this too. As mentioned above, each model comes with its own governance rights and responsibilities. Just as importantly, each model has its own unique way in which "ownership" is created. Even with all these choices and flexibility, we can identify some key components of an ownership culture:

1. **A financial stake in business success** – Every model discussed in this book provides the mechanism for

employee owners to financially benefit from business success.

- 2. Access to information and open communication** – In order to understand what defines success, and whether those measures of success have been reached, open communication is integral. Often, this can (and we believe should) involve some form of sharing financial information and results, or open book management.
- 3. Education and Training** – It doesn't do a lot of good to provide information if recipients don't fully understand the information you've given them. This is most commonly true with financial information. In addition, you will want to educate about the specific employee ownership model you've chosen. Each has its own way of doing things, and your people should understand what that is and how it works.
- 4. An opportunity to provide input and feedback, and influence decisions** – Participatory structures allow employee owners to take ownership of decisions made. As importantly, allowing each employee owner to share ideas, and develop new ideas, can drive innovation and success.

For many business owners and leaders, some—if not all—of these practices can be difficult to start and equally challenging to sustain. Getting started can be scary. It's easy to slip back into familiar routines and harder to fully embrace lasting change. And there are many misconceptions about what these concepts actually mean in practice. Open-book management doesn't mean that everyone knows each other's

salary, and participation doesn't mean that everyone makes every decision.

What may be helpful is to think of these practices as operating on a continuum. On one end, there's no sharing of information or participation and decision-making, and on the other, is full sharing and participation. You need not pick one side or the other, but something in between. Figuring out where your company is, and where it wants to be, is the most important first step. Sustainability of your new practices requires constant dedication to the new way of doing business.

Developing a first-class ownership culture is important, and can be the subject of its own book—we've included some resources to look into at the back of this book! But it can be one of the most rewarding aspects of becoming an employee-owned company.

We've seen time and again the difference—and sometimes the transformation—that happens when employees genuinely think and act like owners. A strong ownership culture builds shared values and purpose into the everyday work of the company, shaping how people make decisions, solve problems, and take responsibility.

When employees understand how their work contributes to success and are empowered to act on it, performance and engagement improve across the board.

■ Part Two: Employee Stock Ownership Plans (ESOPs)

What It Is

Employee Stock Ownership Plans (ESOPs) are the most common form of broad-based employee ownership in the U.S. There are roughly 6500 ESOPs that have over 14 million participants and hold close to \$2 trillion in assets.

Formally established in 1974 through the Employee Retirement Income Security Act (ERISA), an ESOP is a qualified employee retirement plan. It differs from other qualified retirement plans in two ways: (1) it invests primarily in the stock of the employing company, and (2) it can borrow money. Since it is a qualified plan, company contributions to the ESOP are tax deductible, including when they are used to repay the principal borrowed to buy stock in the company. A company that sponsors an ESOP may also offset taxable income by contributing treasury stock to the ESOP as tax-deductible contributions to a qualified retirement plan. In addition, there is a handsome tax break for owners of closely-held companies who sell their C-corporation stock to their employees through an ESOP.

Because the ESOP can borrow money, it can be a ready market for closely-held stock, including minority interests. A controlling owner can sell a minority portion of his or her holdings now, obtaining liquidity but retaining control until selling the controlling interest at some point in the future. As with other forms of leveraged buyouts, it will probably be necessary to provide collateral on the ESOP loan in the form of company assets. Thus, the same assets cannot be leveraged for other purposes.

With the basics of what an ESOP is in place, we can turn to why an owner would want to choose an ESOP.

Why An Owner Might Choose This Path

A sale to an ESOP has five main advantages:

- 1. Fair Market Value:** The selling shareholder can sell the stock for the fair market price (as determined by an independent third-party valuation of the business), even when the owner wants to sell a minority interest—for example, in a long-term staged sale. Minority interests in privately-held companies are not really marketable to outside purchasers, and a sale of a minority share of the business will typically also be discounted.
- 2. Reduced Financing Cost:** In a transaction where dollars are borrowed to purchase the equity (a “leveraged ESOP”), financing a stock purchase through an ESOP reduces costs because the ESOP can buy C-corporation stock with pretax dollars. Both the principal and the interest on the payment are deductible, whereas only interest would be deductible for a non-ESOP company. Assuming an effective corporate income tax rate of 30% between state and federal taxes, this means that the company must earn only \$1.00 to buy \$1.00 of stock, rather than earning \$1.30 to pay \$0.30 in taxes and have \$1.00 to buy stock. In an S-corporation, the same reduction of finance costs holds true because contributions to the ESOP are tax-free both to the company and to the ESOP.
- 3. Employee Job Stability:** The ESOP can help make employees feel secure through the difficult transition of leadership. Since the employees will share in the future success of the business, they are motivated to help the transition go smoothly and make the business successful in the future. Employees, though, are not guaranteed a job

ESOPs and Estate Planning

Brian Bornino, GBQ Capital Advisors



Business owners face unique challenges when it comes to estate planning. A common challenge is that since the family business is typically the largest asset in a family's estate, it is difficult (if not impossible) to transfer ownership control to one or a few key children while keeping inheritances equal for children who are not active in the family business. Additionally, many business owners struggle to find a solution that achieves the following goals: (a) create enough liquidity to fund retirement; (b) equalize the inheritances of all family members, including both those who are active in the business as well as those who are not; and (c) ensure that family members with business leadership potential have the opportunity to maintain operational control of the business.

An ESOP is an outstanding estate planning solution to meet the challenges described above because it provides:

Liquidity for Retirement: By selling some or all ownership to an ESOP, illiquid shares are converted into liquid assets in the form of (a) cash and/or (b) a known payment stream in the form of seller notes. A known payment stream, which often includes a competitive interest rate and potentially detachable warrants for upside potential, provides liquidity for selling shareholders to fund retirement.

Liquidity for Estate Planning: It is significantly easier to transfer cash and/or seller notes with a payment stream that quickly turns into cash in the context of estate planning. Inheritances for all children can easily be equalized using the proceeds from the sale of the business.

Family Can Remain in Business: After a sale to an ESOP, family members who are active can remain in their leadership roles.

Additionally, these leaders no longer need to balance the needs of non-active family members (e.g., pay distributions to non-active family members or retain profits in the company); rather, their focus will be on growing the company and making decisions in its best interest.

§1042 Rollover: If an ESOP owns 30% or more of the company's outstanding common stock immediately after the sale, and certain other requirements are met, business owners can defer or even eliminate capital gains taxes by reinvesting the proceeds in Qualified Replacement Property ("QRP") within one year. QRPs may include most securities issued by U.S. public companies and can provide retirement income while allowing business owners to defer capital gains tax until the QRP is sold. Additionally, holding the QRP until death allows heirs to receive a stepped-up basis in the assets, permanently eliminating capital gains.

Post-Transaction Gifts of Financing Warrants: If the seller notes include financing warrants, these can be ideal assets for estate planning. Because warrants have limited value immediately after a leveraged ESOP transaction, yet have the potential for significant appreciation as company debt is repaid and stock value grows, transferring warrants to heirs can be a highly effective estate-planning strategy.

While ESOPs are an outstanding business succession alternative that provides significant financial and operational advantages to companies and valuable benefits to employees, they can also provide liquidity and advantageous estate planning opportunities to sellers.

in an ESOP company, as they can be subject to discharge or layoff as with a non-ESOP company.

- 4. Defer Capital Gains Taxes:** Through a sale of C-corporation stock to an ESOP, the selling shareholder can defer capital gains taxes, and perhaps avoid them all together.
- 5. Control:** ESOP shares are held in a trust for the employees until they leave the company. Typically, the trustee of the ESOP exercises most of the "ownership rights" over the stock, and the trustee is usually appointed by the company's board of directors. While the trustee remains the legal holder of shareholder rights, ESOP plans may provide broad pass-through voting to participants.

- 6. Flexibility:** ESOPs also allow for a lot of flexibility. You can sell anywhere from 1% to 100% of the business, and you can continue to work in the business after the sale.

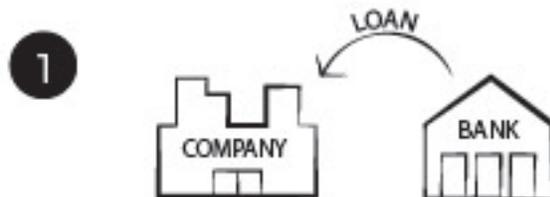
These advantages make ESOPs an attractive option for business owners seeking liquidity, succession, and long-term stability while rewarding employees with a meaningful ownership stake. The next section explains how such transactions are typically structured and financed.

How the Transaction is Structured

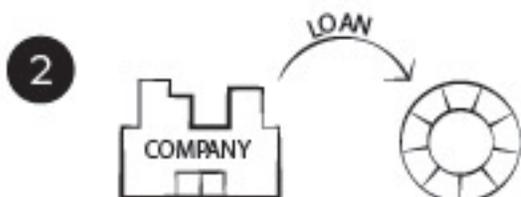
Here's how a leveraged ESOP purchase of company stock typically works. The ESOP purchase takes place in three stages:

HERE'S HOW A LEVERAGED ESOP PURCHASE OF COMPANY STOCK TYPICALLY WORKS.

THE ESOP PURCHASE TAKES PLACE IN THREE STAGES:

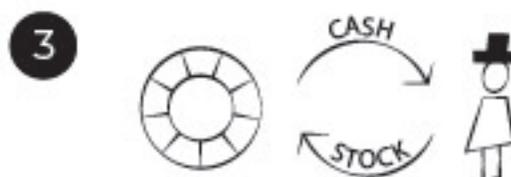


The company establishes an ESOP and goes to a bank to get a loan for stock acquisition. Company assets are used as collateral.



The company then loans that money to the ESOP. This is the ESOP note.

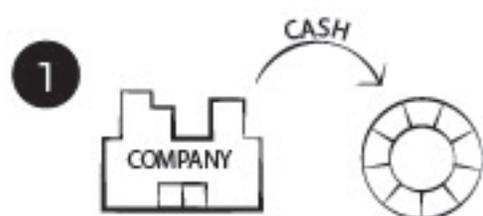
(The ESOP note can have the same terms as the bank loan, but frequently the ESOP Note has a longer term than the bank loan.)



The ESOP uses the loan to purchase the stock from the original owner of his/her beneficiaries. At this point, the ESOP owns the stock, but it is in a suspense account. It has not yet been allocated to any of the individual ESOP participants.

AFTER THE STOCK IS IN THE ESOP, THE LOAN PAYMENTS NEED TO BE MADE. THESE PAYMENTS ARE ACCOUNTED FOR AS CONTRIBUTIONS TO A QUALIFIED RETIREMENT PLAN.

THERE ARE 4 STEPS:



The company makes tax-deductible cash contributions to the ESOP.



The payments are large enough to pay the principal and interest on the ESOP note. The ESOP uses the contribution to make a payment to the company for the ESOP note.



The company makes a payment on the bank loan.



As the ESOP note is repaid, shares of stocks are released from the suspense account and allocated into the individual accounts of ESOP participants.

1. The company establishes an ESOP and goes to a bank to get a loan for stock acquisition. Company assets are used as collateral.
2. The company then loans that money to the ESOP. This is the ESOP note. (The ESOP note can have the same terms as the bank loan, but frequently the ESOP Note has a longer term than the bank loan.)
3. The ESOP uses the loan to purchase the stock from the original owner or his/her beneficiaries. At this point, the ESOP owns the stock, but it is in a suspense account. It has not yet been allocated to any of the individual ESOP participants.

After the stock is in the ESOP, the loan payments need to be made. These payments are accounted for as contributions to a qualified retirement plan. There are four steps:

1. The company makes tax-deductible cash contributions to the ESOP.
2. The payments are large enough to pay the principal and interest on the ESOP note. The ESOP uses the contribution to make a payment to the company for the ESOP note.
3. The company makes a payment on the bank loan.
4. As the ESOP note is repaid, shares of stock are released from the suspense account and allocated into the individual accounts of ESOP participants.

Financing and Multi-Step Transactions

Depending on the “facts on the ground,” it may be difficult to finance a 100% leveraged sale of a business to employees in a single step. Or, a partial transaction may be more in line with the goals and objectives of the seller(s). As a result, partial or multi-step transactions may be the right path.

In a typical multi-step ESOP transaction, the owner may first sell the minimum percentage of stock—often around 30%—needed to qualify for §1042 capital gains deferral. This initial sale is often financed partially by the owner and, in some cases, by a bank, providing confidence that the owner retains a majority stake and remains actively involved in the business.

As the initial portion is paid off, the owner can gradually sell additional shares—commonly another 19%—while maintaining control. When these sales are completed, the remaining stock can be sold to the ESOP. By this point, the ESOP may already own a significant minority position, and ideally a management succession plan is largely implemented, giving lenders and

stakeholders assurance that leadership and operations are stable under the new ownership structure.

It’s important to understand that, today, most ESOP transactions are 100% ESOP transactions to get the ESOP to 100% tax free S-corp status (discussed below). That requires at least some seller financing, or it may be 100% seller financed. How comfortable you are with that is very much a personal decision and based on your comfort level with playing the role of bank for the transaction.

With commercial financing, lenders may require personal guarantees from sellers (this is an item of negotiation) and may use the replacement property as collateral. Multi-step transactions typically take 5 to 10 years to complete. If that time is available, it is almost always possible to structure the transaction so that it can be done successfully. Even in a 0% to 100% ESOP transaction, the seller may anticipate keeping some level of activity with the company after the transaction until they are comfortable that the seller debt payment will be fully made.

With this basic structure established, it’s important to understand the tax implications for all parties involved—the company, the employees, and the selling owner.

Tax Treatment and Legal Framework

Of all the forms of broad-based employee ownership, ESOPs are the most tax advantaged. The company, the employees, and the seller all have tax advantages from ESOPs.

