

The Economics of ESOPs for S Corporations

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The following is an update of an article originally written in 1998 and published in the Summer 1998 edition of The Journal of Employee Ownership Law and Finance. This update reflects the impact of the Jobs and Growth Tax Relief Reconciliation Act of 2003. The Act lowered personal tax rates as well as tax rates on dividends and capital gains.

Changes in the tax law enacted in the Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997 allowed S corporations to have an employee stock ownership plan ("ESOP") as a shareholder. This broadened the opportunity for implementing employee ownership to include many of the businesses presently organized as S corporations. In addition, existing ESOP companies can now make the S corporation election. This option prompts an examination of whether ESOP companies are better off operating as C corporations or S corporations.

The primary purpose of this paper is to analyze the economic differences to shareholders depending on whether the company operates as:

- a C corporation
- a C corporation with an ESOP
- an S corporation
- an S corporation with an ESOP

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To examine the effect of each structure on the shareholders of the company, I will begin by creating a hypothetical company to illustrate the differences between the structures. In these examples, the operations of the company are identical except for the difference in tax treatment resulting from either making an S election or choosing ownership by an ESOP. There is much to say in this area; for purposes of this article, I will concentrate on the simple situation where the ESOP owns 100% of the company. This approach allows the economic differences to be clearly illustrated.

Tax Differences

The general rules regarding the tax treatment of the different structures is as follows:

- **C Corporation:**
The company's income is taxed at corporate tax rates to the corporation. Dividends paid to shareholders are also taxed to the shareholders. This effectively creates a "double tax" on the earnings. The shareholders will receive long-term capital gains treatment on the sale of stock to the extent of their gains, assuming the stock has been held for 12 months.
- **C Corporation with an ESOP**
The company's income is taxed at corporate tax rates to the corporation. Dividends used to repay an ESOP loan or passed through to ESOP participants may be deductible by the corporation. Dividends received by the ESOP are generally not taxable because the ESOP is normally a tax-exempt trust. Capital appreciation on the shares owned by the ESOP is generally not subject to taxation. The participant in the ESOP will ultimately be subject to ordinary income tax rates on the distributions from the ESOP trust or a rollover trust (such as an IRA), presumably during retirement when the taxpayer may be in a lower tax bracket.
- **S Corporation**
The company's income is taxed directly to the shareholders in proportion to their

relative shareholdings. Distributions of earnings may or may not be made each year. Such distributions are generally not taxable to the extent that they represent distributions of previously taxed income to shareholders. Capital appreciation is taxed at capital gains rates, although undistributed earnings increase basis and have the effect of reducing capital gains.

- **S Corporation with an ESOP**
The company's income is taxed directly to its shareholders. Because the ESOP is not a taxable entity, its share of the earnings is not subject to federal tax. Capital appreciation on the shares owned by the ESOP is not subject to taxation. As with an ESOP in a C corporation, the distributions from the trust will ultimately be taxable as ordinary income to the beneficiaries.

Description of Hypothetical Company

The hypothetical company has sales of \$10 million and operates at a 15% profit margin. The operating value of the company is assumed to be six times earnings before interest and taxes (EBIT). Revenue is expected to grow 6% per year. Corporate taxes are assumed to be 34% and the shareholders' personal tax rate is assumed to be 35% for ordinary income and 15% for capital gains. I have ignored the impact of state taxes for the purpose of our analysis.

For simplicity, let us assume that the company is purchased for \$9 million. This is based upon an EBIT of \$1.5 million times a multiple of six. To further simplify, we have assumed that the company is purchased for cash and has no debt on its books. This assumption will allow us to examine the ESOP and S corporation election separately from the company's financial structure. Let us also assume that at the end of five years the stock of the company will be sold for cash.

For the purpose of this comparative analysis, I have developed a five-year economic model. The value of the firm's operation is assumed to



be six times the current year EBIT. The market value of the company is assumed to be the firm's operating value plus cash balance. My model assumes that the company will need to invest in fixed assets and working capital to support its growth in revenue. The model further assumes that at the end of the fifth year, the company is sold based upon a price of six times EBIT plus cash balances.

