

Insights

IRS Issues Notice Regarding ESOP Compliance

August 22, 2023

On August 9, 2023, the Internal Revenue Service (the "IRS") issued a cautionary statement to business owners, plan sponsors, individual taxpayers, advisors, and attorneys concerning a range of compliance issues associated with employee stock ownership plans ("ESOPs"). The IRS emphasizes the need to ensure proper administration, valuation, and adherence to regulations to prevent compliance issues. Non-compliance could lead to adverse tax consequences for both plan sponsors and participants. The IRS Notice can be found [here](#).

Specifically, the IRS noted that it has identified issues related to the (i) valuation of employer stock, (ii) prohibited allocation of shares to disqualified persons, and (iii) failure to follow tax law requirements for ESOP loans. The IRS additionally stated that it will take a more aggressive approach to review ESOP transactions to ensure they are consummated in accordance with federal law.

The IRS indicated that some of its concerns on these issues stem from aggressive marketing from "promoters focused on marketing questionable transactions." In its Notice, the IRS provided an example of one such promoted "scheme" where a management S corporation whose stock is wholly owned by an ESOP is set up for, what the IRS claims, diverting taxable business income to the ESOP from another entity. Such S corporation then provides loans to the business owners of that other entity in the amount of the business income to avoid taxation of that income. Krieg DeVault would not recommend such schemes to our clients.

Many ESOP advisors and professionals are concerned that the IRS warning statement could have a chilling effect on employee ownership. This would go against Congress's encouragement of employee ownership, which is shown by the recently proposed Employee Equity Investment Act of 2023 which would provide federal loan guarantees for the sale of small businesses to ESOPs.

Krieg DeVault has significant experience in advising business owners and trustees on establishing and selling stock to an ESOP. Having assisted in the consummation of over 500 ESOP implementation transactions, and assisted with compliance for ESOPs with over 44,000 participants in 45 different industries, we know how to successfully establish and maintain ESOPs in accordance with federal laws and regulations. If you're uncertain about the legality of ESOP transaction structures being promoted to you and have concerns, we're here to help by offering expert legal advice and assistance.

If you have any questions or would like to discuss this latest article in more detail, please contact **Lisa A. Durham** or another member of Krieg DeVault's **Employee Benefits & Executive Compensation Practice**.

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