Company

The company is able to repay debt used to acquire stock in the ESOP with pretax dollars. The loan payments take the form of a contribution to the ESOP. For both C- and S-corporation ESOPs—because the ESOP is a qualified retirement plan—the ESOP contribution is a pretax expense. Additionally, in a partial ESOP in an S-corporation, the S-corp distribution made to non-ESOP stockholders to cover their incremental tax liability must also be made on a pro-rata basis to the ESOP as an S-corporation may only have a single class of stock with identical dividend rights. However, this amount ends up being tax-free to the ESOP because the ESOP is not a taxable entity, income tax exempt qualified retirement plan trust. In a 100% ESOP S corporation, since the shareholder is the ESOP which is income tax exempt, there would be no requirement for the company to make an S-corp distribution and the contribution to the ESOP can be made without regard to income taxes.

The ESOP then uses the contribution to pay off the ESOP note. This means that the business needs to commit \$1.00 of pretax earnings to pay for \$1.00 of debt repayment. In traditional financing, and again assuming a 30% combined tax rate - the business must commit \$1.30 of pretax earnings to pay \$0.30 in taxes and have \$1.00 to repay debt. So, an ESOP reduces the company's finance costs.

Employees

Since an ESOP is a qualified retirement plan, ESOP participants pay no tax on their shares until they cash them out, presumably when they are in a lower tax bracket at retirement.

Selling Owner

In a C-corporation, the selling shareholder can take advantage of a tax-free rollover of his or her capital investment. If, after the sale, the ESOP owns at least 30% of the outstanding stock in the company, and the owner has held the stock for more than three years, he or she can take advantage of the §1042 rollover. The §1042 rollover allows the selling shareholder to defer capital gains taxes on the proceeds of the sale, as long as he or she reinvests those proceeds into stocks or bonds of domestic operating businesses within a 15-month period. In this way, a sale to the employees via an ESOP often provides the best after-tax price to the seller.

Traditionally, this capital gains tax deferral was available only to businesses structured as C-corporations at the time of the transaction. Beginning January 1, 2028, owners of S-corporations who sell to an ESOP will also be eligible to defer capital gains taxes on up to 10% of the sale proceeds. The example below helps illustrate the mechanics of this tax deferral and how it can create significant after-tax benefits for the selling owner.

Example: The §1042 Rollover

Fred initially invested \$100,000 in his company and now has stock worth \$2,100,000. If Fred sold it to someone else, he would have a taxable capital gain of \$2,000,000 (current value minus the original investment). Assuming a federal capital gains tax rate of 15%, Fred's capital gains tax on this amount will be \$300,000, leaving him \$1,800,000 to spend or invest.

If Fred sells the same stock to his employees through an ESOP, and he invests the proceeds in stocks and/or bonds of domestic operating companies, the capital gains tax is deferred until he sells the replacement securities. In this way, Fred is able to invest the full \$2,100,000, rather than the after-tax \$1,800,000.

If Fred does not sell the new investments, he will never pay capital gains taxes. When the stock passes to his estate, the basis increases to current value. Thus, the business was sold and capital gains taxes were fully avoided. In this case, Fred has saved \$300,000 in federal taxes on the capital gains. The new investments will be part of Fred's estate and will be subject to estate taxes, unless other plans have been made.

Requirements for the §1042 Rollover

For the seller to use the §1042 rollover, the following requirements have to be met:

- The stock being sold must be closely held and, under current law, must be "C" corporation stock to qualify for full capital gains tax deferral under IRC §1042. (see update in next section).
- The stock must have been owned by the selling stockholder for at least three years.
- Immediately after the sale, the ESOP must own at least 30% of the total outstanding stock of the company.
- Sale proceeds must be reinvested in "qualified replacement properties" (QRP) within a 15-month period. This "reinvestment period" begins three months before the date of the sale and ends twelve months after the date of the sale. QRP includes the stocks and bonds of U.S. operating companies. Mutual funds are not eligible as QRP, and neither are investments in financial institutions. The selling owner should consult a QRP specialist so as not to inadvertently trigger the tax.
- If the replacement property is sold, the seller must pay capital gains taxes on the proceeds.

The capital gain on which the tax is calculated will be the original basis for the company stock. In the example above, this means that Fred's capital gains tax would be based on the current value of the investments. If the replacement securities pass into Fred's estate at death, the deferred tax liability goes away. His heirs could sell the replacement properties without capital gains tax and regular estate taxes apply to the rollover securities.

C-Corporation vs. S-Corporation Status for ESOPs

Traditionally, this capital gains tax deferral was available only to businesses structured as C-corporations at the time of the transaction. Beginning January 1, 2028, owners of S-corporations who sell to an ESOP will also be eligible to defer capital gains taxes on up to 10% of the sale proceeds.

A Banker's Perspective on Financing the Transition

Dan Bender, First Financial Bank



When an exiting owner sells his or her company to an ESOP trust, they typically want to receive a portion of the sale price at closing. This is where a bank can get involved to provide those funds to the outgoing owners.

It should be noted that banks will structure their loan to the operating company as that entity is the one that generates cash to service the debt and has assets which can collateralize the loan. The bank will look at several factors when determining how much money can be borrowed by the company.

One main area of focus is cash flow. Banks will analyze how much a business has generated historically, and is projected to generate, in "Earnings Before Interest, Tax, Depreciations, and Amortization" which commonly known as EBITDA. This calculation represents the free cash flow of the company, and the bank will size their loan based on this figure while also accounting for other obligations the company needs to pay.

Banks will also consider collateral. It's common to have appraisals completed to determine the value of equipment or real estate that is involved in a transaction. Working capital assets like accounts receivable and inventory can also be considered, but those assets are typically used to collateralize lines of credit and not the term debt which is used to compensate exiting owners.

In addition to understanding the cash flow and collateral of business, banks will also want to be comfortable with the key employees who will manage the company going forward. If a business owner wants to pursue an ESOP, that individual must develop bench strength within the organization prior to transitioning the company. The bank might request bios for those key employees to understand their longevity with the company and their core competencies.

Typically, in an ESOP transition, banks will provide 1.5 to 2.5 times EBITDA in senior debt. The exiting owner, or owners, will then have a seller note for the balance of the sale price. For example, if a company produces \$4 million in EBITDA and negotiates a \$20 million purchase price with the Trustee, a bank might lend \$8 million which will result in the exiting owner having a seller note for the remaining \$12 million. Seller notes are subordinated to the bank, but in most cases, the holder of the seller notes can receive interest on those notes. As the senior debt is paid down overtime, the company will be able to work with their bank to refinance the seller notes which will typically be paying a higher interest rate.

Prior to 1998, ESOPs were not permitted in S-corporations. Effective January 1, 1998, ESOP rules were expanded to include S-corporations. While ESOPs in the C-corporation and in the S-corporation are fundamentally governed by the same rules, the tax situation for sellers is fundamentally different.

In a C-corporation, income taxes are paid by the corporation at the corporate level, and your taxable basis in the stock is set at the time of acquisition. In an S-corporation, there is no income tax at the corporate level; instead, income is passed through to shareholders, increasing each owner's stock basis over time.

As a result, capital gain on C-corporation stock is often substantial, making the tax-deferred §1042 rollover especially advantageous. The longer you hold C-corporation stock, the greater the potential tax savings from a §1042 transaction.

Conversely, because S-corporation stock basis increases annually with allocated income (and is reduced by distributions), the capital gain on sale—and therefore the relative benefit of a §1042 rollover—is typically lower.

If you are selling C-corporation stock to an ESOP, you generally maintain C-corporation status through the sale to preserve eligibility for §1042 treatment. If you and other owners do not plan to elect §1042 treatment, the C versus S status decision is largely a corporate-level tax consideration.

Independent of the §1042 rollover issue, S-corporation ESOPs have a significant advantage: once the company is 100% ESOP-owned, it becomes income tax-free at the federal level.

Steps in doing an ESOP – Every ESOP transaction can be unique. However, below is an outline for doing an ESOP transaction. It is important to understand that the order of items may change, or even overlap depending on your specific circumstances.

- 1. Exploration** – Learn what you can about ESOPs and whether they might be an option .
- 2. Feasibility and Preliminary Valuation Analysis** – Does it make sense for me, and the business?

3. **Start Engaging with Professionals and Begin Structuring the Transaction** – Put together the seller advisory team.
4. **Trustee Engagement and Independent Valuation** – Establish impartial oversight and determine fair value.
5. **Financing the Transaction** – Bank and/or seller financing.
6. **Negotiation and Closing** – Finalizing the transaction.
7. **Plan and Legal Documentation** – Signing Day!
8. **Post-Transaction Administration and Communication**– Rollout to Employees, Begin Communication. You can start to communicate about the ESOP before the Transaction, but it is seldom done as most sellers do not want to set expectations or be perceived to have made promises until the ESOP transaction is completed.

Governance and Financial Rights

ESOPs are not only financial mechanisms but also legal structures. While establishing an ESOP does not require fundamental changes to a company's day-to-day operations or governance, it does introduce specific rules around governance, fiduciary duties, and participant rights. Understanding these elements is essential to maintaining compliance and supporting a healthy ownership culture.

Trustees and Fiduciary Roles

The ESOP is a trusteed retirement plan, so you will need a trustee to be responsible as a fiduciary for the plan. The trustee is responsible for protecting the interests of the plan participants. Trustees are selected, approved, and hired by the board of directors.

In addition to managing the assets of the ESOP trust, the trustee is responsible for voting the ESOP participants' shares at the stockholders' meetings and for approving the ESOP stock price used. This is true for the transaction and each year the ESOP is in existence. The trustee hires a qualified independent valuation advisor to analyze the company and prepare a valuation report (40–80 pages) recommending a stock price. The trustee should review the valuation report and accept or reject the recommended stock price. As such, it is the trustee who actually determines the ESOP stock price.

When hiring or appointing a trustee, there are several choices. The trustee may be an internal trustee who works in the company or an external trustee, such as a professional or institutional trustee. The trustee may be independent (i.e., making up his/her own mind on how to vote the stock in every

situation) or be directed by the board, an ESOP administration committee, or by a vote of the plan participants. Even if directed, the trustee still has the fiduciary obligation to follow the law and the plan provisions—even if it goes against the received direction.

It is legal for you, the selling owner, to act as the trustee for the plan and the transaction. However, it is usually considered prudent, and strongly so, that you hire an external and independent trustee for the transaction to avoid conflict-of-interest entanglements.

After the transaction is complete, the choice between an internal or external trustee generally involves a trade-off between educating the internal trustee adequately and paying the external trustee. Trustees have a fiduciary responsibility to act solely for the benefit of plan participants.

Internal trustees are typically company executives familiar with the business, such as the CFO, or a trustee committee that may include other senior managers. Like all fiduciaries, internal trustees face personal liability—their home, car, or personal savings could be at risk if they are found to have breached their duties. Trustees or committees should become familiar with their obligations and should be covered by fiduciary liability insurance. By law, internal trustees generally may not receive compensation beyond their regular salaries for serving in that role, though the company typically covers the costs of training, conferences, and insurance associated with taking on these fiduciary responsibilities.

External trustees today are generally independent fiduciary firms that specialize in ESOP oversight rather than traditional bank trust departments. Their fees vary based on company size and complexity, reflecting their fiduciary responsibility and the risk of liability for breaches.

Larger companies more commonly use external trustees, while smaller companies are more likely to rely on internal trustees. A majority of companies today tend to rely on outside trustees, and the percentage has continued to grow over the last decade. It's worth reiterating that owners (or their family members) should not serve as trustees when selling stock to the ESOP to avoid conflicts of interest.

Independent vs. Directed Trustees

Independent trustees exercise their own judgment in voting shares—both allocated and unallocated—and otherwise act on behalf of plan participants, except on certain issues (see below under “Voting and Governance”), on which federal law

requires pass-through of voting rights to ESOP participants. (The law also permits full pass-through of voting rights to ESOP participants, but this is not required by law).

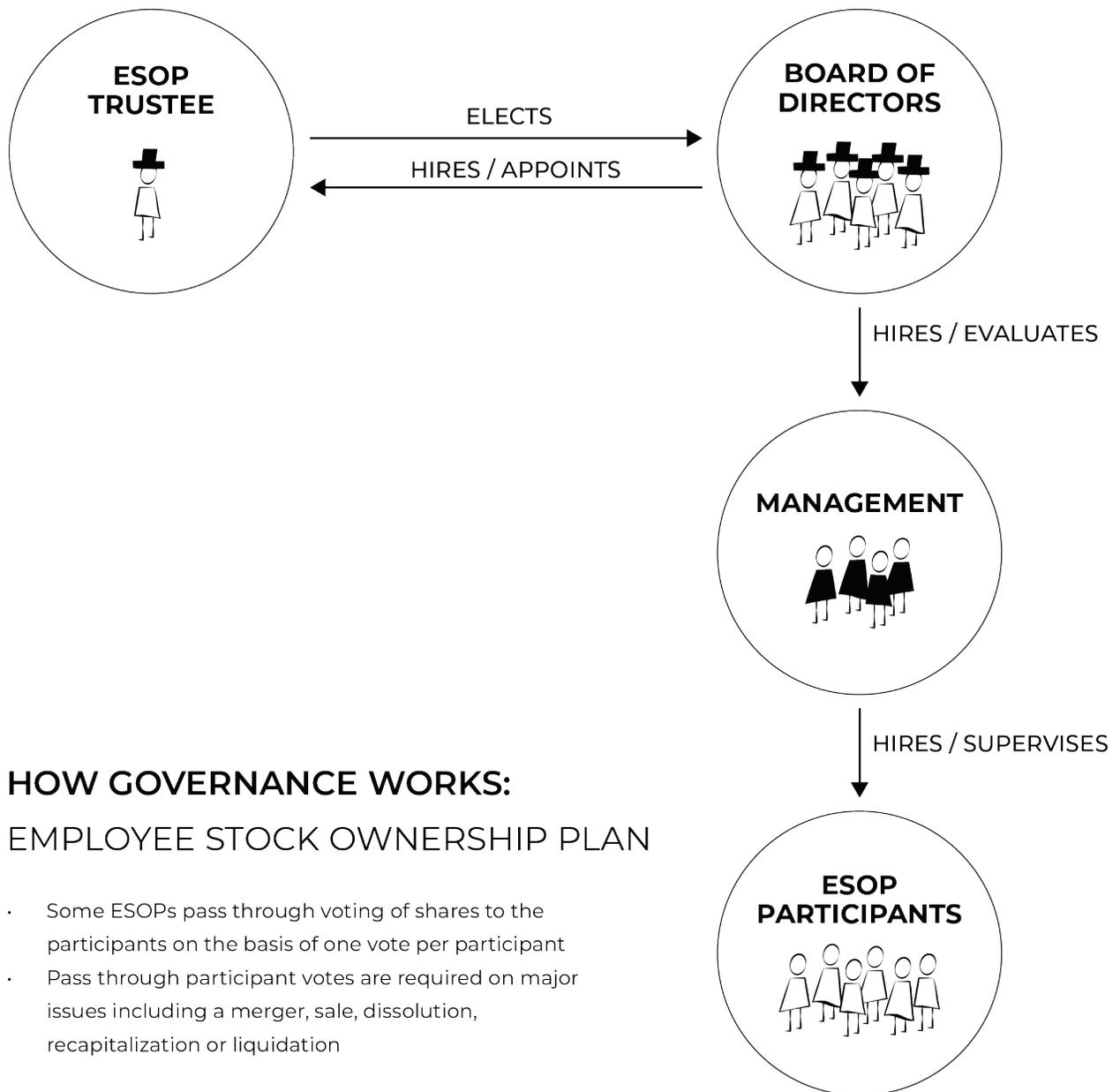
Directed trustees act on the basis of direction received from pass-through voting of shares by ESOP participants or direction from ESOP administration committees or the board of directors. Generally speaking, any of the three provides some protection against fiduciary liability by the trustee. Being a “directed trustee” may be a valuable protection for an internal trustee and may reduce the cost of an external trustee. Ultimately, however, trustees’ fiduciary responsibilities

trump all other concerns, and directed trustees should ignore direction that would cause them to violate their fiduciary responsibility (and the law) if followed.