Initially, let us examine the four different structures assuming that all free cash flow is retained by the business. Free cash flow is defined as the amount of cash available for distribution to the owners of the business. Generally it is net income plus depreciation and amortization minus investments in fixed assets and net investments in working capital. The four structures are the C corporation (Exhibit 1), the C corporation with a 100% ESOP (Exhibit 2), the S corporation (Exhibit 3), and the S corporation with a 100% ESOP (Exhibit 4).

Under each structure, assume the company earns 5% on its cash balances. Also assume that the company's pension plan expenses, aside from the funds received through dividends and distributions, are the same under each structure. Because no dividends or distributions are paid, the cash flow available to the shareholders is based solely upon the proceeds of the sale of stock at the end of the five-year time period. The gain on the sale of the stock must be tax affected in order to determine the after-tax cash flow available to the shareholders at that time.

Each of the following examples calculates the return on investment, which is defined as net income divided by the market value of the firm. Also calculated is the internal rate of return to the shareholder. This is defined as the rate, which equates the present value of the after-tax cash flows to the shareholders to the initial investment in the company. Because of the differences in tax treatment of each structure, the internal rate of return to shareholders appears to be a suitable method for use in ranking the different structures.

Analysis

C Corporation

The first example is the C corporation (Exhibit 1). The return on investment is 14.5% in year one declining to 11.9% in year five. The reduction in the overall return on investment results from the decreasing risk of the business as evidenced by the growing cash balances. The value of the company at the end of five years is \$16.6 million, consisting of \$12.0 million in operating value and \$4.6 million in cash. Over the five-year period, the stock appreciated by \$7.6 million. This appreciation produces \$1.1 million in capital gains tax upon the sale of the stock. Based upon an initial investment of \$9.0 million and after-tax proceeds from the sale of stock of \$15.5 million, the internal rate of return on an after-tax basis is 11.5%.

C Corporation with 100% ESOP

The second example is the 100% ESOP C corporation (Exhibit 2). The return on investment is identical to that of the C corporation. The only difference stems from the fact that the sale of stock at the end of the five-year period does not result in the payment of capital gains tax because the stock is owned by a qualified plan. Accordingly, the \$9.0 million investment results in after-tax proceeds to the shareholder of \$16.6 million. The internal rate of return on the investment to the shareholder increases to 13.1% as compared to the 11.5% for the C corporation.

S Corporation

The third example is the S corporation (Exhibit 3). The return on investment is significantly greater than the C Corporation structure because no taxes are paid at the corporate level. The return on investment is 20.7% in year 1 declining to 15.2% in year 5. As with the other structures, the return declines over time as the company increases its cash balances. Each year, a smaller percentage of the company's assets are invested in risky business assets as compared to cash, which is a risk free type of asset. With the S corporation, the shareholder will be required to make tax payments based upon the income of the corporation. This analysis assumes that no distributions or



dividends will be paid. This means that the shareholder will need to invest additional cash flow in terms of tax payments until the stock is sold at the end of the fifth year. In this case, the initial investment was \$9.0 million. An additional \$3.5 million in tax payments would be made over the five-year period.

At the end of the fifth year, the operating value of the business is \$12.0 million and the accumulated cash is \$8.2 million, for a firm value of \$20.2 million. The cash flow available upon the sale must be reduced by the capital gain tax on the sale of the stock. A sale price of \$20.2 million and an adjusted basis of \$18.9 million results in a taxable gain of \$1.3 million. Based upon a tax rate on capital gains of 15%, the tax on sale would be \$0.2 million. The S corporation structure results in after-tax proceeds of \$20.1 million. Taking into consideration the initial investment amount and tax payments by the S corporation shareholder the resulting rate of return is 11.9%.

S Corporation with 100% ESOP

The fourth example is the S corporation with a 100% ESOP (Exhibit 4). The return on investment is 20.7% in year 1 declining to 15.2% in year 5. This is the same return on investment as the S corporation without an ESOP. Because the ESOP owns 100% of the stock, there is no tax paid on the corporate income attributable to the ESOP, as it is exempt from tax on such income.

