How Proceeds from ESOP Sales Compare to Those from Other Buyers

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How Proceeds from ESOP Sales Compare to Those from Other Buyers

Most owners who sell to an employee stock ownership plan (ESOP) are focused more on legacy and values than price. They have spent much of their lives building a great business and want to see the people who have helped build it carry it forward. Other owners, however, want to consider all their options and may be concerned that selling to an ESOP means giving up significant value. They may have heard that selling to an ESOP means giving up some of what they could get by selling to another buyer.

When these owners consider an ESOP, the first question is often whether the purchase price will match what another buyer would pay. The more useful question is what the owner will net, and when, after fees, taxes, and financing terms. Below, we outline the key mechanics that shape those outcomes.

How Do the Proceeds from Selling to an ESOP Compare to Those from Another Buyer?

An ESOP is essentially a financial buyer that can often match an alternative financial buyer's price. Individual investors and private equity firms are typical examples of financial buyers, although some private equity firms may be willing to offer a synergistic price depending on their other holdings. But a common misconception is that selling to a strategic buyer will always be a more fruitful transaction for the owner than selling to an ESOP. Although there are certainly cases where that can be true, many sellers find that ESOP transactions can produce proceeds comparable to, or even better than, those from selling to all but the most aggressively priced buyers, especially once transaction costs, taxes, and financing terms are considered.

The NCEO has previously discussed why selling to an ESOP often involves lower transaction costs than selling to another buyer[1] and how costs, contingencies, and outcomes may differ between ESOP sales and third-party sales.[2] The NCEO found that selling to an ESOP costs about 2% to 4% of the total deal price, while selling to another buyer costs 4% to 9%. Here, we focus on what drives seller proceeds in an ESOP transaction: how the price is determined, what the key tax considerations are, and how seller financing can change total returns.

How an ESOP Sale Works

In an ESOP transaction, the company establishes an ESOP trust to acquire shares from the selling shareholder. Employees do not buy the shares. Instead, the company funds the ESOP through ongoing pretax contributions.

A company can transition ownership gradually through annual contributions, but more often the ESOP purchase is financed, typically with a combination of senior debt and seller notes. In a leveraged ESOP:

1. Corey Rosen, *Why Selling to an ESOP Costs Less than Selling to Another Buyer* (NCEO, 2026), available at https://www.nceo.org/employee-ownership-blog/new-nceo-paper-finds-selling-to-an-esop-costs-less-than-selling-to-another-buyer.
2. "Selling to an ESOP vs. a Conventional Sale: Pros, Cons, and Costs," NCEO, accessed September 4, 2026, https://www.nceo.org/what-is-employee-ownership/selling-to-an-esop-versus-conventional-sale.

- The company borrows money and re-loans it to the ESOP (often called the internal loan).
- The ESOP uses the funds to purchase shares from the seller.
- The company makes tax-deductible contributions to the ESOP, and the ESOP uses those contributions to repay the internal loan.

ESOPs can purchase anywhere from a minority stake to 100% of the company. Fully ESOP-owned transactions are increasingly common, with senior lenders generally funding less than half of the purchase price and seller notes financing the balance. Seller notes are junior to senior debt and may include delayed principal payments or other subordination features.

Shares held in the ESOP are allocated to eligible employees over time, typically 20 years or more. In addition, participant (employee) accounts in the ESOP become vested over time, up to six years. Participation must be broad-based, and generally all full-time employees who have worked for a year or more are in the plan. Employees typically receive distributions after they leave the company, subject to plan terms. You can dive deeper into how ESOPs work in the article How an Employee Stock Ownership Plan (ESOP) Works.

Major Tax Benefits of ESOP Transactions

ESOPs can create meaningful tax advantages for the company and, in some cases, for the selling owner(s), including:

- Tax-deductible funding of the purchase. Company contributions to fund an ESOP are tax-deductible, within the applicable limits. Because the ESOP's purchase is financed over the long term through company contributions to the ESOP, the purchase price will ultimately be expensed, resulting in tax deductions for the purchase price. For example, a $10 million stock redemption that would normally require roughly $14 million in pretax earnings (which yields $10 million in after-tax earnings) to fund would cost only $10 million through an ESOP.
- Potential capital gains deferral under Section 1042 (for a qualifying sale). In a qualifying "1042 rollover," sellers to an ESOP can defer capital gains taxes by reinvesting the proceeds in stock and bonds of US operating companies. Taxes are deferred until the replacement investments are sold. Any investments held until death are stepped up in basis, so no capital gains taxes are paid. The full deferral applies only to sales to an ESOP in a company that is or converts to C status and in which the ESOP owns at least 30% of the stock. A recent change to the Internal Revenue Code, effective in 2028, will provide a tax deferral for 10% of the capital gains when the company is an S corporation.
- Potential ongoing tax advantages for S corporations with ESOP ownership. Because S corporation income is generally taxed at the shareholder level, the portion of earnings attributable to an ESOP (a tax-exempt trust) is not subject to federal income tax. For example, an ESOP owning 30% of an S corporation will not pay federal income tax on its share of the company's earnings. In a 100% ESOP-owned S corporation, no federal taxes at all will be levied on the company's earnings as a result of the ESOP's ownership. The ESOP must receive a pro rata share of any distributions paid to other shareholders, however.