ESOP Administration Committees

Federal law does not require an ESOP administration committee, but it is good practice to have one. This committee oversees plan administration and is typically made up of representatives of plan participants, which can be both hourly and salaried.

Many ESOP plans give discretion to the plan administrator in developing specific policies and procedures for the ESOP. The



Rethinking Liquidity: ESOPs as Both Exit and Growth Strategy

Tim Jamison, Prairie Capital Advisors



Planning an exit strategy can be an emotional and complex process for owners of closely held businesses. After years of dedication, the thought of transferring control to an outsider can feel unsettling. Many owners worry about maintaining the company's legacy, protecting employees, and ensuring a smooth transition. Traditional exit paths, such as selling to a third party, don't always align with these goals—especially in the absence of a clear successor.

Fortunately, Employee Stock Ownership Plans (ESOPs) provide a compelling alternative. ESOPs offer flexibility, liquidity, cultural continuity, and the potential for long-term growth—all while engaging employees in the business's future success.

A Smart Ownership Transition Strategy

Attract and Retain Talent – ESOPs empower employees by giving them a direct stake in the company's success. This sense of ownership can boost morale, foster deeper engagement, and strengthen retention. When employees see their contributions reflected in company performance and, ultimately, their personal financial growth, it energizes their day-to-day work.

Strengthen Culture and Drive Value – Many businesses already have cultures where employees feel responsible for results. ESOPs reinforce this by formalizing a shared stake in outcomes. Companies that build a strong ownership culture often benefit from improved productivity and higher valuations—enhancing both business value and employees' ESOP holdings.

Preserve Legacy – An ESOP allows a company to remain independent and under the stewardship of those who helped build it. This continuity protects the owner's values and ensures the company's contributions to the community and industry are preserved. Selling to a third party, in contrast, often disrupts culture and local roots.

Maintain Independence – Selling to strategic buyers or private equity can erode brand identity or alter the business's direction. ESOPs, while subject to fiduciary responsibilities, enable the company to remain autonomous. Ownership transitions to

employees in a structured, tax-advantaged manner—without compromising the business's core mission.

Liquidity With Flexibility – An ESOP can be structured to meet a range of liquidity goals. Some owners prefer to sell 100% of the business, while others seek only partial liquidity. ESOPs are especially useful in multi-owner businesses where some shareholders want to exit while others stay engaged.

The structure is adaptable: it can start with a minority sale and evolve over time. This gives owners the option to unlock value gradually while setting the stage for future transitions—whether to the ESOP or another buyer.

By converting private company equity into diversified, liquid wealth, ESOPs offer a path for owners to secure their financial future without abruptly stepping away from the business.

Fueling Growth Through Acquisitions

ESOPs are not just a tool for succession—they're also a growth engine. According to the National Center for Employee Ownership (NCEO), ESOP companies made 1,387 acquisitions from 2020 to 2024, adding 96,000 employees to the model. These acquisitions are now nearly as impactful as new ESOP formations in expanding employee ownership.

A key driver behind this expansion is the tax-advantaged structure of S-corporation ESOPs, which allows them to build capital and reinvest in strategic growth. C-corporations also benefit from the 1042 election, which lets selling shareholders defer up to 100% of capital gains tax on the sale to an ESOP. Employee-owned businesses tend to outperform their peers, enhancing financial flexibility and acquisition potential.

For owners seeking an exit, being acquired by an ESOP company can be a win-win—providing liquidity and continuity while promoting employee ownership.

ESOP administrative committee is responsible for developing those policies and procedures. As such, ESOP administrative committee members are fiduciaries and have a fiduciary responsibility to perform solely for the benefit of ESOP plan participants.

The committee considers issues not addressed by the plan, and its guiding principle is to maintain records of its decisions to ensure consistent treatment of people in similar circumstances. ESOP recordkeeping and plan administration may be done in-house or more commonly through a

third-party administrator (TPA) that specializes in ESOP administration. In either case, the company needs to maintain the data relevant to plan administration.

Voting Rights and Governance

Federal law requires pass-through ESOP participant voting only on certain issues such as mergers, recapitalizations, liquidation, or the sale of substantially all company assets. The law does not require votes on acquisitions, the sale of ESOP stock, full-company stock sales, or board elections. How employee governance rights are structured—and how

employees participate in the business—largely determines whether an ESOP improves long-term performance. Studies consistently show that closely held ESOP companies that combine ownership with meaningful employee participation outperform both non-employee-owned companies and ESOPs without worker engagement. While participation beyond voting rights is rarely addressed in the plan itself, it's often a key driver of success.

ESOP law does not require giving plan participants full voting rights in closely held companies; the trustee typically holds the default voting power. However, plans can provide expanded pass-through voting rights. For many business owners, this may feel like a major shift, but it can also strengthen the sense of ownership among employees—deepening engagement, accountability, and long-term commitment.

One way to make ownership tangible is through employee seats on the board of directors. Although ESOP law does not require employees be board members, experience shows that employee directors can add valuable operational insight and signal to all participants that ownership is real and meaningful at the company.

Concerns that expanded voting could lead to instability or “popularity contests” can be mitigated through thoughtful plan design, governance structure, and communication. Gradual expansion of voting rights and carefully considered employee representation can balance stability with authentic ownership.

Financial Rights of Employees

Beyond governance, the ESOP defines specific financial rights for employees—when they become participants and enter the plan, how they vest, how shares are allocated, and how distributions occur. These decisions are central to both compliance with ERISA and fairness.

Participation: The government-allowed eligibility requirements for participation in the ESOP plan are that the participant is 21 years of age, has 12 months of continuous service, and has worked 1,000 hours during that 12 month period. That generally works fine unless your business is one where employees tend to hire in at 18 (and make a career of it), or you have a seasonal work year due to weather or industry. Companies are able to adjust their ESOP plan in ways that make participation easier (lowering the limits above), but they cannot make participation harder. For example, you can drop the age requirement to 18, but you cannot increase it to 22. Likewise, the month and hour requirements can be adjusted downward, (e.g. 6 months and

500 hours, but not upward). Finally, workers do not need to formally decide to participate in the ESOP; they are entered into it once they fulfill the eligibility requirements outlined in the ESOP plan document.

Vesting: “Vesting” is acquiring a guaranteed right of ownership to the value of the stock and cash in your ESOP account, so it is very important to employees. The law permits you to vest quickly (immediately on day of hire is even possible) or slowly (up to 6 years) or somewhere in between. Again, you cannot increase vesting beyond 6 years, but you can lower it. You may wish to provide vesting credit for years of service prior to forming the ESOP, which is also allowed.

Allocation: Allocation determines how much stock goes into individual employee accounts. Allocation of ESOP stock is always based on a formula, and that formula is applied to all participants – there are not different formulas for different workers. Typically the formula is related to labor input into the business during the past plan year. The question is, how is that labor input measured? Using W2 earnings, hours worked, tenure, or some combination of all three are common approaches. It's important to understand that participants do not purchase shares with their own money. Employee contributions to the ESOP are prohibited.

Distribution: Your ESOP plan's distribution formula determines how your employees get their money out of the ESOP, and it matters intensely both to the employees and to the company. The company must balance ensuring liquidity for distributions with maintaining capital for future growth.

Diversification: ESOP participants who have reached the age of 55 and have been participants in the ESOP for 10 years have the right to diversify 25% of their account for a five-year period and 50% of their account in year 6.

These provisions—eligibility, vesting, allocation, and distribution—form the core of how ownership is experienced by employees. They must be designed carefully to ensure fairness, manage repurchase obligations, and reinforce long-term retention. Going beyond the basic legal requirements requires careful planning, but doing so thoughtfully can have positive impacts on company operations and culture.

Ownership Culture and Participation

As mentioned earlier, employee participation also extends beyond governance. There are a few additional ESOP specific components to ownership culture that deserve a mention here.

Consider Selling a Minority Stake of Your Company to an ESOP

Eric Zaleski, PCE



Business owners are increasingly turning to ESOPs to convert some of their illiquid privately held company stock into cash and other liquid investments. A partial ESOP strategy is particularly appealing for business owners who want to diversify personal wealth while continuing to run—and retain majority ownership—of their business.

Partial ESOPs are attractive for their tax savings, flexible deal structures, and the speed with which a transaction can be completed. Debt providers are active participants in ESOP deals, often providing significant liquidity at closing.

Why a Partial ESOP is a Smart Liquidity Strategy for Owners

The flexibility of a partial sale to an ESOP allows business owners to:

- Sell a portion of their company
- Receive cash for the sale of stock
- Eliminate or reduce personal and corporate taxes
- Motivate and retain employees
- Retain upside in the business
- Maintain control and benefit from future growth

Case Study: How a Partial ESOP Unlocks Liquidity While Retaining Ownership

Meet John, a 50-year-old owner of a successful electrical distribution company. John started the business 15 years ago and has achieved continuous growth, but personal goals have him contemplating exiting the business entirely in 10 years at age 60. However, uncertainty around the timing of his plans and whether the M&A market will be strong at that time has him evaluating a partial liquidity strategy today.

John and his advisors examine different liquidity strategies: a leveraged recap, a sale to an outside equity investor, and a partial sale to an ESOP. To determine whether this approach aligns with his financial and business objectives, John undergoes an ESOP feasibility study to analyze valuation, structures, tax benefits, and liquidity. John's advisors perform an ESOP feasibility study to understand valuation, transaction structures, tax outcomes, and financing potential.

With the feasibility study completed, John decides to pursue a partial sale to an ESOP for several reasons: better financing options, the ability to retain control and direct equity, the benefit to his employees, and personal and corporate tax savings.

Financing a Partial ESOP Sale

Lenders are highly supportive of funding partial ESOP transactions. Exploring various financing options is crucial to structuring a transaction that aligns with business goals and liquidity needs. John receives offers in the \$20 million range from senior lenders as well as another \$7-\$10 million in subordinated debt. John and his advisors decide to limit total debt at \$20 million—roughly 34% of the company's value. Post-transaction, the ESOP trust owns 34% of the business, while John retains 66% ownership.

By converting his company to a C corporation before the transaction, John qualifies for a powerful tax benefit: he can defer all capital gains taxes on the shares sold to the ESOP. If his company isn't a C corporation but instead an S corporation, the business would not pay income tax on the 34% portion the ESOP owns.

The Bottom Line

Partial ESOPs are a compelling liquidity tool for business owners who want to:

- Cash out a portion of their ownership
- Continue to lead and grow the business
- Reap tax advantages
- Reward employees with shared equity

For owners like John—and many others—ESOPs strike a smart balance between financial diversification and business continuity.

Because ESOPs are almost always implemented without significant employee input, early education and communication are critical. Without it, employees may feel uncertain or even skeptical about what the ESOP means for them, slowing mental buy-in and limiting the ESOP's initial impact. An ESOP is also a very unique form of ownership, and itself can be complex to grasp. It's important to describe it as it is, accurately and fully. Clear, ongoing communication—especially about why the company became employee-owned and how employees benefit—builds trust, engagement, and the “ownership culture” that makes ESOPs work.

Challenges and Considerations

While ESOPs provide significant financial, tax, and cultural benefits, they also require careful management and long-term planning. Business owners should understand the complexities of financing, administration, and leadership transition before deciding to move forward.

Repurchase Obligations and Liquidity

One of the most common operational challenges ESOP companies face is managing the repurchase obligation—the need to buy back shares from departing or retiring employees.

The value at which employees cash out their ESOP accounts is determined by the legally required annual ESOP valuation. Companies may distribute account balances in cash or stock, depending on the plan's design and corporate restrictions.

If the company distributes in stock, employees have a right to "put" the stock back to the plan or company at the current valuation or at the valuation in the year immediately following their leaving employment with the company, and the company is obligated to honor the "put" and repurchase the shares.

ESOP participants are entitled to a distribution from their accounts on retirement, death, disability, or termination, and according to the terms in the ESOP Plan Document. Most ESOP plans begin distribution more rapidly at retirement, disability, or death, while those who quit or are terminated must wait a longer period to begin receiving their distributions.

Essentially, distributions for death, disability, and retirement begin within the year following the date of the event, and distributions for other terminations can be delayed for up to 5 full plan years after termination.