At the end of the fifth year, the operating value of the business is \$12.0 million and the accumulated cash is \$8.2 million for a firm value of \$20.2 million. The cash flow available upon the sale of the stock was not reduced for taxes since an ESOP owns the stock. With a purchase price of \$9.0 million and a sale price of \$20.2 million, the internal rate of return available to the ESOP of the S corporation is 17.6%

Comparison by Structure Type

A comparison of the value at the end of the five-year period and the after-tax internal rate of return to the shareholders for investing in the company under each structure is summarized in

the following chart. These observations assume no dividends or S distributions are paid.

**Comparison of Values and IRR
Based on Structure Type (Non-Distributing)**

	Initial Value	Residual Value	IRR
Regular C	\$9.0	\$15.5	11.5%
Regular C – ESOP	\$9.0	\$16.6	13.1%
Subchapter S	\$12.5	\$20.1	11.9%
Subchapter S – ESOP	\$9.0	\$20.3	17.6%

Initial Value for Subchapter S No ESOP includes \$3.467 million in tax payments by shareholders on corporate income.

Based upon the observation summarized above, it is clear that the ESOP structure is more efficient in accumulating capital as compared to the non-ESOP structures. It is also quite evident that the S corporation ESOP’s internal rate of return (IRR) is superior to the C corporation ESOP’s IRR. This analysis considers only tax differences and does not include any other factors such as the potential for increased productivity as a result of employee ownership and participation.

A comparison would not be entirely complete if we did not take into consideration that the assets accumulated in a qualified plan will, upon distribution to the plan beneficiary, be taxed at the beneficiaries’ personal tax rates. What impact does this have on the desirability of the structure? The answer to this question is dependent upon both the differences in the rates of return between the ESOP and non-ESOP structures and on the characteristics of the individual plan participants. The participant’s years until retirement and personal tax rate must be taken into consideration. Longer time periods and large differences in the rate of return tend to favor the use of the ESOP as a more efficient structure to accumulate capital. Longer time periods allow the impact of compounding returns at higher rates to offset the negative impact of paying ordinary personal tax rates when distributing assets to plan participants. Lower personal income tax rates may be available if participants’ income tax rates decline at retirement. In contrast to the ESOP structures where ordinary income tax rates would be



applied on the value of all distributions, capital gains rates would be available on the accumulated appreciation in the non-ESOP structures.

Now that we've examined the economic impact of the tax structure on the rates of return to investors in a hypothetical company that has no debt, let us next examine the impact of changes to some of our initial assumptions.

Impact of Dividend/Distribution Policy

The following analysis compares the internal rates of return for each structure (see exhibits 5 through 8) type assuming that the company pays out 100% of its free cash flow as a dividend or distribution. In each case, the internal rate of return is greater for a distributing company than for a non-distributing company.

Comparison of Internal Rates of Return Based upon Corporate Type (Distribution)

	Initial Value	Dist./ Div.	Residual Value	IRR
Regular C	\$9.0	\$3.6	\$11.6	12.4%
Regular C - ESOP	\$9.0	\$4.2	\$12.0	14.3%
Subchapter S	\$9.0	\$4.1	\$11.8	13.8%
Subchapter S - ESOP	\$9.0	\$7.3	\$12.0	20.3%

Dividends on Regular C and distributions on Subchapter S are after the impact of personal taxes at a 35% rate.

The internal rates of return are generally higher in the distributing example because the company's free cash flow is retained and the accumulated cash is invested in low risk investments like a money market account. The accumulated cash is assumed to earn only a 5% return, which is considerably lower than the rate of return on the company's risky business assets. As a result of accumulating cash in the non-distributing examples, the risk of the business is reduced by the excess cash balances thereby reducing the IRR in the non-distributing examples.

Impact of Debt

The initial examples here assume the company had no debt. This was necessary to simplify the comparisons of the different structures and create a common financial structure for the

purpose of comparing the alternatives. Transactions involving the purchase of a company's stock by an ESOP often involve the use of borrowed funds. These loans can be repaid through contributions to the plan or through dividends or distributions on stock held by the plan.

