

## ESOP Shares Sold to a Corporation Mid-Year Without a Special Valuation

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An interest-free loan can be used to avoid the cost of a special mid-year valuation when the corporation wishes to purchase a former employee's shares from an Employee Stock Ownership Plan instead of having them recycled through the ESOP.

Assume an ESOP with a plan year ending December 31. Assume a former employee's benefit is being distributed around 6/30/11. He wants to exercise a put for the entire \$250,000 benefit and the company wants to pay him a lump sum. The company wants to deposit cash into the ESOP and purchase the shares from the ESOP. This would normally call for a "down-dated letter" or a special valuation. Further assume that the shares can't simply be distributed to the participant first, with an option for the participant to "put" the shares to the corporation. This is usually the case when the employer is an S corporation or when the articles of incorporation preclude ownership by non-employees.

The company can make an interest-free loan to the ESOP on 6/30/11, in the amount of \$250,000. With that deposit the company would give the trustee a letter indicating this is *not* an advance contribution but, instead, an interest free loan to be paid back in

shares once the next appraisal is completed. The participant's benefit is then paid from the ESOP with this cash.

In this example, the company enters into an interest-free loan transaction on, say, 6/25/11, to purchase \$250,000 worth of shares, but based on the 12/31/11 price per share. Once the 12/31/11 appraisal is completed, we know exactly how many shares were purchased (\$250,000 divided by the price per share); and those shares are transferred back into the corporate treasury.

Why do we call it an interest-free loan instead of an advance contribution? Because it is not a contribution; it is not deductible; and it is to be paid back (in shares) at year-end. It is a true loan.

Normally a loan to a plan would be a prohibited transaction. However, the IRS Prohibited Transaction Exemption 80-26 (as amended on 3/1/02) permits this kind of a transaction and provides more details on how this is done.

If we can be of any help with the design, installation, or administration of an ESOP, please don't hesitate to contact us.