Most companies will pay a lump-sum distribution for small accounts, typically \$5,000–\$10,000. They then write into the plan the option to distribute larger accounts on an installment basis over a five-year period, paying the cash value of one-sixth of the shares in cash immediately and five subsequent annual payments of the then-current cash value of one-sixth of the shares.

C-corporations that are still paying down their transaction debt have the option to defer distributions until the debt is paid off. While electing this option during the loan years helps cash flow, it may impose serious repurchase obligations on the company immediately after the loan is paid off. As always, good planning and consultation with advisors is essential for making these decisions.

ESOP participants who are eligible to begin receiving their ESOP benefit distribution and who have ESOP accounts greater than \$7,000 must consent to the distribution before it can be paid to them.

Proper planning for repurchase obligations is critical to an ESOP's sustainability. Companies often use repurchase studies to forecast cash needs and prevent liquidity crises as the workforce ages.

Management Succession

We've discussed management and leadership transition, but an ESOP specific aspect deserves mention. One of the major advantages of a multi-step sale of the business to the employees is that it can provide time to develop and implement a management succession program. With a 100% sale, this means that you need to start thinking ahead in planning for your transition out of the business—a stepped transaction may allow you to cash out some equity while developing the next generation of leadership.

Plan Design Flexibility and Compliance

Federal law on ESOPs is a bit like the frame around a painting. Anything you paint outside the frame disqualifies the plan, but you can paint many different pictures inside the frame.

ESOP legal boilerplate generally meets only the minimum federal standards for qualifying the plan. If you want your ESOP to fit the type of business you are or to have more impact on making employees feel (and act) like owners, you may want to go beyond just the legal requirements.

As noted in previous sections above, there are basically three groups of decisions that need to be made: those concerning employees' financial rights under the plan, those concerning ESOP administration, and those concerning employee involvement in decision-making and corporate governance.

These decisions—especially around governance, eligibility, vesting, and allocation—must all fit within ERISA and IRS regulations. Working with experienced ESOP attorneys, trustees, and third-party administrators is essential to ensuring compliance and avoiding costly errors. While these decisions are often seen as technical matters (in some sense, they are), you should always keep in mind that they will also impact company culture and the extent to which workers act and feel like owners. Be sure to dedicate time to thinking through how you want your ESOP to operate.

■ Part Three:

Worker Cooperatives

What It Is

Worker cooperatives are another form of broad-based employee ownership. Compared to ESOPs, they have a longer history in the United States, with some of the first successful examples emerging during the Industrial Revolution in the late 19th century. Then, as is the case today, worker cooperatives were established to create workplaces that offered workers a means through which to participate in governance and the production process, as well as a share in the value created by the company.

Worker cooperatives are part of the broader family of cooperatives, which you may be familiar with, including agricultural cooperatives like Ocean Spray, consumer cooperatives like REI, insurance mutuals like Nationwide, purchasing cooperatives like Ace Hardware, as well as utility cooperatives, housing cooperatives, and others. While the services provided by each of these cooperatives differ, a key characteristic that all cooperatives share is that they are owned and democratically controlled by the individuals who work for them or use the services they offer. For example, Ocean Spray is owned and governed by producers who provide cranberries to the cooperative, REI is owned by customers who purchase its products, and housing cooperatives are owned by their tenants. In a worker cooperative, the business is owned and governed by the workers who provide their labor to the cooperative.

Unlike ESOPs, which are qualified retirement plans, a worker cooperative is a formal corporate entity. This means that the decision to become a worker cooperative is “complete” in the sense that there is no option to become a 30% or 50% cooperative-owned business indefinitely. There are ways to structure a sale to a cooperative over time, which is referred to as a “stepped” transaction. But any transition to a worker

cooperative is made with the assumption that the employees will eventually own 100% of the company.

There are aspects of cooperative governance and financial rights that are baked into the corporate form. Financially, any worker who becomes a member of the cooperative by purchasing a membership share earns the right to share in the company’s profits through “patronage refunds,” also referred to as patronage dividends. From a governance perspective, worker cooperative members have the right to elect and/or serve on the company’s board of directors.

While worker cooperatives are fewer in number compared to ESOPs, there has been a measurable increase in the United States over the past 20 years. In the early 2000s, there were approximately 250 worker cooperatives; today, there are over 1,000 operating within various industries. Moreover, worker cooperatives are a business form that can be found in various countries worldwide, including Spain, the United Kingdom, Italy, France, and many others.

Why an Owner Might Choose This Path

There are various reasons why a cooperative worker may be attractive to a business owner. For some owners, choosing the worker cooperative model may be a financial decision. Unlike ESOPs, worker cooperatives are a form of incorporation, not a qualified retirement plan. For this reason, worker cooperatives are not as highly regulated and do not require federal pension plan compliance costs or other maintenance costs such as annual valuations, third-party administrators, or external trustees. This significantly reduces the costs of setting up and maintaining a worker cooperative compared to an ESOP. It also makes the transaction less complicated, as a smaller number of professional service providers are required.

Why Consider a Worker Cooperative

Allison Curtis, ICA Group



Each year, thousands of small business owners explore succession options. Yet the pathway to a successful sale is far from guaranteed. Only about 20% of small businesses listed for sale ultimately find a buyer. Many profitable businesses quietly shut down—not due to a lack of value, but because of a lack of viable successors.

Many are familiar with Employee Stock Ownership Plans (ESOPs) and often discover that the model does not meet their needs, as it is typically suited for larger companies. Worker cooperatives offer a compelling alternative for small businesses. They are less expensive to establish, easier to administer, and particularly well-suited for companies with 5 to 75 employees. For small business owners seeking a cost-effective, value-aligned succession strategy, the worker cooperative model can be an ideal fit.

What is a Worker Cooperative

A worker cooperative is a business owned and controlled by its employees, rather than a single owner, partners, or outside shareholders. Ownership is shared equally among employees who choose to buy in. That ownership gives employees the right to a portion of the business's profits, as well as a say in how the business is run. Worker-owners vote on significant business decisions and elect a board of directors. Because it's not practical for worker-owners to vote on every decision, managers typically handle daily operations. From the outside, a worker cooperative looks like any other business—providing a service or good to the community and employing workers and managers. Any business can be organized as a cooperative, and there are hundreds of successful worker co-ops in a variety of sectors.

What are the benefits of selling to a worker cooperative?

Cooperative buyouts significantly increase the likelihood of a completed sale. Employees understand the value of the business and are invested in its continued success. Unlike outside buyers who conduct extensive due diligence, worker-owners have firsthand knowledge of the company's inner workings and are less likely to walk away.

Employees bring institutional knowledge and strong relationships with customers, vendors, and one another. This continuity minimizes disruption, preserves the business's reputation, and ensures operational stability. It is difficult to overstate the importance of a successor who already understands the daily functions, workplace culture, and stakeholder relationships that drive the business forward.

Cooperative buyouts also grant selling owners greater control over the terms and timeline of the transition. Sellers can determine their continued involvement, whether they choose to exit immediately or stay on. In contrast, sales to private equity firms or external buyers often involve restrictive contractual terms, such as earn-outs, non-compete clauses, or compressed timelines that may not align with a seller's goals.

For many business owners, the company represents far more than a financial asset—it embodies years of effort, relationships, and values. Selling to employees allows an owner to preserve their legacy while rewarding the individuals who helped build it. It ensures that jobs and wealth remain in the local community, rather than being extracted or relocated. Moreover, employee ownership helps workers build wealth through profit sharing, a step towards addressing wealth inequality.

Finally, worker cooperative buyouts are often financially competitive. Unlike asset sales, which are common in third-party transactions and can be tax-disadvantageous to the seller, most cooperative conversions are structured as stock sales. This structure can result in lower tax liability. Additionally, sellers may qualify for a Section 1042 rollover, allowing them to defer capital gains taxes by reinvesting in qualified securities—a significant benefit for those planning for retirement.

There is more flexibility in the types of companies that can utilize this model. Typically, having 5 or more employees increases the chance that the transition to a worker cooperative will be successful. However, any company, regardless of its size, can adopt the worker cooperative model, even in its early stages of operation, making it an excellent fit for small to mid-sized companies. Most worker cooperatives in the US are small, typically 25 employees or fewer. However, there are worker cooperatives in the United States with hundreds of employees. There is no structural limitation preventing a large company from becoming a worker

cooperative, or that prevents a worker cooperative from growing into a large company.

Another attractive aspect of a worker cooperative is how it can formalize company practices and workplace culture that are already in place, or that the selling owner and current leadership aspire to instill in the company. Small business owners who have built participatory workplace cultures that delegate decision-making authority may find the governance aspects of worker cooperatives appealing. Similarly, mission-driven businesses that are community-focused or based

on values such as fairness or equity may find that the governance and financial rights provided to worker members align with their company's overall strategic vision. Relatedly, this model allows for the selling owner to continue working in the company, even after the sale – allowing them to transfer knowledge and skills to the current and future leadership.

Finally, tax benefits associated with the worker cooperative model may be appealing. For selling owners, the §1042 capital gains deferral option available in ESOP transactions is also available in worker cooperative transactions, as long as the selling company is a C-corp at the time of sale and 30% or more of the company's stock is sold in the first transaction. For the company, patronage paid to worker-members is deductible from the company's taxes if specific requirements are met as outlined in Subchapter T of the US tax code. These, and other tax benefits associated with the worker cooperative, are detailed in the sections that follow.

Small business owners who have built participatory workplace cultures that delegate decision-making authority may find the governance aspects of worker cooperatives appealing.

Governance and Financial Rights

A worker cooperative is a form of corporate entity (like an S-corp or an LLC) that has members rather than shareholders. Statutes governing the operation of worker cooperatives are state-specific, and several states have more favorable statutes, while others have statutes that make it more difficult. It is possible that a company can incorporate in a different state (with a favorable worker cooperative statute) other than the primary state where it operates. Additionally, a company can use an alternative form of incorporation, such as an LLC or C-Corp, and establish cooperative principles through its articles and bylaws. While statutes differ by state, there are fundamental characteristics common to all worker cooperatives regarding the organization of financial and governance rights provided to those who become worker-members.

Membership

Becoming a member is voluntary; workers have the choice to join the cooperative – it is not something they are required to

do. In a worker cooperative, a process is created for becoming a member. Typically, this process begins with an application that allows the worker to declare their intention to become a member. The worker is then provided with information outlining the rights and responsibilities they will have as members of the cooperative, as well as the other requirements they must meet to become members.

Usually, requirements include a waiting period, being voted in by other members of the cooperative, and the purchase of their membership share. The length of the waiting period is set by the cooperative; common time periods are 6 months to a year, although companies can adjust this to be shorter or longer. Companies can also require specific training and education to be completed as part of the membership process. Membership fee amounts are also established by the cooperative and vary from company to company, ranging from a few hundred dollars to thousands of dollars. This membership fee is returned to the worker upon leaving or retiring from the worker cooperative.

A good practice to follow when determining the dollar amount for the membership fee is to use a number that is high enough to make becoming a member a meaningful decision, but low enough to ensure it is financially feasible to pay. The size of this number will vary depending on your workforce. Likewise, the cooperative will establish how the fee is paid. Some cooperatives may require membership fees to be paid in a lump sum, while others allow payment over time. Once the waiting period is completed and the membership share has been paid for, workers become full members of the cooperative and receive a share certificate and typically sign a membership agreement outlining their rights, roles, and responsibilities as members.

Financial Rights in the Cooperative

Becoming a member provides financial rights within the company. Once members, workers will begin to receive a portion of the company's profits through what is called "patronage refunds" or patronage dividends. Worker cooperatives typically divide their annual profits between a modest, unallocated reserve account and internal capital accounts. The reserve account is designed to absorb losses or otherwise serve as capital for the cooperative to use for investments and other activities, which are taxed at the corporate level. The internal capital accounts are used to hold the portion of profits that are shared among cooperative members through patronage, which is taxed at the individual member level. Patronage paid to worker members can be considered a deductible expense for tax purposes by the

company when certain requirements are met as outlined in Subchapter T of the tax code (see Tax Treatment and Legal Framework section below).

The amount of patronage a member receives in a given year is determined by a formula created by the cooperative. Typically, this formula is based on the amount of labor a member contributed to the cooperative that year and is based on hours worked, years of service, or a combination thereof. Workers must report patronage they receive as part of their gross income for federal tax purposes. After establishing the total amount of patronage for each worker, a portion of this amount is paid out in cash, and the remainder is allocated to their internal capital account. The amount paid out in cash is typically a sufficient percentage of the total patronage a member receives to cover the taxes due for their individual income tax return associated with their patronage refund that year (typically 20% or more of the total payout).

The remaining amount is placed in their internal capital account, which is redeemable upon retirement or departure from the company. When the internal capital account balance is redeemed, the member does not pay taxes, as the tax was already paid when the money was initially deposited into the member's account. Effectively, the cooperative achieves a tax benefit like that available to ESOP participants, except that cooperative members pay taxes on the income currently, rather than when they begin to receive payments from their accounts. The trade-off for the current taxation of amounts received by worker-members is that members gain current and direct ownership of the cooperative and its profits.