The impact of debt typically increases the financial risk of the company. This means that the equity holders will require a higher rate of return to be compensated for the added risk caused by the debt. This impact exists no matter which tax structure the company chooses. For ESOP companies, financial risk may be reduced because both the interest and principal on ESOP acquisition loans are normally tax deductible. The corporate income tax expense of an ESOP company would be less than an identical company with a non-ESOP loan having the same terms and conditions. This results in enhanced cash flow to service debt, thereby reducing financial risk as compared to a standard loan whose principal must be repaid out of after-tax cash flow.

Impact of a Less-Than-100% ESOP

Assuming the company is not 100% ESOP owned, the analysis of the internal rates of return discussed above are still valid except that the after-tax rates of return are different for ESOP and non-ESOP shareholders. Assuming that our C corporation has a 50% ESOP stockholder and a 50% individual stockholder, the returns to the ESOP stockholder would be similar to that of the C corporation ESOP and the returns to the non-ESOP stockholder would be similar to that of the C corporation. Based upon the example above for a non-dividend paying company, the 50% ESOP shareholder would receive \$8.3 million in proceeds upon sale (or a 13.1% IRR) and the 50% individual stockholder would receive \$7.4 million in after-tax proceeds (or a 11.5% IRR). The same analogy holds true for the less than 100% ESOP companies that have made an S election.



Another effect of having less than a 100% ESOP results from the difference in dividend treatment for the C corporation relative to the treatment of distributions for the S corporation. Because the C corporation can include more than one class of stock, it is not uncommon for the securities purchased by the ESOP to have superior dividend rights compared to the common stockholders of the company. In many cases the ESOP purchases either a convertible preferred stock or a common stock with a superior dividend. A security with a dividend preference is often structured to overcome the limitations on contributions to service the ESOP debt or to reduce the dilution in value on the stock held by the remaining shareholders. Because a separate class of stock can be produced for C corporation ESOP's, a structure can be created whereby the ESOP receives dividends from its security while the common stockholders do not. This allows the corporation to retain greater earnings that can be used to grow the business.

The S corporation allows only one class of stock to be issued and outstanding. Each share must be identical with regard to the rights of the holders with the exception that differences in voting rights are permitted. As was discussed previously, the S corporation's income and expenses are divided among, and passed through to its shareholders. The shareholders must in turn report the income and expenses on their personal tax returns. Where the corporation is profitable, the taxable income to the shareholders is increased without regard to the company's decision to pay out distributions sufficient for its shareholders to meet the personal tax obligation on their share of the corporation's net income. This involves distributions to the shareholders of up to 35% for federal taxes, plus distributions for any state and local taxes.

Thus, several distribution issues arise for a corporation with a less-than-100% ESOP. S corporations can have only one class of stock. Consequently, all shareholders must receive the same distribution on a per-share basis. It is not possible to create a second class of stock like

that available to a C corporation. Therefore, the economic effect to the company is that less cash flow would likely be retained in the less-than-100% S corporation ESOP than would be retained by the equivalent C corporation ESOP. The resulting impact on the shareholders of the S corporation ESOP would be that the ESOP shareholders would receive distributions without necessitating any tax payments, whereas the other shareholders would receive distributions of which a substantial portion would have to be paid as personal income tax. In essence, a portion of the tax that would have to be paid by the C Corporation to the Internal Revenue Service is, in the case of the S corporation ESOP, paid to the ESOP trust, where it accumulates for the benefit of the participants.

Impact of Tax Policy

The difference between personal income tax rates and corporate income tax rates may also affect the attractiveness of making an S election. Currently, the highest marginal personal tax rate is comparable to corporate tax rates. However, the avoidance of double taxation on dividends leads many companies to make an S election. If personal rates increase relative to corporate rates, the net advantage of an S election could disappear. If tax rates generally increase, ESOPs would become more attractive relative to non-ESOP structures because increased tax deferral opportunities would materialize under the ESOP structures.

