

Insights

IS AN ESOP RIGHT FOR MY BUSINESS?

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Ownership transitions are rarely simple. Many founders seek liquidity and a clear succession plan, while also wanting to preserve their company's legacy, culture, and people. In the right circumstances, an employee stock ownership plan (ESOP) can offer a compelling solution - providing an exit opportunity for owners while giving employees a meaningful ownership stake through a qualified retirement plan.

When evaluating whether an ESOP makes sense, business owners often ask a series of key questions: What is an ESOP? When is it commonly used? How do the tax benefits work? What are the practical trade-offs? Answering those questions requires careful analysis. Experienced legal, financial, and valuation advisors play a critical role in assessing feasibility and designing an ESOP structure that aligns with both the company's objectives and its long-term strategy.

WHAT EXACTLY IS AN ESOP?

An ESOP is a tax-qualified employee benefit plan that holds company stock on behalf of participating employees. In an ESOP transaction, a business owner sells all or a portion of his or her shares and those shares are ultimately acquired by the ESOP. Those shares are held in the ESOP as security for the loan taken out by the ESOP to acquire those shares, and then are allocated over time to employees' ESOP accounts based on the plan's design, typically as part of their overall retirement benefits and generally without any out-of-pocket investment by employees.

For owners, an ESOP can serve multiple purposes: it can function as a buyer of the company's shares, support a succession strategy, and facilitate a gradual transition of ownership to the next generation of leadership, all while allowing the business to remain independent.

ARE ESOPS COMMON?

ESOPs are a well-established ownership and benefits model in the United States. According to the National Center for Employee Ownership, as of January 2026 there are more than 6,500 ESOPs in the U.S., collectively employing 10.7 million people, and holding more than \$2.1 trillion in assets.

ESOPs are especially common among small- and middle-market businesses. Privately held ESOP companies are frequently found across a range of industries, including professional services, manufacturing, construction and contractors, finance and insurance, and wholesale trade.

WHY WOULD A BUSINESS OWNER CONSIDER AN ESOP?

While every ESOP transaction is unique, the reasons business owners consider this structure tend to fall into four core themes:

SUCCESSION PLANNING

An ESOP can provide a structured path to transition ownership when there is no obvious internal successor or attractive third-party buyer.

TAX ADVANTAGES

Depending on the company's entity type and transaction structure, ESOPs can potentially offer an opportunity to avoid immediate tax on the sale of the shares by the owner, allowing for a tax-free rollover into certain other US stock and bonds. It may also allow the company to operate essentially free of federal (and most state) income taxes. .

REWARDING AND RETAINING EMPLOYEES

ESOPs offer a retirement benefit that aligns employees' interests with company performance, helping attract, motivate, and retain talent over the long term.

MARKET AND CULTURE ADVANTAGES

By reinforcing independence and preserving legacy, ESOPs can help sustain a company's culture and foster an ownership mindset that supports stability and growth.

WHAT ARE THE TAX BENEFITS OF AN ESOP?

The potential tax benefits of an ESOP can be significant, but they depend heavily on the company's tax status— most notably whether the company is structured as an S-corp or a C-corp and on how the transaction is designed and executed.

S-CORP

For an S-corp, the portion of the business owned by the ESOP is generally exempt from federal income tax. In practical terms, if an S-corp becomes 100% ESOP-owned, it may be able to operate without incurring federal income tax at the corporate level. This tax shield indirectly benefits the selling shareholders by both increasing cash available to repay seller notes and accelerating the increase in value of the stock of the company.

C-CORP

For a C-corp, tax benefits primarily accrue at the shareholder level. A selling shareholder may be eligible to defer capital gains tax through a “1042 exchange” under Section 1042 of the Internal Revenue Code. In broad terms, a qualifying C-corp owner who sells shares to an ESOP and reinvests the proceeds in qualifying replacement property (including certain U.S. company stocks and bonds) will defer capital gains taxes. In some cases, that capital gains tax may be avoided if the reinvested assets are held until death.