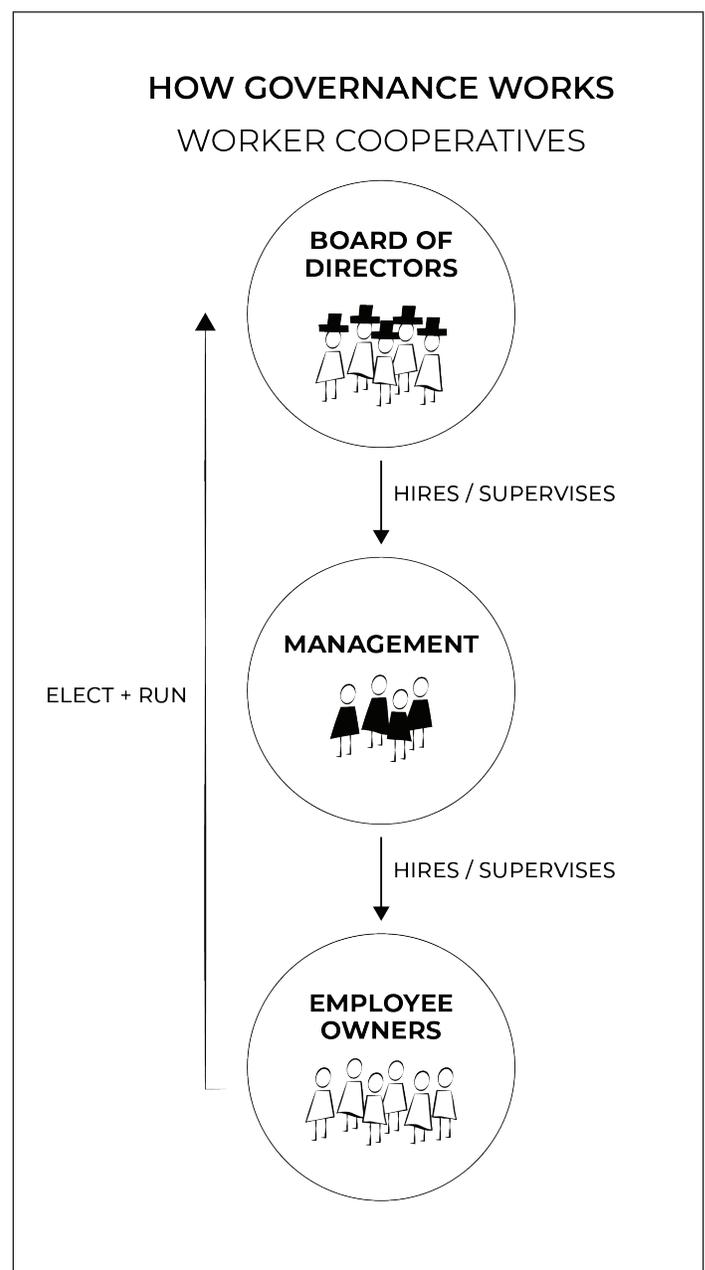
Governance Rights in the Cooperative

Membership also provides governance rights to members. Once a worker becomes a member, they hold a share in the company, making them eligible to vote for and serve on the company's board of directors. Worker cooperatives typically reserve a majority of the board seats for worker members. The cooperative will determine the timing of board elections and the pace at which seats open. Typically, a worker cooperative holds an annual members' meeting where vital decisions about the company are discussed and, when appropriate, voted on by all members. This may include voting for the board, formally admitting new members into the cooperative, amending the bylaws, or making other strategic decisions for which input from members is wanted.

One important distinction to note about voting membership shares in a worker cooperative is that they are exercised on a one-person, one-vote basis. Unlike other corporate models,

which attach the weight of an individual's vote to the number of shares they hold, in a worker cooperative, each person has one share (regardless of the size of their internal capital account) and thus, one vote.

Outside of workers being able to vote for and serve on the board, and the one-person one-vote principle, the governance at a worker cooperative is similar to that found in other companies. The board is elected by members. And once it is seated, it typically meets between 2 and 4 times per year, depending on the need. The entire group of workers will also meet at annual meetings throughout the year as needed, usually around the same time as the board. Once elected, the board then hires and oversees management, which in turn oversees the worker-members (see graphic below).



Holding the Door Open: Generations of Change in a Worker Cooperative

Sarah Crisp, The Industrial Commons



At fifteen, Danilo was working third shift at a poultry plant while attending high school by day. He slept when he could—sometimes during class—but still showed up every day. One teacher noticed his perseverance and introduced him to Opportunity Threads, a worker-owned cooperative in the foothills of the Blue Ridge Mountains. They didn't offer charity. They offered purpose—a role and a future.

Danilo began as a part-time intern, helping wherever he could: hauling boxes, cleaning, listening. When it came time to train on the machines, his hands—already skilled from years of sewing in his home in Guatemala—adapted quickly. By nineteen, he was full-time. By his mid-twenties, he had become a team leader. Today, he coordinates workflow, ensures quality, and mentors others.

In 2024, at just twenty-four years old, Danilo bought his first home. A coworker, Raul, wrote him a recommendation for the mortgage. Now, Danilo is on track to become a worker-owner—nominated for his leadership and steady commitment. But for him, it's not about the title or the paycheck. "It's the peace," he says. "Knowing I'm part of something bigger."

That "something" is Opportunity Threads. Founded as a worker-owned cut-and-sew facility, OT was never just a business—it was a response to job loss, disinvestment, and the marginalization of working families. From the beginning, the cooperative asked a simple question: What if workers owned the place where they labored?

They built a business where decisions are shared, equity is collective, and people come first. OT's impact reaches far beyond its walls—donating to local causes, helping families in crisis, and mentoring young Hispanic men at Freedom High School. When community colleges host workforce or entrepreneurship events,

OT shows up not just as a participant but as a partner. Through support of the MADE (Morganton Arts Design and Engineering) competition and youth leadership programs, OT sends a clear message: young people belong here—and they are the future.

That commitment also lives through the OT College Fund, a scholarship program for employees and their children. It has already helped eight students graduate. One of them is Sandy.

Sandy's mother, Sandra, has worked at OT for years. As a high schooler, Sandy heard her mother talk about how coworkers supported one another. When she needed a job, she joined OT while juggling evening shifts at a fast-food restaurant.

After high school, she enrolled at Western Piedmont Community College, later transferring to Western Carolina University to study Communication Sciences and Disorders. When rising tuition costs threatened her final semester, the OT College Fund covered the gap. She graduated in 2025 and is now completing certification as a speech-language pathology assistant while continuing part-time at OT.

"There were hard days," she says. "But I remembered why I started. You have to look forward and ask for help. Staying silent keeps you stuck."

In this warehouse in western North Carolina, they aren't just sewing quilts from old t-shirts. They're stitching futures—each line of thread holding together dignity, opportunity, and the belief that working people can shape not only a business, but the community around it.

A key point to keep in mind is that neither the board nor the entire cooperative membership will be involved in making day-to-day decisions within the cooperative. Those responsibilities are delegated to management and leadership, who oversee operations, as well as other work teams or committees that the cooperative establishes. Most worker cooperatives will opt for a less top-down management structure than a typical business and will delegate responsibilities more broadly among the worker-owners; however, every cooperative will organize itself differently.

Structuring the Sale

Transitions to a worker cooperative can take two general forms. A single-stage sale where the selling owner sells all the assets, and a multi-stage sale where the owner sells a portion

of the company with the intent to sell the remainder in future transactions.

Single-Stage Sale to a Cooperative

If the selling owner is able to sell substantially all of their shares to employees in a single transaction, it can be done relatively simply with a cooperative. Employees either form a new cooperative that purchases the shares or assets from the owner, or the existing corporation is converted into a cooperative that redeems all the owner's shares. In practice, the choice of creating a new company or converting the existing company into a cooperative depends on circumstances. It usually makes sense to keep the existing company if doing so preserves eligibility for Subchapter T tax treatment and avoids the disruption of transferring contracts, licenses, or regulatory approvals. Creating a new cooperative

may be preferable if the company's structure is changing (for example, from an LLC to a cooperative corporation) or if a "clean break" from past liabilities or other complications associated with the current company is a goal of the employee and the selling owner. The decision should always be discussed with your attorney and tax professional.

In either case, a fair-market value appraisal should be conducted to ensure employees are paying a fair and defensible price.

Once a purchase price is established, the purchase can be financed through seller financing (a seller note), outside financing from a cooperative-friendly lender, or a combination of the two. Regardless of the financing structure used, the loan is repaid from the company's future profits. Employees are not personally liable for this debt. Repayment periods typically range from five to ten years, with outside lenders often requiring shorter terms (five to seven years), while seller notes sometimes stretch longer.

Selling owners should weigh how the loan size and term affect both repayment to the seller and what remains for member patronage. A large single loan, or short payback period, can absorb most profits for several years, potentially delaying or reducing the co-op's ability to allocate patronage until debt service is eased. In many cases, outside financing will not cover the full purchase price; that's why many sellers either carry a seller note to fill the gap or consider structuring the sale in stages over time.

Multi-stage sale to a cooperative

A multi-stage sale addresses the issues associated with financing a 100% leveraged transaction. In this structure, the owner first sells at least 30% of the company's stock to the cooperative, the minimum required to potentially qualify a selling shareholder for a Section §1042 capital gains deferral. The remaining shares are sold in one or more later stages, after the initial debt has been repaid or materially reduced.

This structure can be implemented either by converting the existing company into a cooperative or by creating a new cooperative that purchases the old company's stock or assets. As with a single stage transaction, the right choice depends on the situation: keeping the existing company is often the simplest option if Subchapter T tax treatment applies and continuity of contracts, licenses, and regulatory approvals is crucial. A new cooperative may make more sense if the business structure changes (e.g., from an LLC to a cooperative corporation) or if the employees want to avoid inheriting past liabilities.

Once the cooperative structure is set, the company purchases the initial stake with a mix of financing sources. Subsequent purchases occur under agreed-upon terms. Each stage should be priced using a current fair-market valuation.

As with single-stage deals, debt is repaid from future profits and employees are not personally liable. Typical repayment horizons are five to ten years, with outside loans on the shorter end and seller notes often longer. One practical advantage of staging is that each loan is smaller, so annual debt service usually consumes a smaller share of profits. That can make it possible for the cooperative to begin paying patronage sooner (if there is sufficient profit after debt service and required reserves), rather than waiting until all debt is retired. From the selling owners perspective, a multi-stage transaction enables them to continue to benefit from company growth that occurs between the first and future transactions. It also makes it more likely that external financing will be able to cover a larger portion of the total transaction, meaning less will be held as seller notes.

Tax Treatment and Legal Framework

Taxes shape both the seller's decision to pursue a cooperative sale and the cooperative's ability to operate sustainably after the transition. Understanding how capital gains deferral works for the selling owner, and how Subchapter T governs the cooperative's ongoing taxation, is essential to structuring a successful deal.

Selling Owners – §1042 Rollover

For selling owners, the key tax opportunity is the §1042 rollover. This provision allows a selling shareholder in a C-corporation to defer capital gains taxes if at least 30% of the company's stock is sold to the cooperative and the seller reinvests the proceeds in "Qualified Replacement Property" (generally U.S. operating company securities) within one year. The critical requirement is that the entity be a C-corporation at the time of sale, and that the sale is of stock, not assets.

This requirement affects the decision of whether to convert the existing company into a cooperative or to create a new cooperative business, which then acts as the buyer. In the case of converting an existing company that is a C-corporation, §1042 treatment can apply as long as the sale is made before any conversion to a cooperative corporation under state law. The usual sequence is to complete the qualifying stock sale while the company is still a C-corporation, then amend the articles and bylaws (or merge into a

cooperative corporation) after the sale closes. If a brand-new cooperative is created to act as the buyer and the seller is still selling C-corp stock, the §1042 eligibility remains intact.

In practice, some business owners, once they explore the complexity of qualifying for C-corp status and the requirements of reinvesting in Qualified Replacement Property, decide that the potential tax deferral does not outweigh the added cost and complexity. Because these issues are highly technical, owners should consult a tax attorney or CPA with experience in cooperative or ESOP transactions before deciding whether to pursue a §1042 rollover and which approach to take.

This means there is greater flexibility, but also greater responsibility to ensure that employees are fully informed and that the transaction is carried out fairly.

The New Cooperative Company – Subchapter T

Subchapter T allows cooperatives taxed as C-corporations to deduct patronage dividends—the allocations of net profits back to members in proportion to their patronage (e.g., wages, hours, or another equitable formula). This benefit is available to state-chartered cooperative corporations that are taxed as C-corporations, or to C-corporations that operate on a cooperative basis by following cooperative principles such as democratic member control and patronage allocations.

Several requirements must be met to use Subchapter T. The most important is the Written Notice of Allocation. To take a current-year deduction (a “qualified” patronage refund), the cooperative must deliver a written notice to each member within eight and a half months after the fiscal year-end. The notice must state the total allocation, specify how much is paid in cash and how much is retained in the member’s internal capital account, and make clear that the retained portion is taxable to the member in the current year. Critically, at least 20% of each patronage allocation must be paid in cash (or by qualified check) within that window; the remaining balance is usually retained in members’ capital accounts. To simplify administration, most cooperatives adopt a one-time consent bylaw at membership, which authorizes the co-op to treat retained allocations as currently taxable to members. Only

when these requirements are met can patronage refunds be treated as a tax-deductible expense.

If those requirements are not met, the allocation is nonqualified. In that case, the co-op does not get a deduction in the current year; it only gets the deduction later, when the retained amount is ultimately redeemed. Similarly, the member is not taxed until redemption. Many co-ops prefer qualified allocations (deduction now; member taxed now), but nonqualified allocations can be useful in certain cash-flow or tax-planning situations.

Subchapter T also requires cooperatives to keep patronage and non-patronage income separate. Patronage income—profits from members’ use or work—is deductible when allocated. Non-patronage income—such as investment earnings, rental income, or business with non-members—is taxed at the corporate level and must be tracked separately.

Finally, debt service affects the timing of patronage dividends. Because loans must be repaid before margins are available for allocation. If no patronage margin remains after debt service and required reserves, no allocation is made—qualified or nonqualified. The Subchapter T benefit is not lost, but it is deferred until the cooperative has sufficient margin to allocate.

Key Steps in the Cooperative Transition

Once the basic structure of the transaction is decided and the financing and tax issues are understood, the cooperative itself must be put in place. Unlike ESOPs—which are highly regulated retirement plans overseen by the Department of Labor—worker cooperatives are not subject to the same level of statutory oversight. Instead, the members and the selling owner act largely on their own behalf. This means there is greater flexibility, but also greater responsibility to ensure that employees are fully informed and that the transaction is carried out fairly.

One of the most important tools for this purpose is a written offering statement. The offering statement describes the company, how it will be run as a cooperative, its financial condition, and its business prospects. It also explains the proposed transaction: the owner’s intent to sell, how the cooperative will finance the purchase, the members’ investment obligations, the governance structure of the co-op, and the risks involved. The offering statement does not need to be as formal as a securities prospectus, but it serves

the same purpose of making sure potential co-op members understand what they are buying into. Many cooperatives supplement the offering statement with a feasibility study and pro forma financials, showing how the company is expected to perform under cooperative ownership.