The above comparison of structure by type we assumed that at the end of five years the stock would be sold for cash. With the S corporation structure, there is an added advantage in that the assets of the company could be sold without triggering a capital gain to the corporation if it has been an S corporation for at least 10 years or since its inception. If the company converted to S status within ten years, the taxable gain on the sale of assets would be based on the market value of the assets at the time of the conversion, with the appreciation in value from the date of the S election escaping corporate capital gains tax. This is significant to buyers and sellers because buyers of assets will likely pay more for assets than for stock when the assets of the



company have appreciated in value. Buyers of assets can obtain a larger depreciation deduction for appreciated assets than is available in a stock transaction.

Issues Relating to the S Corporation ESOP

There are several potential disadvantages to the use of S corporation ESOPs. One of the issues that must carefully be considered is that the deferred recognition of gain on the sale of stock to an ESOP (Internal Revenue Code Section 1042 “Rollover”) is not available for stock of S corporations. This favorable tax treatment is often a significant motivating factor to the seller and frequently is the key to the creation of new ESOP companies. For existing C corporations, a transaction making use of section 1042 treatment could be structured and at a later time the company could make an S election. Once the S election is made, the remaining stockholders can no longer take advantage of Section 1042 unless the company converts back to a C corporation. (Note that once the S election is terminated, it cannot be reinstated for five years.) The key will be to negotiate a transaction price that is fair to both parties, given that in many cases only the buyer (S election) or the seller (1042 treatment) can obtain favorable tax treatment in an ESOP transaction.

Both S and C corporations can contribute up to 25 percent of covered payroll to the ESOP. However, for C corporations, the interest payment on the ESOP loan does not count toward the 25 percent limit, but in S corporations, it does. Furthermore, with C Corporation ESOPs, the payroll limitation can often be overcome through the creation of a super-dividend paying common stock or convertible preferred stocks. These options are not available for an S corporation since an S corporation can only issue one class of stock.

Most S corporations make distributions to cover the personal tax obligations of the company's shareholders. Even though the ESOP does not have a tax obligation to pay, it must receive pro rata distributions with the other shareholders. If

the company has both an ESOP and other shareholders, the required pro rata payout to the ESOP reduces the cash available to reinvest in the business. On the positive side, the cash in the ESOP also creates liquidity that could be used to repay ESOP debt, pay cash distributions to terminating employees or to purchase additional new shares.

Despite these disadvantages, the increased rate of return on stock of S corporation ESOPs creates a huge advantage to ESOP participants. This advantage is unique to the structure of combining an ESOP with an S corporation.

Valuation of the S Corporation ESOP

A key element of the economic impact of an ESOP company's S election is the effect of the election on the stock value. The impact of making an S election on the value of a company's stock has been debated in valuation literature for many years. Opinions on this issue range from the S election having no impact on the value of the company to the value being increased proportionately with the taxes saved. This debate has become even more pronounced with the added tax benefits of the S corporation ESOP.

Of key importance in this debate is the definition of fair market value. Fair market value is generally defined as the price at which the stock would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all relevant facts. This definition has generally been interpreted to refer to a hypothetical buyer and seller in the marketplace, and is not a personalized one, which envisions a particular buyer and seller.

Based upon this definition of fair market value, it appears that the special characteristics associated with an S corporation ESOP should not be factored into the valuation analysis. The ESOP is a particular buyer that has unique tax attributes not available to the hypothetical buyer envisioned in the definition of fair market value.



Assuming that fair market value is determined without regard to the special tax treatment available for S corporation ESOPs, an interesting issue exists. The issue results from the fact that the economic value of the stock to the plan participants may be greater than the fair market value of the stock in an arm's length transaction with a hypothetical willing buyer. Therefore, it may be in the best interest of the plan participants to maintain the Subchapter S ESOP structure rather than to sell the stock in a transaction that may be at or even slightly above the stock's fair market value.