In addition, ESOPs are often described as the only way a company can use pre-tax dollars to buy out current owners. In a typical leveraged ESOP, the ESOP borrows funds to purchase company shares, and the company makes tax-deductible contributions to the ESOP to service the debt. Subject to applicable limits and structure, both principal and interest can be deductible.

HOW DOES AN ESOP BENEFIT EMPLOYEES?

For employees, an ESOP can serve as a meaningful, long-term retirement benefit tied to the company’s overall value and performance. Employees typically receive allocations of company stock through the ESOP, most often without having to contribute their own cash—unlike a 401(k) plan, which generally relies on employee contributions. Over time, as the company’s stock value grows due to paying off transaction debt and growth in its business, the ownership stake given to participants in the ESOP can represent a significant component of total retirement benefits, often exceeding other forms of retirement benefits.

Beyond individual retirement outcomes, ESOPs can also influence the broader employment experience. By keeping ownership within the company, an ESOP transaction often helps preserve independence and continuity while creating an ownership culture in the company. Compared to a sale to private equity or a strategic buyer— transactions that can sometimes lead to restructuring or shifts in control—an ESOP more often allows the existing management team to remain in place and the business to continue operating with less outside influence. Often, retaining the business in a small community can serve an important civic purpose as well.

CAN AN ESOP REALLY MAKE A DIFFERENCE IN HOW EMPLOYEES WORK?

It can. In our experience, companies where employees understand the connection between day-to-day decisions and the company’s long-term value often see higher engagement and stronger operating discipline. When employees have a meaningful stake in the business, it can reinforce an “owner mindset” that supports productivity, growth, and retention. The best ESOP companies use employee involvement in a structured and empowering way, often producing large productivity gains for the company.

WHAT SIZE COMPANY IS A GOOD FIT FOR AN ESOP?

There is no single profile that fits every ESOP, and suitability often depends on a combination of industry, capitalization, and long-term goals. That said, there are practical thresholds that tend to make an ESOP more feasible.

As a general rule of thumb, companies with at least 25 employees and annual EBITDA exceeding \$2 million are often better positioned to support an ESOP structure and the attendant costs. At this scale, the company is more likely to generate sufficient cash flow to fund the transaction and absorb the ongoing administrative, valuation, and compliance costs associated with maintaining the plan. That said, BCLP's ESOP team generally works with companies with an enterprise value of at least \$40 million.

WHAT ARE THE TRADE-OFFS AND RISKS TO UNDERSTAND?

ESOPs are not a one-size-fits-all solution and understanding both the trade-offs and risks involved is critical to determining whether this structure is the right fit. Common considerations include:

EXIT TIMELINE AND ONGOING INVOLVEMENT

An ESOP is often not the best option for owners seeking an immediate exit. In many cases, owners remain involved in the business for several years to support leadership transition, operational continuity, and the company's ongoing performance. Sellers also oftentimes receive seller notes and warrants as part of their transaction consideration, which by their nature are continue to be tied to the ongoing performance of the company.

LEVERAGE AND BALANCE-SHEET CAPACITY

ESOP transactions often involve the incurrence of significant amounts of debt, so the company must be able to sustain recapitalization and maintain a healthy cash flow.

REPURCHASE OBLIGATION

As employees vest in their ESOP accounts and later leave the company or retire, the company is required to repurchase their shares. For private ESOP companies, this can require repurchasing roughly 2%–5% of shares annually once the plan matures, depending on workforce demographics and plan design.

PROFITABILITY AND PREDICTABILITY

ESOPs generally work best for established, profitable businesses with predictable earnings. For startups or businesses that are not yet profitable, or are experiencing financial distress, the cost and structural demands of an ESOP often outweigh the benefits.

WHAT SHOULD OWNERS DO IF THEY WANT TO EXPLORE AN ESOP?

Start by assembling the right advisory team. Implementing an ESOP involves considering ERISA and general tax compliance, transaction structuring, valuation, fiduciary processes, and ongoing plan administration. Contact a member of BCLP's ESOP team to discuss whether an ESOP is feasible for your business and what a prudent evaluation process should look like.

RELATED CAPABILITIES

- ESOP
- Employee Benefits & Executive Compensation

MEET THE TEAM



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