After preparing an offering statement, several foundational decisions should also be made: how workers will qualify for membership, the purchase price for a membership share, how the purchase price will be paid, and how earnings will be allocated among members.

The company's legal structure must then be aligned with cooperative law. In most cases, this involves amending the articles of incorporation and adopting new bylaws to establish the firm as a cooperative under state law. As mentioned before, not every state's cooperative statute is easily adaptable to employee ownership, so the choice of state of incorporation is an important legal decision. However, some states have more favorable cooperative statutes, and worker cooperatives can incorporate in states other than the primary state in which they operate.

With the legal entity in place, the members elect a board of directors on a one-member, one-vote basis. The board may include the selling owner, who may also join the cooperative as a member during the transition period. The board authorizes the stock redemption and borrowing required to fund it, and enters into agreements with each member regarding their employment and their purchase of cooperative equity.

The documents prepared for this stage typically include:

- A stock redemption agreement laying out the terms for redeeming the owner's remaining shares
- Membership agreements and stock subscription agreements for the new co-op members
- A business plan spelling out financial and operational expectations
- Employment agreements for members
- An employment agreement for the selling owner, which may provide for a period of continued involvement as a "protected shareholder" until the remaining stock is redeemed.

Because a §1042 rollover assumes a sale of C-corp stock to employees, the stock redeemed from the owner is normally re-sold to the members as cooperative membership stock. Members typically fund this obligation through their share of

company profits. If the selling owner remains a member of the co-op during the transition, they will also make the required member investment and will receive patronage allocations, though not any reacquired stock.

Over time, as new employees join, the cooperative must determine their investment obligations and adjust its allocation formula to include them. Members' internal capital accounts may also need to be paid out periodically to reflect changes in membership and accumulated patronage.

Finally, while the financial and legal structures are being put in place, the selling owner should use the transition period to transfer management skills and responsibilities. A formal business plan with a clear timeline for management succession can help ensure that the cooperative is well-prepared to thrive once ownership has fully passed to the members.

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While the financial and legal structures are being put in place, the selling owner should use the transition period to transfer management skills and responsibilities.

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Challenges and Considerations

The selling owner must be comfortable with a board elected on a one-member, one-vote basis and with the inherently democratic nature of the cooperative. Likewise, employees must be prepared to assume the responsibilities of both share ownership and active participation in the cooperative's governance. The culture of an employee cooperative works best when it fosters mutual trust, accountability, and a participative management style. For this reason, it is often good practice for a selling owner considering a worker cooperative to gauge interest in the idea from their workforce before moving too far down the path of setting up the transaction. If employees are not interested, the cooperative will not be successful.

Relatedly, employee readiness is another central factor. Not every worker will immediately understand or embrace the responsibilities of cooperative ownership. Education, training, and open communication are essential to prepare employees for their new roles as both workers and

owners. Without that preparation, the cooperative risks governance challenges, disengagement, or poor operational performance.

Beyond culture, there are practical realities to consider. Cooperative conversions usually rely on a mix of outside financing and seller financing, and in the early years, debt service can consume much of the company's profits. This means there may be a strain on cash flow and little room for patronage allocations until loans are paid down, delaying the moment when employees feel the tangible benefits of ownership. For the seller, structuring repayment terms requires balancing their own need for liquidity with the cooperative's need for breathing room to succeed.

State law also plays a role. Cooperative statutes vary significantly, and not all states have laws that are easily adaptable to employee cooperatives. In some cases, owners may need to consider re-incorporation in another state or work closely with legal counsel to maximize the benefits of the available statutes.

The setup process itself also requires careful planning. While worker cooperatives are not subject to the same regulatory oversight as ESOPs, the transition still involves amending incorporation documents, drafting bylaws, preparing offering statements, and establishing systems to manage capital accounts and patronage allocations. Each of these steps requires professional guidance and clear communication with employees.

Finally, the importance of leadership succession cannot be overlooked. If not already in motion before exploring a conversion to a worker cooperative, the transition period should be used to transfer the selling owner's knowledge and leadership skills to other members of the cooperative. Without a clear plan and active mentorship, the cooperative may struggle to thrive even if the ownership transfer itself is successful from a transaction standpoint.

In short, the cooperative model can be a powerful way to preserve a business and empower its employees, but success requires the selling owner to approach the transition with clear eyes about its financial, legal, and cultural demands.

■ Part Four:

Employee Ownership Trusts (EOTs)

What It Is

An Employee Ownership Trust (EOT) is a form of broad-based employee ownership in which a company's shares are held in trust for the benefit of its employees. Rather than employees owning stock directly, the trust holds legal ownership of the company's shares, and employees participate as beneficiaries—often receiving a share of the company profits and an indirect voice in governance through structures established in the trust agreement.

EOTs have become an increasingly popular model for mission-driven or legacy-minded business owners who want to preserve their company's independence, protect jobs, and reward the people who helped build the business. While EOTs are relatively new in the United States, the model originated in the United Kingdom where thousands of companies have adopted it. EOTs are now gaining traction in the United States as employee ownership support organizations and service providers have adapted the model to U.S. tax and corporate law (see Part 6: Additional Resources and Assistance).

EOTs are typically structured as either grantor trusts, where the selling owner temporarily pays taxes on the trust's earnings during the buyout period, or as perpetual trusts, which operate for the benefit of employees once the sale is complete. This flexibility allows owners to align the structure with their financing strategy and long-term ownership goals.

While EOTs share some conceptual similarities with worker cooperatives and Employee Stock Ownership Plans (ESOPs)—both provide broad-based employee benefits and ownership structures—they are far simpler to set up and maintain. An EOT does not require ERISA compliance, annual plan audits,

or external trustees in the same way as an ESOP, making it a lower-cost, values-aligned succession option for many small- to mid-sized companies. Likewise, EOTs are not a form of incorporation and do not have a set governance structure as worker cooperatives do, allowing owners to structure worker involvement in the company as they see fit.

Why an Owner Might Choose This Path

Owners often choose an EOT because it balances financial return, legacy preservation, and continuity. Unlike selling to a third party or private equity firm, a sale to an EOT keeps the business independent and locally rooted.

An EOT sale is typically structured around these key goals:

- **Fair market value sale:** The owner receives a fair price for their shares, supported by an independent valuation.
- **Flexible exit:** The sale can occur in stages or all at once, allowing for a gradual transition. Like an ESOP, EOTs can hold any percentage of the company.
- **Cultural and mission continuity:** The trust structure safeguards the company's purpose, values, and long-term independence.
- **Simplicity and cost-efficiency:** With fewer regulatory burdens than ESOPs and no requirement for employee buy-ins, the EOT can be established more quickly and affordably.
- **No repurchase liability:** Because employees are beneficiaries, not direct shareholders, the company avoids the ongoing repurchase obligations that ESOPs face.

Financially, EOTs are funded much like ESOP or cooperative transactions—using a combination of seller financing and outside lending. The company borrows funds to purchase some or all of the company's shares from the owner, then repays that loan using the company's future profits. Employees do not personally guarantee this debt.

Governance and Financial Rights

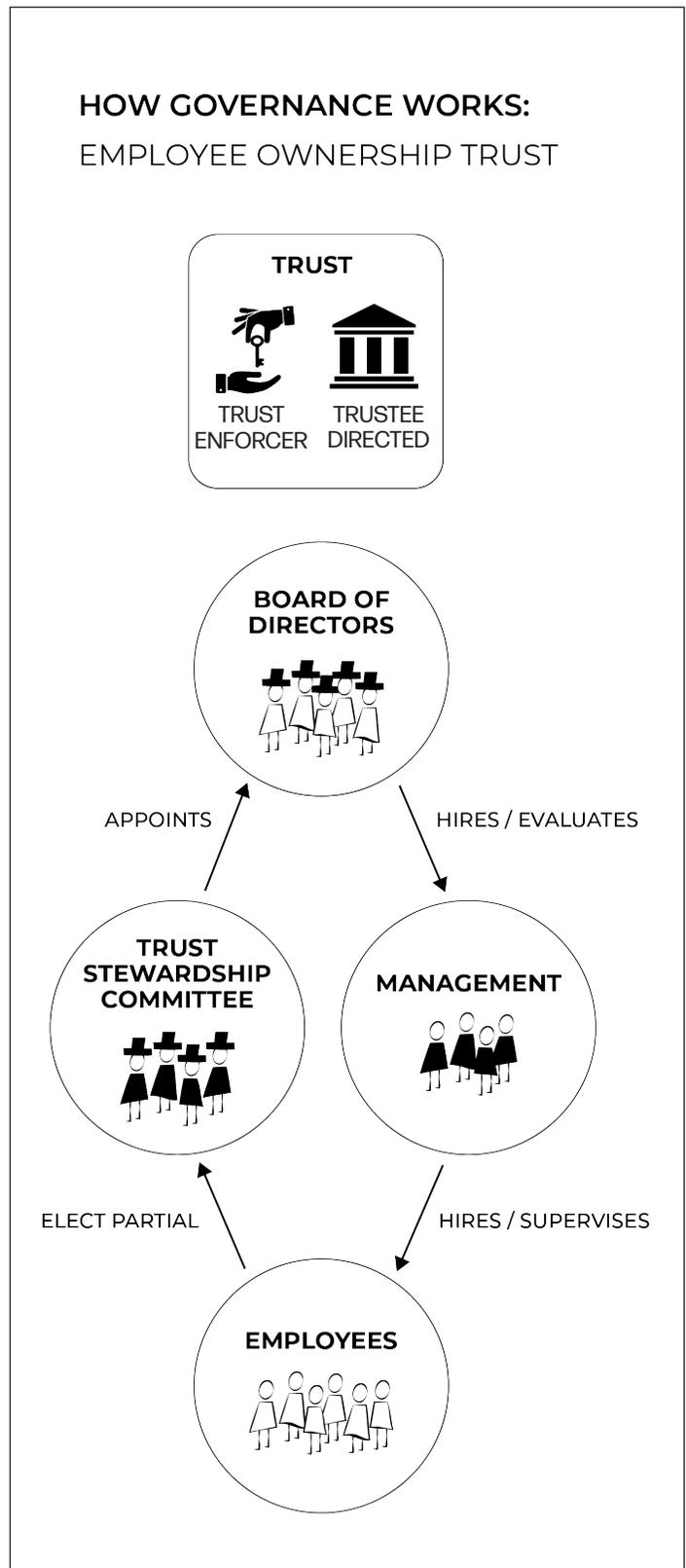
Under an Employee Ownership Trust, the company's shares are held collectively by a trust for the benefit of all employees. The trust—not individual employees—owns the company's stock. Employees are beneficiaries of the trust, meaning they share in the company's success through profit-sharing or bonus programs, rather than through direct stock ownership.

As depicted in the graphic to the right, governance in an EOT structure separates corporate management from trust stewardship:

- **The Board of Directors** – provides strategic oversight and ensures the company's long-term success. The board sets direction, approves major decisions, and oversees the management team, which typically runs day-to-day operations. Its fiduciary duty is to the company's overall health and sustainability.
- **The Trustee** – (either an individual or a corporate trustee) serves as the legal shareholder for the benefit of the trust's beneficiaries. The trustee's role is primarily fiduciary and administrative—to ensure that the company and its board operate in accordance with the trust agreement and that the trust continues to serve its stated employee-benefit purpose. The trustee does not participate in daily management or company strategy.
- **Trust Enforcee** – ensures conflicts between TSC, board, and/or management that arise are resolved in line with the trust document
- **The Trust Stewardship Committee (TSC)** – sometimes called an advisory or oversight committee—is an optional but increasingly common feature. It represents employee interests, advises the trustee, and ensures that the company's culture, values, and employee-benefit commitments are upheld over time. In many designs, the TSC includes employee representatives, independent members, and occasionally a member of the company leadership.

From a financial perspective, employees benefit through profit-sharing, annual bonuses, or other incentive programs

linked to company performance. These distributions are not tied to individual ownership accounts but to collective company success, reinforcing shared responsibility and transparency.



Structuring the Sale

An EOT sale is typically financed through a combination of seller notes and external financing. The owner sells some or all of their shares to the trust at fair market value, and the trust repays that loan over time using company profits. Repayment periods often range from five to ten years, depending on the company's cash flow and financing sources.

Depending on the owner's goals and financing structure, an EOT can be structured as either a grantor trust or perpetual trust. In a grantor trust, the selling owner temporarily pays income tax on the trust's earnings during the repayment period, simplifying compliance and reducing cash flow strain on the business. Once the debt is repaid, the EOT can convert to a perpetual form, operating indefinitely for the benefit of employees.

Due to their design, EOTs do not have to repurchase departing employees' shares as with an ESOP or maintain individual capital accounts as with a worker cooperative. This makes the EOT a stable, evergreen ownership structure, well-suited for companies that want to remain independent indefinitely. When structuring the transaction, an independent valuation determines fair market value. The sale may be completed in a single-stage transaction (selling all shares at once) or a multi-stage transaction (selling an initial majority stake, followed by remaining shares later). As with ESOPs, any percentage of the company can be sold to an EOT. The right approach depends on the company's financing capacity and the owner's transition timeline.

EOTs can be established as new entities that purchase the stock of an existing company, or—if state law allows—by converting an existing company into one owned by a trust. Owners should consult experienced legal and tax counsel to determine which approach best aligns with their tax objectives, financing structure, and operational continuity.

Tax Treatment and Legal Framework

As with other forms of employee ownership, understanding how taxes apply to both the selling owner and the ongoing company is essential to structuring a successful Employee Ownership Trust. While EOTs share similarities with ESOPs and worker cooperatives in that they provide employees with an economic benefit tied to company performance, their tax treatment is distinct and notably simpler.

EOTs trade the more complex regulatory and tax-deferred advantages of ESOPs for a simpler, lower-cost, and more

flexible ownership structure. While EOTs do not currently provide the same federal tax deferrals available to ESOPs, some states have begun introducing tax incentives to encourage employee ownership through EOTs.