Conclusion

It is clear from the above analysis of the economics of an S corporation ESOP that it can be an extremely attractive option as a result of the potential tax savings from combining an S election and an ESOP. The tax savings can be either retained to grow the value of the business or paid out as additional distributions to shareholders. In either case, the after-tax returns available to the ESOP are greater than those available to non-ESOP shareholders. While, under the definition of fair market value, it may not be appropriate to increase the value of the stock for the higher returns resulting from the expected tax savings on shares owned by an ESOP, the value of the S corporation ESOP stock should be enhanced over time by the value of the tax savings retained by the business.

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About the Author

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Rick is a Senior Member of the American Society of Appraisers and is a cofounder of ComStock Advisors. He has over 20 years of experience in the valuation and management of closely held business interests, as well as securities comprising their capital structure. He has extensive background in trust and estate planning, Employee Stock Ownership Plans (ESOPs), litigation support, and related financial advisory service. He has acted as an arbitrator and has served as an Expert Witness or Consulting Expert regarding financial issues in the United States Federal Tax Court and the United States District Court.



Exhibit 1
Regular C Corporation
No Dividends

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income		19	59	103	150	202
Pretax Profit	1,500	1,609	1,744	1,889	2,044	2,209
Taxes	510	547	593	642	695	751
Net income	990	1,062	1,151	1,247	1,349	1,458
Cash	-	762	1,595	2,505	3,496	4,576
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	8,182	9,460	10,842	12,334	13,943
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	6,062	7,213	8,460	9,809	11,267
Total Liabilities and Equity	7,000	8,182	9,460	10,842	12,334	13,943
Dividend Payments		0	0	0	0	0
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		762	1,595	2,505	3,496	4,576
Total Value	9,000	10,302	11,708	13,224	14,859	16,620
Appreciation		1,302	1,406	1,516	1,635	1,761
Dividends		0	0	0	0	0
Total Return		1,302	1,406	1,516	1,635	1,761
% Return		14.5%	13.6%	13.0%	12.4%	11.9%
Dividends		0	0	0	0	0
Tax Payments by Shareholder		0	0	0	0	0
Residual Value						15,477
After Tax Cash Flow	(9,000)	0	0	0	0	15,477
Internal Rate of Return		11.5%				
Total Value (Residual Year)						16,620
Appreciation						7,620
Tax on Appreciation						(1,143)
After Tax Residual Value						15,477



Exhibit 2
 Regular C Corporation - 100% ESOP
 No Dividends

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income		19	59	103	150	202
Pretax Profit	1,500	1,609	1,744	1,889	2,044	2,209
Taxes	510	547	593	642	695	751
Net income	990	1,062	1,151	1,247	1,349	1,458
Cash	-	762	1,595	2,505	3,496	4,576
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	8,182	9,460	10,842	12,334	13,943
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	6,062	7,213	8,460	9,809	11,267
Total Liabilities and Equity	7,000	8,182	9,460	10,842	12,334	13,943
Dividend Payments		0	0	0	0	0
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		762	1,595	2,505	3,496	4,576
Total Value	9,000	10,302	11,708	13,224	14,859	16,620
Appreciation		1,302	1,406	1,516	1,635	1,761
Dividends		0	0	0	0	0
Total Return		1,302	1,406	1,516	1,635	1,761
% Return		14.5%	13.6%	13.0%	12.4%	11.9%
Dividends		0	0	0	0	0
Tax Payments by Shareholder		0	0	0	0	0
Residual Value						16,620
After Tax Cash Flow	(9,000)	0	0	0	0	16,620
Internal Rate of Return	13.1%					
Total Value (Residual Year)						16,620
Appreciation						7,620
Tax on Appreciation						0
After Tax Residual Value						16,620