How ESOP Shares Are Valued

In a transaction where the ESOP is buying stock, the ESOP cannot pay more than fair market value. The ESOP trustee, ideally an independent fiduciary with ESOP transaction experience, retains an outside financial advisory firm to advise on valuation and financial matters to support its negotiations with the seller on price.

In an ESOP transaction, the financial analysis provided to the ESOP trustee by its financial advisors informs the negotiations between the trustee (as buyer, acting on behalf of the ESOP trust) and the seller on the purchase price. The valuation advisor will provide to the ESOP trustee a conclusion expressed as a defensible range of value from which the trustee will negotiate with the seller. At closing, the trustee's financial advisor will issue a fairness opinion to the trustee indicating that the ESOP has not paid more than adequate consideration and that the transaction is fair to the ESOP from a financial point of view. The opinion will be supported by a report detailing the financial advisor's analyses, including its valuation of the company.

As noted earlier, ESOP fair market value reflects what a hypothetical financial buyer would pay for the company based on expected future cash flows and risk, not what a synergistic buyer might pay if it expects additional value from combining operations. A strategic buyer may justify a premium based on anticipated synergies. The ESOP cannot pay for synergies it will not realize.

That said, even where a strategic premium exists, the difference in after-tax outcomes may be smaller than it first appears, particularly once transaction costs and contingent consideration (such as earnouts, escrows, or indemnities) are factored in.

How Seller Notes Can Outperform a Higher Strategic Price

Many ESOP transactions include seller notes for a meaningful portion of the purchase price. Because seller notes are typically junior to senior debt, advisors often structure them to provide a higher expected all-in return than bank debt provides. The components of the return on seller notes include interest and often warrants. Warrants provide an opportunity for additional upside if the company's value grows post-transaction.

Seller Note Returns: Interest Rates and Warrants

Advisors often structure seller notes with lower rates of interest than the expected all-in return, and sometimes even lower than the interest rates on senior debt. This is done to ease the burden on cash flow created by the interest on the additional tranche of debt (i.e., the subordinated debt provided by the seller).

To augment the return, advisors will have the company grant the seller warrants as part of the overall deal structure. Warrants are financial contracts that grant the holder the right to purchase shares at a stated price written into the contract (the "exercise price"). Upon the exercise of the warrants, the holders will receive the value represented by the difference between the exercise price and the company's stock price at the time of the exercise. Therefore, if the stock price at exercise is higher than the exercise price, the warrant will provide an additional payoff to the seller.

Warrants typically have exercise periods of up to 10 years, although they generally are not eligible for exercise until the subordinated seller notes are repaid in full. The economics of the terms of the notes and warrants are evaluated by the ESOP trustee's financial advisor and reviewed by the trustee to ensure the overall package is fair to the ESOP.

Sellers often view the "notes + warrants" structure as an opportunity to earn an attractive return, with a mix of fixed income and capital appreciation from the warrant in a company they know well and whose ability to service its debt and grow in value they have confidence in. In addition, if the seller remains active in the company's leadership, they can influence the ultimate outcomes of their ongoing investment in a way that other investments cannot provide. However, sellers give up the benefit of diversification on this portion of their total proceeds.

Below is a simplified illustration of how an ESOP can compete even at a lower headline price.

Assume an owner has two options:

- *Strategic buyer:* $15 million cash at closing.
- *ESOP:* $10 million in total consideration, including a seller note.

Strategic buyer assumptions:

- The seller's tax basis in the stock is $3 million, resulting in a $12 million capital gain.

- 25% all-in capital gains rate (federal + state),[3] resulting in a capital gains tax of $3 million and after-tax proceeds of $12 million.
- The annual compounded rate of return on cash proceeds is 10%.

ESOP transaction assumptions:

- $4 million cash at closing (from senior debt).
- $6 million 10-year seller note at a 14% all-in expected return (interest + warrants).
- The seller elects to defer capital gains arising from the sale to the ESOP.
- The annual compounded rate of return on cash proceeds is 10%.

Over a 10-year investment horizon, assuming the seller notes provide the 14% all-in expected return assumed above, the investment returns in dollar terms would be approximately 5% higher from the ESOP transaction, despite the strategic sale yielding a 50% higher price.