Company and Trust

An EOT is not a qualified retirement plan under ERISA and, unlike worker cooperatives, does not fall under Subchapter T of the tax code. Instead, it is treated under federal law as a trust arrangement—typically a grantor trust during the buyout phase or a perpetual trust once the sale is complete.

In most cases, the company continues to operate as a C-corporation, S-corporation, or LLC, and its income taxes are filed as usual. The trust itself is generally not a separately taxed entity in the same way an ESOP trust is. Payments the company makes to service the sale debt—for example, loan repayments to fund the trust's purchase of stock—are not deductible, since they represent capital expenditures rather than business expenses. However, to the extent the company itself is directly servicing debt (e.g., on a seller note or third-party financing), it may be able to deduct the interest portion of those payments. This treatment keeps compliance straightforward for most companies.

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While the EOTs lack the specialized tax incentives of ESOPs or the cooperative-specific benefits of Subchapter T, they compensate with clarity, durability, and the ability to anchor ownership locally without ongoing regulatory complexity.

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The company can also deduct reasonable compensation and profit-sharing payments made directly to employees as beneficiaries of the trust, provided those payments qualify as ordinary and necessary business expenses under Section §162 of the Internal Revenue Code. These distributions—bonuses, incentives, or other forms of cash-based profit sharing—function as the primary vehicle for delivering company tax-deductible employee ownership benefits under the EOT model.

Where the trust is structured as a grantor trust, the selling owner (the grantor) continues to pay the income tax on the

The Ripple Effects of an Employee Owned Trust

Zoe Schlag, Common Trust



You've spent years – maybe decades – building something meaningful: creating jobs, serving customers, supporting your community, and shaping a company you're proud of. The question now is how to carry that impact forward for your business and your people when you're no longer at the helm.

Every ownership transition brings change – to leadership, to culture, and sometimes even to where the work happens. An Employee Ownership Trust (EOT) lets you set the pace of that change while maintaining continuity where it matters most. It's a proven, values-aligned exit that shares upside with employees, safeguards mission, and keeps the business independent.

How an EOT Works

An EOT is a purpose-driven trust that holds the company for the benefit of its people. The owner sells some or all of their shares to the trust at fair market value, set by an independent valuation. Employees become indirect, broad-based owners, participating through programs like profit-sharing or bonuses (no personal buy-in). Trustees oversee the trust to keep decisions aligned with its guidelines and employees' interests, and the existing leadership team typically stays intact to minimize day-to-day disruption.

In addition to being one of the simplest and most customizable ways to transition to employee ownership, EOTs are also among the most cost-effective exit strategies available.

Beyond the sale, an EOT is a long-term operating model, supporting employee engagement, sustaining culture, and building resilience.

Client Perspective: Clegg Auto

"The EOT structure offered the flexibility and customization we were looking for. It allowed us to design incentive structures that aligned with our goals and ensured long-term employee ownership."

– Kevin Clegg, CEO, Clegg Auto

Why an EOT Makes Strategic Sense

- **Sell at fair market value:** Independent valuation supports a fair, durable sale.

- **Exit on your terms:** You set the timeline, leadership handoff, and post-sale role.
- **Protect mission and culture:** A purpose-built trust safeguards independence and values.
- **Preserve jobs and know-how:** Continuity for employees and customers remains local.
- **No repurchase obligation:** EOTs avoid long-term cash drain from buybacks.
- **Sustainable ownership:** Long-term structure without the need for a future sale.
- **Resilience over time:** Employee-owned firms often retain talent and adapt through cycles.
- **Shared upside, local impact:** Profit-sharing supports retention and keeps dollars circulating locally.

The Ripple Effect in Action

We've seen this firsthand: a fair, values-aligned sale up front, followed by a second-order effect as wages flow back into the community – often through first-home down payments, college tuition, or purchases from other local businesses. In practice, shared ownership translates into stability for families, stronger local economies, and deeper commitment from people with a direct stake in the future.

Carrying Your Legacy Forward

Selling to your employees through an EOT doesn't just help you navigate a transition – it's a succession plan that balances financial return with legacy. It positions the company, and the people who helped build it, to thrive for the long haul. You exit at a fair price while preserving mission, relationships, and local jobs, keeping the value your business creates rooted in your community. people who helped build it, to thrive for the long haul. You exit at a fair price while preserving mission, relationships, and local jobs, keeping the value your business creates rooted in your community.

trust's earnings until the sale debt is satisfied, after which the trust is typically toggled to a non-grantor trust. During this period, the trust's assets remain, for tax purposes, under the grantor's ownership. This structure defers any tax liability for the employees while simplifying compliance for the company and allowing business income to be used pre-tax to service the seller note.

Selling Owner

For the selling owner, the sale of shares to an EOT is generally

treated as a capital transaction, with any gain realized subject to capital-gains tax. Unlike ESOPs, sales to an EOT do not qualify for the Section §1042 capital-gains rollover, which allows deferral of gains if the proceeds are reinvested in Qualified Replacement Property. Owners considering an EOT should weigh this difference alongside other transaction factors such as simplicity and cost.

However, this distinction often matters less than it might appear. Under standard estate-tax rules, when an owner

passes away, all property—including the stock sold to an EOT—typically receives a step-up in basis to its fair-market value at the time of death. This effectively eliminates capital-gains exposure on appreciated stock value, allowing owners who retain some portion of their wealth in company stock or related assets to achieve similar long-term tax efficiency through estate planning.

Because EOT tax treatment can vary based on company type (C-corp, S-corp, or LLC), trust structure, and seller objectives, owners should work closely with an experienced tax attorney or CPA familiar with both trust taxation and employee-ownership transactions.

Employee-Owners

Employees in an EOT do not own individual stock accounts and therefore do not experience capital gains from the appreciation of company shares. Instead, their participation occurs through profit-sharing, performance bonuses, or other cash-based benefits.

These distributions are taxable as ordinary income to employees in the year they are received and are subject to normal payroll and income-tax withholding. In this respect, EOT employee benefits resemble conventional company bonuses, though they are tied to company performance and the trust's long-term employee-benefit purpose rather than short-term metrics.

Because employees are not required to purchase shares or invest personal funds, there is no personal financial exposure, and no tax is owed until benefits are actually distributed. While EOTs lack the specialized tax incentives of ESOPs

or the cooperative-specific benefits of Subchapter T, they compensate with clarity, durability, and the ability to anchor ownership locally without ongoing regulatory complexity.

Challenges and Considerations

EOTs offer a streamlined and mission-aligned path to employee ownership, but they are not without challenges. Owners must be comfortable with the idea of indirect ownership—employees do not own individual stock—and with the model's limited liquidity (the trust, not a market, holds the shares indefinitely). Similarly, employee-owners will need to receive education regarding the indirect nature of ownership that an EOT creates.

Because debt repayment typically takes priority over employee distributions, early years may see fewer profit-sharing payouts. However, good planning can ensure that workers receive profit-sharing payments while the transaction debt is being paid. Transparency and communication are essential to helping employees understand the long-term value of the model and how servicing the debt from the transaction and employee profit sharing are balanced in the early years.

Finally, establishing a trustee and defining their role clearly within the trust agreement is critical. The trustee must ensure compliance with the trust's purpose while respecting the board's governance authority. As with cooperatives or ESOPs, success depends on establishing strong leadership, employee engagement, and a culture of accountability.

■ Part Five: Direct Stock Ownership and Hybrid Models

What It Is

Beyond the three primary forms of broad-based employee ownership—ESOPs, worker cooperatives, and employee ownership trusts—some companies create ownership opportunities by issuing stock directly to employees. This approach, often referred to as direct share ownership, allows a company to transfer a portion of its equity directly to its workforce without establishing a formal trust or cooperative structure.

In this model, employees personally hold shares in the company rather than through a collective entity. The result is a form of ownership that can be tailored to the size, goals, and culture of the business and its founder.

Direct share ownership can take many forms. In some companies, employees buy stock outright or through payroll deductions. In others, they receive shares as part of their compensation or as a reward for tenure or performance. What unites these approaches is that employees hold actual ownership stakes—complete with the potential for dividends, appreciation, and voting rights—rather than receiving only a financial benefit linked to company performance.

While many firms use direct share programs to encourage engagement or align incentives, they can also serve as a true ownership succession vehicle. In certain cases, especially for smaller or values-driven companies, direct share ownership allows a founder to transfer control gradually while maintaining

flexibility over structure and pace (see sidebar for a detailed example of how one such model works in practice).

Why an Owner Might Choose This Path

Owners who pursue direct share ownership are often motivated by flexibility. The structure can be designed to fit the size, culture, and goals of the business—without triggering the costs, complexity, or statutory requirements associated with an ESOP, worker cooperative, or a trust-based model. It also offers a way to reward employees who have contributed to the company's success while maintaining a close connection between ownership and day-to-day work.

For founders who want to transition ownership but retain some control or continue earning a return, direct share ownership provides a gradual path. The sale of shares can be staged over time, allowing the owner to diversify personal wealth while building an internal ownership base. For companies not yet ready for a full transition, it can be an intermediate step toward more formal employee ownership structures.

How the Deal is Structured

In a typical direct share ownership transaction, the company or its founder sells or grants shares directly to employees. Shares may be issued at fair market value, at a discount, or in exchange for continued service or performance milestones. Because shares are personally owned, employees assume

Direct Employee Ownership: A Flexible Pathway to a Legacy of Shared Success

Drew Mousetis, Tandem Center for Shared Business Success



For many business owners, the decision to transition ownership is one of the most personal and impactful moments of their career. It's not just about securing financial stability but about the people, culture, and values that built the business.

That was the case for Chip Cargas, founder of Cargas Systems, a Lancaster, Pennsylvania-based business software and consulting company. After nearly two decades working for other companies, Chip started Cargas with a simple concept: everyone would be in the know, work collaboratively, and share in the company's success.

As the company grew, that vision evolved from open-book management and profit sharing into something more enduring: direct employee ownership. "The lightbulb went off when I heard another business leader talk about the benefits of direct employee ownership," Chip recalled. "It was the final foundational piece I needed."

Why Direct Employee Ownership?

When Cargas had just 15 employees, ESOPs and other ownership structures didn't make sense financially or operationally. Direct employee ownership provided a simpler, more flexible alternative. Employees could buy shares directly using payroll deductions, profit sharing, bonuses, or out-of-pocket payments. The company could offer grants or bonuses in stock, and ownership could be transitioned gradually over time.

This flexibility was key for Chip. At 51, he wasn't ready to step away, but like many owners, most of his net worth was tied up in the business. Direct employee ownership allowed him to sell shares incrementally, diversifying his personal assets while keeping a meaningful stake. For employees, it meant the chance to invest early, build wealth alongside the company, and choose their own pace. By age 77, Chip worked his way to 100% retirement and 0% ownership, and the next generations of employee-owners are continuing his legacy.

Unlike ESOPs, where ownership is indirect and tied to retirement, direct employee ownership creates a tangible, immediate connection. Employees can attend shareholder meetings, vote for the board, and see their names on stock certificates. That visibility fosters a deeper sense of accountability and pride, which, for Cargas, outweighed the tax advantages of an ESOP.

How the Tandem Model for Direct Employee Ownership Works

The Tandem model for direct employee ownership is a flexible framework created by Tandem Center for Shared Business Success. It combines three elements: employee engagement, broad profit sharing, and stock ownership open to all employees. The model is designed so each company can adapt it to fit its size, goals, and workforce.

Stock Purchase and Grants

Stock purchases usually take place twice a year, with a modest

minimum such as \$300. All regular employees can participate from the start, and many companies make it easy through payroll deductions.

Profit sharing and bonus payouts can be timed with these purchase opportunities, giving employees the option to use part of their payout to buy stock. This connection makes ownership more accessible and helps employees steadily build their stake.

Grants can further accelerate participation. For example, an employee might receive a \$1,000 stock grant after their first purchase, with additional grants at higher ownership levels. Some companies also add stock-based bonuses tied to performance, requiring a portion of the payout to be taken in stock.

Rules and Buybacks

Direct employee ownership requires clear rules for buying and selling stock. If an employee leaves or wishes to sell, the company has the right to buy back the stock and typically exercises it. Restrictions, such as maximum purchase amounts and waiting periods between sales and new purchases, help maintain stability. In C corporations, some companies also allow stock donations to nonprofits via community foundations.

Costs Compared to ESOPs

Direct employee ownership is far less complex and costly to set up than an ESOP. There is no need for a trust, no federal compliance process, and no large up-front transaction. The trade-off is fewer tax benefits. ESOPs provide powerful tax advantages but involve high legal and administrative costs.

The Tandem model allows flexibility. Companies can set eligibility rules, offer a mix of purchase and grant programs, and pace the ownership transition over many years. Employees pay for shares with after-tax income, often supported by company incentives, which reinforces their commitment.

Gradual Transition for Owners

For selling owners, direct employee ownership makes it possible to transfer ownership in small steps. Stock can change hands in increments as small as fractions of a percent. Owners can sell gradually, diversify assets, and still retain a stake as the company grows. With enough time and profitability, the entire transition can occur without borrowing. If the timetable is shorter, borrowing may be needed by the company or employees.

This incremental process avoids the disruption of a single large sale and gives employees time to grow into their new role as owners. Over time, second and third generations of employee-owners can establish themselves, carrying forward the culture and stability the founder hoped to preserve.

both the benefits and risks of ownership: their investment value depends on the company's performance.

To maintain control and protect liquidity, many companies establish an internal buy-sell agreement or repurchase policy. This allows departing employees to sell their shares back to the company or to a designated buyer at an independently determined fair market value. The repurchase obligation ensures that shares remain within the company and that employees can eventually realize the financial value of their ownership without relying on an external market.

Because shares in privately held companies do not trade publicly, direct share ownership programs rely on regular independent valuations to establish fair market value for stock purchases and redemptions. Most companies obtain an annual third-party appraisal or maintain an internal marketplace based on a defensible valuation formula, ensuring transparency and compliance while providing employees with predictable liquidity.