Exhibit 3
Subchapter S Corporation
No Distributions

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income		33	103	180	266	361
Pretax Profit	1,500	1,623	1,788	1,967	2,160	2,368
Taxes	-	-	-	-	-	-
Net income	1,500	1,623	1,788	1,967	2,160	2,368
Cash	-	1,323	2,793	4,423	6,226	8,216
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	8,743	10,659	12,760	15,063	17,583
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	6,623	8,411	10,378	12,538	14,907
Total Liabilities and Equity	7,000	8,743	10,659	12,760	15,063	17,583
Distributions		0	0	0	0	0
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		1,323	2,793	4,423	6,226	8,216
Total Value	9,000	10,863	12,906	15,142	17,588	20,260
Appreciation		1,863	2,043	2,237	2,446	2,671
Distributions		0	0	0	0	0
Total Return		1,863	2,043	2,237	2,446	2,671
% Return		20.7%	18.8%	17.3%	16.2%	15.2%
Distributions		0	0	0	0	0
Tax Payments by Shareholder		(568)	(626)	(688)	(756)	(829)
Residual Value						20,057
After Tax Cash Flow	(9,000)	(568)	(626)	(688)	(756)	19,228
Internal Rate of Return		11.9%				
Total Value (Residual Year)						20,260
Appreciation						11,260
Tax on Appreciation						(203)
After Tax Residual Value						20,057



Exhibit 4
Subchapter S Corporation - 100% ESOP
No Distributions

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income		33	103	180	266	361
Pretax Profit	1,500	1,623	1,788	1,967	2,160	2,368
Taxes	-	-	-	-	-	-
Net income	1,500	1,623	1,788	1,967	2,160	2,368
Cash	-	1,323	2,793	4,423	6,226	8,216
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	8,743	10,659	12,760	15,063	17,583
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	6,623	8,411	10,378	12,538	14,907
Total Liabilities and Equity	7,000	8,743	10,659	12,760	15,063	17,583
Distributions		0	0	0	0	0
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		1,323	2,793	4,423	6,226	8,216
Total Value	9,000	10,863	12,906	15,142	17,588	20,260
Appreciation		1,863	2,043	2,237	2,446	2,671
Distributions		0	0	0	0	0
Total Return		1,863	2,043	2,237	2,446	2,671
% Return		20.7%	18.8%	17.3%	16.2%	15.2%
Distributions		0	0	0	0	0
Tax Payments by Shareholder		0	0	0	0	0
Residual Value						20,260
After Tax Cash Flow	(9,000)	0	0	0	0	20,260
Internal Rate of Return		17.6%				
Total Value (Residual Year)						20,260
Appreciation						11,260
Tax on Appreciation						0
After Tax Residual Value						20,260



Exhibit 5
Regular C Corporation
Maximum Dividends

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income		-	-	-	-	-
Pretax Profit	1,500	1,590	1,685	1,787	1,894	2,007
Taxes	510	541	573	607	644	682
Net income	990	1,049	1,112	1,179	1,250	1,325
Cash	-	-	-	-	-	-
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	7,420	7,865	8,337	8,837	9,368
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	5,300	5,618	5,955	6,312	6,691
Total Liabilities and Equity	7,000	7,420	7,865	8,337	8,837	9,368
Dividend Payments		749	794	842	893	946
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		-	-	-	-	-
Total Value	9,000	9,540	10,112	10,719	11,362	12,044
Appreciation		540	572	607	643	682
Dividends		749	794	842	893	946
Total Return		1,289	1,367	1,449	1,536	1,628
% Return		14.3%	14.3%	14.3%	14.3%	14.3%
Dividends		749	794	842	893	946
Tax Payments by Shareholder		(112)	(119)	(126)	(134)	(142)
Residual Value						11,587
After Tax Cash Flow	(9,000)	637	675	716	759	12,392
Internal Rate of Return	12.4%					
Total Value (Residual Year)						12,044
Appreciation						3,044
Tax on Appreciation						(457)
After Tax Residual Value						11,587