The above analysis does not consider the differences in cost to execute each transaction, and it also does not reflect the possibility that, in a strategic transaction, the seller may be required to take back seller notes (although likely for a shorter period of time). In addition, the all-in return on the seller notes issued in an ESOP transaction may exceed the 14% assumed above if the company performs very well, allowing it to repay the subordinated seller debt faster and thereby yield a larger return from the warrants.

While this analysis simplifies the factors that can impact actual results, it reflects the potential for ESOP transactions to yield results comparable to even those of strategic transactions.

3. The all-in federal capital gains rate approaches 24%, and many states levy their own capital gains tax in excess of 1%. As a result, the 25% rate assumed here is generally on the lower end of the range.

Additional Considerations: Timing and Risk

ESOP transactions can be highly successful, but it is also critical to consider timing and risk, in addition to potential earnings upside. For instance:

- *Payment timing.* Strategic sales often deliver most proceeds at closing, though earnouts, escrows, required seller financing, and indemnities can delay or reduce the final net proceeds. In addition, in a sale to a private equity firm, the seller may be required to reinvest some of the sale proceeds in that firm. In ESOP sales with seller notes, a meaningful portion of proceeds is paid over time.
- *Credit risk.* While defaults are widely viewed as uncommon in ESOP transactions, they are not impossible. In some cases, companies renegotiate seller note terms if performance falls short of projections. Some deals may include explicit contingent provisions tied to performance.
- *Warrant risk.* Warrants have value only if the company's share value rises above the exercise price during the exercise window.

The Bottom Line

An ESOP sale may not always match the top strategic bid on headline price, but the net outcome can be competitive once tax advantages, lower transaction costs, and seller financing economics are included. For many owners, the decision comes down to a tradeoff between potentially higher total proceeds over time and the timing and risk profile of payments, particularly when seller notes and warrants are part of the structure. The right answer depends on the company's cash-flow durability and financing capacity and on the seller's priorities around liquidity, legacy, and ongoing involvement.

About the Authors

Corey Rosen

Corey Rosen is the NCEO's founder and former executive director and now is its senior staff member. Corey has spoken on various subjects related to employee ownership all over the world with government, business, and union leaders, and he is regularly quoted in leading magazines and newspapers. He has appeared on national television and radio programs and also has authored four books on employee ownership, plus more than 100 articles for various business, academic, and professional publications. He has authored or coauthored several of the NCEO's practical and research publications. He holds a PhD in political science from Cornell University.

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Eric Zaiman is a managing director in J.P. Morgan's ESOP Advisory Group (EAG), where he serves as its national credit manager, overseeing the credit aspects of EAG's activities. In this capacity, Eric advises on credit and structuring issues across EAG's geographic footprint. A 37-year banking and financial industry veteran, Eric has been active in the ESOP community for nearly 30 years, including with such firms as Valuemetrics and Duff & Phelps, where he represented companies in structuring transactions and ESOP trustees.

Regina Carls

Regina Carls is a managing director and head of J.P. Morgan's ESOP Advisory Group (EAG). She helps bankers and their privately held clients evaluate the benefits of selling stock to an ESOP and creating liquidity for the owners. Regina led the initial development of EAG in 2007 and quickly became a liaison across the firm, helping analyze and structure complex ESOP financings. Over the course of EAG's 19-year history, Regina has built J.P. Morgan's ESOP practice into a market leader in banking for ESOP companies. Regina has been with J.P. Morgan for more than 34 years. Before leading EAG, Regina served as a division manager within middle market banking, where she gained broad finance experience.

About the NCEO

We are the National Center for Employee Ownership (NCEO), a nonprofit organization that has been supporting the employee ownership community since 1981. We have thousands of members because we help people make smart decisions about employee ownership, with everything from reliable information on technical issues to inspiration to help companies reach the full potential of employee ownership.

We generate original research, facilitate the exchange of best practices at our live and online events, feature the best and most current writing by experts in our publications, and help employee ownership companies build ownership cultures where employees think and act like owners.

Whether you are considering employee ownership, managing an existing plan, or advising clients, we can help. Our members have access to all of our online resources, and we are committed to providing extensive materials for anyone interested in learning more about employee ownership, from people considering employee ownership to decision-makers at employee-owned companies to ESOP participants to journalists to stock plan administrators and other service providers. We welcome everyone to sign up for our email list on our website and to visit our blog.

Our staff covers the nation from multiple locations in the US, and our board includes representatives from employee-owned companies and the professional advisors who serve them.

We are supported almost entirely through membership fees and our activities, but we do accept donations, which are tax-deductible (we are qualified as a 501(c)(3) nonprofit charitable organization).

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