Unlike an ESOP, there is no single statutory framework that governs direct share ownership. Instead, each program is structured according to the company's goals, size, and desired level of employee participation. Companies should work closely with qualified attorneys, accountants, and valuation professionals to ensure that the plan complies with tax, securities, and corporate governance requirements. Every plan must also include a clear mechanism for liquidity—most often through an internal buy-sell agreement that requires the company to repurchase shares at fair market value when employees leave. Some firms stop there, while others develop a more formal internal marketplace that allows active employees to buy and sell shares during designated trading windows. Each approach carries its own requirements for valuation, vesting, and liquidity management.

Tax and Governance Considerations

Because shares are owned outright, employees may have voting rights and the ability to participate in company decisions. However, the degree of influence varies depending on share classes and company bylaws. Many firms issue nonvoting shares to preserve decision-making authority while still linking employees' financial interests to company performance.

From a tax perspective, there are no special deferrals or rollover provisions as with ESOPs and worker cooperatives.

Gains or losses on employee-held shares are generally treated as capital gains when sold. For the company, issuing shares may dilute existing ownership but does not typically create a deductible expense unless shares are granted as part of compensation. Companies must also plan for the long-term cost of repurchasing shares and managing valuations—tasks that require periodic appraisal and professional guidance.

Challenges and Considerations

Direct share ownership can strengthen employee commitment and financial engagement, but it also introduces administrative and cultural considerations. Valuing and repurchasing shares requires ongoing attention, and ownership among a small group of employees can create unequal dynamics if not managed transparently. Clear communication about valuation, rights, and liquidity is essential to sustaining trust and maintaining a sense of fairness across the workforce.

Because employees own individual shares rather than through a trust, liquidity events—such as redemptions or buybacks—must be carefully planned to avoid cash flow strain. These challenges make professional support important, particularly around valuation, securities compliance, and plan design.

Other Approaches to Sharing Equity

While direct share ownership can function as a full succession tool, many companies that share equity with employees do so through equity compensation or profit-sharing plans. These mechanisms tie part of employees' pay or bonuses to company performance and value but typically stop short of transferring permanent ownership or governance rights to employees. They are common in both public and private firms and are often used as tools for attraction, retention, and alignment.

- **Stock Options** give employees the right to purchase stock at a set price in the future. If the company's value increases, employees can buy shares below market price and realize a gain. Options are primarily a long-term incentive rather than a form of ownership until exercised.
- **Restricted Stock and Restricted Stock Units (RSUs)** grant actual shares or the promise of shares once certain conditions—such as time or performance—are met. Employees may receive dividends or voting rights

once stock vests, but these awards are generally used to reward key talent rather than create broad-based ownership.

- **Phantom Stock and Stock Appreciation Rights (SARs)** mimic the value of company stock without transferring actual shares. Both allow employees to benefit from the company's financial growth, but they differ in how that value is calculated and paid out. Phantom stock typically mirrors the full value of a share, while SARs reward employees only for the appreciation in value over time. In both cases, payouts are usually made in cash, giving privately held companies a way to share financial success without the complexity of adding new shareholders or issuing equity.
- **Employee Stock Purchase Plans (ESPPs)** allow employees to buy company stock, often at a discount through payroll deductions. While these programs are most common in publicly traded firms, private companies can also implement similar plans if they have reliable share valuation and buyback mechanisms in place. In either case, employees become direct shareholders, typically holding modest ownership stakes. ESPPs are generally designed to encourage participation and financial alignment rather than to facilitate ownership succession.
- **Profit- and Gain-Sharing Programs** distribute a portion of the company's financial success to employees, but they do so in different ways. Profit-sharing typically allocates a set percentage of overall company profits to employees as cash bonuses, linking rewards directly to the bottom line. Gain-sharing, on the other hand, ties rewards to measurable improvements in productivity, cost savings, or team performance—allowing employees to benefit more immediately from operational gains even in periods when overall profits may be flat. While not tied to equity, both models mirror ownership outcomes by aligning employees' rewards with company success.

All of these approaches are governed by written plan documents, securities and tax regulations, and board oversight. They are flexible, widely used, and can operate independently or alongside other ownership structures.

Hybrid and Complementary Approaches

Many broad-based ownership companies combine these tools to reinforce engagement and retention. An ESOP company, for example, may also maintain a profit-sharing or bonus program to reward short-term results, or offer stock appreciation rights or performance shares to executives to attract and retain leadership talent. In some cases, direct share ownership companies use similar layered structures, granting additional stock or incentive awards like profit sharing to strengthen alignment with key employees.

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Owners who pursue direct share ownership are often motivated by flexibility. The structure can be designed to fit the size, culture, and goals of the business.

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These hybrid structures recognize that ownership is both financial and cultural. Long-term wealth-building through ownership can coexist with near-term performance incentives, allowing companies to reinforce accountability and shared success at multiple levels. By combining broad-based ownership with targeted incentive tools, companies can balance inclusivity, motivation, and sustainability—creating systems that reward both collective and individual contributions to growth.

Additional Resources and Assistance

Support Organizations

- **The Employee Ownership Expansion Network (EOX) / State Employee Ownership Centers** – a national nonprofit dedicated to creating employee ownership centers in all 50 U.S. states. These centers promote all forms of employee ownership. The main EOX website includes links to individual state center websites, allowing business owners and companies to connect with local support and resources in their state or region. www.eoxnetwork.org
- **National Center for Employee Ownership (NCEO)** – A nonprofit organization providing research, education, and practical resources on all forms of broad-based employee ownership, for both selling owners and existing employee-owned companies. www.nceo.org
- **Ohio Employee Ownership Center (OEOC)** – Based at Kent State University, the OEOC is the nation's longest continually operating state employee ownership center. It advances employee ownership through three main areas: technical assistance for business owners considering a sale to employees, education and training for employee-owned companies, and research and advocacy on the impact of employee ownership. www.oeockent.org
- **Rutgers Institute for the Study of Employee Ownership and Profit Sharing** – leading academic research center in the U.S. dedicated to the study of employee ownership, profit sharing, and broad-based capital participation. smlr.rutgers.edu/eo
- **U.S. Federation of Worker Cooperatives (USFWC)** – The national membership organization for worker-owned and democratically run businesses. The USFWC advances worker ownership through education, advocacy, and a network that connects and supports cooperative businesses across industries. www.usworker.coop
- **Democracy at Work Institute (DAWI)** – A national organization that supports the growth of worker cooperatives and employee-owned businesses by providing data, training, and technical assistance for conversions, start-ups, and ecosystem building. www.institute.coop

- **The ICA Group** - Founded in 1977, the ICA Group is the oldest national organization dedicated to the development of worker cooperatives and employee ownership models. The ICA Group provides technical assistance and support services for both startup and conversions to worker cooperatives. www.icagroup.org
- **Purpose Trust Ownership Network (PTON)** - A nonprofit organization dedicated to advancing purpose-trust ownership and employee ownership trusts in the U.S. PTON develops educational tools and best-practice resources, supports academic research and financing innovation, and helps business owners and advisors explore long-term ownership models that embed mission, values, and employee benefits. www.trustownership.org
- **Tandem Center for Shared Business Success** - A nonprofit organization that helps business owners implement direct employee ownership, where workers hold shares and participate in profit-sharing without using an ESOP or cooperative structure. Tandem provides education, technical assistance, and tools to design and sustain shared ownership models. www.tandemcenter.org
- **Transform Finance** - Transform Finance is an organization that helps investors and businesses align financial strategies with long-term community and stakeholder value. It provides research, education, and advisory support to encourage investment approaches that strengthen both business performance and social outcomes. The organization also maintains a national database of investment funds and vehicles that support employee ownership transitions across the United States. www.transformfinance.org
- **The ESOP Association (TEA)** - a national trade association that advocates for ESOPs and public policy engagement for employee-owned companies and their advisors. Also includes a local chapter network that offers training and education opportunities, which vary by local chapter. www.esopassociation.org

Books and Other Materials

Broad Overviews of Employee Ownership

- **Chris Cooper and OEOC Staff. Business Succession Planning: An Owner's Manual. 2022.** A comprehensive guide for business owners exploring succession planning options, including employee ownership. The manual walks readers through key steps, timelines, financing options, and real world examples.
- **Corey Rosen and John Case. Ownership: Reinventing Companies, Capitalism, and Who Owns What. 2022.** Argues that expanding employee ownership across all business forms—ESOPs, cooperatives, and employee ownership trusts—can help reduce inequality and build a fairer economy, combining policy insight with contemporary case studies.
- **Joseph Blasi, Richard Freeman, and Douglas Kruse. The Citizen's Share: Putting Ownership Back into Democracy. 2013.** Explores the history, economics, and policy arguments for broad-based employee ownership as a means to strengthen both businesses and democratic society, and provides case study examples and findings from nationally representative surveys.
- **Joseph Blasi, Richard Freeman, and Douglas Kruse. Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options. 2010.** Published by the National Bureau of Economic Research, this book analyzes how various forms of shared capitalism—such as employee ownership, profit sharing, and stock options—affect company performance and worker outcomes, using large-scale national survey data.
- **Corey Rosen, John Case, and Martin Staubus. Equity: Why Employee Ownership Is Good for Business. 2005.** Explains how employee ownership improves productivity, profitability, and workplace culture, using real-world examples from successful ESOP companies to show how broad-based ownership creates alignment between employees and management.

Book Length Case Studies

- **John Abrams. From Founder to Future: A Business Roadmap to Impact, Longevity, and Employee Ownership. 2024.** Shares lessons from Abrams's experience leading South Mountain Company, a worker cooperative, showing how a values-driven business can transition to employee ownership to achieve long-term stability, community impact, and shared prosperity.
- **Robert Beyster and Peter Economy. The SAIC Solution: How We Built an \$8 Billion Employee-Owned Technology Company. 2nd Edition, 2014.** Tells the story of how Science Applications International Corporation (SAIC) grew from a six-person start-up into an employee-owned enterprise of more than 40,000 people through an ESOP, becoming one of the largest technology and engineering firms in the United States.

Research and Case Studies on Employee Ownership

- **What the Research Says: The Impact of Employee Ownership** – A comprehensive online website summarizing decades of research on employee ownership and its effects on business performance, employee outcomes, and community stability. Created and maintained by the National Center for Employee Ownership (NCEO), the site distills findings from hundreds of academic and practitioner studies into clear, accessible summaries.
<https://www.nceo.org/research/research-findings-on-employee-ownership>
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- **Curriculum Library for Employee Ownership (CLEO)** – The world's largest online library of employee-ownership teaching and research materials, hosted by the Institute for the Study of Employee Ownership and Profit Sharing at Rutgers University. CLEO offers more than 600 case studies, syllabi, journal articles, videos, and policy reports covering ESOPs, cooperatives, and other shared-equity models. **cleo.rutgers.edu**

Contributors

Dan Bender is part of the commercial banking team at First Financial Bank, where he works with privately held and middle-market companies on financing, credit structuring, and strategic capital needs. First Financial Bank provides business banking, commercial lending, and treasury services across the Midwest.

- DanBender@westfield-bank.com
- www.bankatfirst.com

Brian Bornino is a Managing Director at GBQ Capital Advisors and leads the firm's valuation practice. GBQ is a national valuation, financial advisory, and transaction consulting firm serving closely held and middle-market businesses.

- BBornino@gbq.com
- gbq.com

Sarah Crisp is a Co-Executive Director of The Industrial Commons, an organization that develops worker-centered manufacturing businesses in Western North Carolina. The Industrial Commons integrates education, workforce development, and cooperative entrepreneurship.

- sarah@theindustrialcommons.org
- www.theindustrialcommons.org

Allison Curtis is a Senior Program Manager at the ICA Group, a national nonprofit consultancy specializing in worker-centered business development. ICA provides technical assistance, financial modeling, and conversion planning for cooperative and shared-ownership enterprises.

- acurtis@icagroup.org
- www.icagroup.org

Mike Frommelt is the CEO of Strategic Talent Partners, a firm specializing in executive recruiting and leadership transitions. He advises companies on talent strategy, succession planning, and preparing leadership teams for ownership change.

- mfrommelt@strategictalentpartners.com
- www.strategictalentpartners.com

Tim Jamison is a Managing Director at Prairie Capital Advisors, where he focuses on valuation, corporate finance, and ownership transition planning. Prairie Capital is a national investment banking and advisory firm serving middle-market companies.

- tjamison@prairiecap.com
- prairiecap.com

Drew Mousetis is Program Director at the Tandem Center for Shared Business Success, where he supports companies exploring broad-based ownership models. The Tandem Center provides education, technical assistance, and transition planning for shared-ownership strategies with a focus on direct share ownership.

- dmousetis@tandemcenter.org
- www.tandemcenter.org

Zoe Schlag is the CEO of Common Trust, an investment and advisory firm that structures long-term, mission-aligned ownership transitions. Common Trust specializes in Employee Ownership Trust (EOT) conversions and multi-stakeholder ownership models.

- zoe@common-trust.com
- www.common-trust.com

Nick Sypniewski is a Managing Director at Comstock Advisors, specializing in valuation and financial advisory services for private and middle-market companies. Comstock Advisors provides independent valuations, fairness opinions, and transaction analysis.

- nsypniewski@comstockadvisors.com
- www.comstockadvisors.com

Ginny Vanderslice is a Senior Consultant at Praxis Consulting Group, where she specializes in leadership development, organizational culture, and governance. Praxis supports mission-driven and participatory organizations through coaching, facilitation, and strategy design.

- ginny@praxiscg.com
- www.praxiscg.com

Eric Zaleski is a Managing Director at PCE, where he advises business owners on mergers and acquisitions and on strategic liquidity options. PCE is a national investment banking firm focused on valuation, ESOP advisory, and corporate finance.

- ezaleski@pcecompanies.com
- www.pcecompanies.com

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Selling Your Business To Your Employees

An Overview Of Employee Ownership Models and Strategies

Employee Ownership is an exit strategy that can provide you with flexibility in how and when you exit the business, a chance to reward employees that helped build the business, significant tax savings, all while priming the company for future growth. This book will provide an overview of the most common forms of broad based employee ownership. Inside you will find:

- A general overview of the most common forms of broad based employee ownership
- Detailed sections for each form of employee ownership including governance and financial rights, how transaction is structured and common challenges and considerations
- A series of short segments from professionals in the field of succession planning and employee ownership

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