Exhibit 6

Regular C Corporation - 100% ESOP
Maximum Dividends

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income	-	-	-	-	-	-
Pretax Profit	1,500	1,590	1,685	1,787	1,894	2,007
Taxes	510	541	573	607	644	682
Net income	990	1,049	1,112	1,179	1,250	1,325
Cash	-	-	-	-	-	-
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	7,420	7,865	8,337	8,837	9,368
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	5,300	5,618	5,955	6,312	6,691
Total Liabilities and Equity	7,000	7,420	7,865	8,337	8,837	9,368
Dividend Payments		749	794	842	893	946
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		0	0	0	0	0
Total Value	9,000	9,540	10,112	10,719	11,362	12,044
Appreciation		540	572	607	643	682
Dividends		749	794	842	893	946
Total Return		1,289	1,367	1,449	1,536	1,628
% Return		14.3%	14.3%	14.3%	14.3%	14.3%
Dividends		749	794	842	893	946
Tax Payments by Shareholder (a)		0	0	0	0	0
Residual Value						12,044
After Tax Cash Flow	(9,000)	749	794	842	893	12,990
Internal Rate of Return	14.3%					
Total Value (Residual Year)						12,044
Appreciation						3,044
Tax on Appreciation						0
After Tax Residual Value						12,044

(a) Assumes dividends are retained by ESOP trust



Exhibit 7
Subchapter S Corporation
Maximum Distributions

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income	-	-	-	-	-	-
Pretax Profit	1,500	1,590	1,685	1,787	1,894	2,007
Taxes	-	-	-	-	-	-
Net income	1,500	1,590	1,685	1,787	1,894	2,007
Cash	-	-	-	-	-	-
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	7,420	7,865	8,337	8,837	9,368
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	5,300	5,618	5,955	6,312	6,691
Total Liabilities and Equity	7,000	7,420	7,865	8,337	8,837	9,368
Distributions		1,290	1,367	1,449	1,536	1,629
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		0	0	0	0	0
Total Value	9,000	9,540	10,112	10,719	11,362	12,044
Appreciation		540	572	607	643	682
Distributions		1,290	1,367	1,449	1,536	1,629
Total Return		1,830	1,940	2,056	2,180	2,310
% Return		20.3%	20.3%	20.3%	20.3%	20.3%
Distributions		1,290	1,367	1,449	1,536	1,629
Tax Payments by Shareholder		(557)	(590)	(625)	(663)	(703)
Residual Value						11,841
After Tax Cash Flow	(9,000)	734	778	824	874	12,767
Internal Rate of Return		13.8%				
Total Value (Residual Year)						12,044
Appreciation						3,044
Tax on Appreciation						(203)
After Tax Residual Value						11,841



Exhibit 8

Subchapter S Corporation - 100% ESOP
Maximum Distributions

Year	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	10,000	10,600	11,236	11,910	12,625	13,382
Operating Profit	1,500	1,590	1,685	1,787	1,894	2,007
Interest Income	-	-	-	-	-	-
Pretax Profit	1,500	1,590	1,685	1,787	1,894	2,007
Taxes	-	-	-	-	-	-
Net income	1,500	1,590	1,685	1,787	1,894	2,007
Cash	-	-	-	-	-	-
Current Assets	3,000	3,180	3,371	3,573	3,787	4,015
Fixed Asset	4,000	4,240	4,494	4,764	5,050	5,353
Total Assets	7,000	7,420	7,865	8,337	8,837	9,368
Current Liabilities	2,000	2,120	2,247	2,382	2,525	2,676
Equity	5,000	5,300	5,618	5,955	6,312	6,691
Total Liabilities and Equity	7,000	7,420	7,865	8,337	8,837	9,368
Distributions		1,290	1,367	1,449	1,536	1,629
Operating Value	9,000	9,540	10,112	10,719	11,362	12,044
Cash		0	0	0	0	0
Total Value	9,000	9,540	10,112	10,719	11,362	12,044
Appreciation		540	572	607	643	682
Distributions		1,290	1,367	1,449	1,536	1,629
Total Return		1,830	1,940	2,056	2,180	2,310
% Return		20.3%	20.3%	20.3%	20.3%	20.3%
Distributions		1,290	1,367	1,449	1,536	1,629
Tax Payments by Shareholder		0	0	0	0	0
Residual Value						12,044
After Tax Cash Flow	(9,000)	1,290	1,367	1,449	1,536	13,673
Internal Rate of Return		20.3%				
Total Value (Residual Year)						12,044
Appreciation						3,044
Tax on Appreciation						0
After Tax Residual Value						12,044