Willamette Management Associates
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Perspectives January 2026

SUCCESSION PLANNING IN 2026: EMPLOYEE STOCK OWNERSHIP PLANS AND THE NEW ESTATE TAX LANDSCAPE

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Employee Stock Ownership Plans (“ESOP”) are gaining traction as a flexible solution that offers liquidity, tax advantages, and company continuity. While the One Big Beautiful Bill Act (“OBBBA”) eased urgency for tax planning by permanently increasing estate and gift tax exemptions, ESOPs remain a compelling option for long-term planning. This article explores how ESOPs work, their valuation requirements, and their role in integrating succession and estate planning.

Introduction

In 2026, the economic and tax landscape continues to reshape the priorities of privately held businesses. With interest rates stabilizing and new tax legislation, business owners are increasingly focused on succession planning and long-term sustainability. Amid this backdrop, ESOPs provide a compelling solution—offering tax advantages, liquidity options, and a path to preserving company culture.

Succession planning is a critical concern for aging business owners, particularly those in the middle market. Many seek alternatives to private equity or strategic buyers that might not align with their legacy goals. ESOPs present a unique opportunity to transition ownership while rewarding employees and maintaining operational continuity.

SUCCESSION PLANNING IS A CRITICAL CONCERN FOR AGING BUSINESS OWNERS, PARTICULARLY THOSE IN THE MIDDLE MARKET.

What Is an ESOP?

An ESOP is a qualified retirement plan that invests primarily in the sponsoring of a company’s stock. Structured as a trust, an ESOP holds shares on behalf of employees, who become beneficial company owners over time. This structure allows employees to accumulate equity in the business, often at no up-front cost to them.

ESOPs are commonly used in full or partial buyouts, particularly when owners look to exit a business gradually or preserve a company's legacy. An ESOP also is a powerful tool for incentivizing employees and aligning interests across the organization. Whether used for succession planning, liquidity events, or employee engagement, ESOPs provide flexibility and strategic value.

An ESOP Valuation

Business valuation plays a key role in any ESOP transaction. The Internal Revenue Service ("IRS") and Department of Labor ("DOL") require that ESOP-owned companies be valued at fair market value ("FMV"), which reflects what a willing buyer would pay a willing seller in an arm's-length transaction. ESOP trustees must obtain an independent valuation annually to ensure compliance and fiduciary responsibility.

ADDITIONAL LAYERS OF RULES MAKE ESOP VALUATIONS SOME OF THE MOST CAREFULLY DOCUMENTED BUT SCRUTINIZED ANALYSES IN THE VALUATION PROFESSION.

Valuation professionals typically consider three approaches to estimate the value of a company:

- Income Approach (specifically the discounted cash flow method): projects future cash flow and discounts it to present value, capturing the company's earning potential
- Market Approach: uses guideline public or private company comparisons to benchmark value
- Asset-Based Approach: focuses on a company's net asset value, although this approach is less commonly used to value operating businesses

Each approach provides a different view, and the concluded value often blends multiple approaches to reflect a company's unique characteristics.

ESOP Valuations Versus Others

Valuing a company for an ESOP differs significantly from other types of business valuations. While both use standard valuation approaches, ESOP valuations are governed by a unique regulatory and fiduciary framework. These additional layers of rules make ESOP valuations some of the most carefully documented but scrutinized analyses in the valuation profession.

Standard of Value

The foundation of any valuation is the standard of value. For ESOPs, this is always FMV, defined as the price at which a willing buyer and seller would transact, with neither under compulsion and both possessing reasonable knowledge of the facts.[1] This is distinct from other engagements that may use fair value (for financial reporting), investment value (for a specific buyer), or intrinsic value (for internal decision-making). In an ESOP context, FMV is applied consistently, from the initial transaction to annual updates, to ensure equitable treatment of plan participants.

Trustee-Driven Process

Unlike business valuations conducted for internal planning or external sale purposes, ESOP valuations are monitored by an independent trustee who acts as a fiduciary for the plan participants. This trustee must ensure that the valuation reflects FMV and is defensible under scrutiny from the DOL and IRS. The trustee cannot simply accept the valuation at face value—he or she must understand the methodology, challenge assumptions, and ensure that the valuation is in the best interest of the employee-owners. This fiduciary layer adds rigor and accountability, often resulting in more conservative and thoroughly documented valuations.

Level of Value

Deciding whether the valuation reflects a controlling or noncontrolling (or minority) interest is another critical distinction. For leveraged ESOP transactions, where the ESOP acquires a controlling stake, the valuation typically concludes a controlling level of value. In contrast, for ESOPs that hold a noncontrolling interest in the subject company, annual updates typically conclude a noncontrolling level of value.

ESOPS NOW CAN BE CONSIDERED MORE STRATEGICALLY FOR THEIR BROADER BENEFITS—EMPLOYEE ENGAGEMENT, BUSINESS CONTINUITY, AND POTENTIAL INCOME TAX ADVANTAGES.

Repurchase Obligation Modeling

One of the most distinctive features of ESOP valuations is the existence of a repurchase obligation. As employees retire or leave a company, the ESOP must buy back their shares at FMV. This creates a future liability that can affect the company's cash flow and capital structure. Repurchase obligations are affected by workforce demographics, vesting schedules, and projected share values. Failure to properly account for repurchase obligations can lead to liquidity issues and underfunded liabilities, making this a critical component of ESOP financial planning.

Assumptions, Discounts, and Documentation

The assumptions in an ESOP valuation—particularly management's projections—are subject to heightened scrutiny. The valuation professional must verify that forecasts are reasonable and achievable because inflated projections can overstate share value and harm participants. Discounts for lack of control or marketability must also be well supported and consistent with DOL expectations. Overly aggressive adjustments can trigger compliance issues or fiduciary concerns.

TCJA Expirations and the OBBBA

The Tax Cuts and Jobs Act ("TCJA"), enacted in 2017, introduced substantial changes to the U.S. tax code. Many of these provisions were scheduled to expire at the end of 2025, reverting to pre-TCJA standards.

Under the TCJA, one such provision was the temporary doubling of the estate and gift tax exemption. Without further legislation, the exemptions would have decreased from nearly $14 million per individual to $7 million in 2026. This created an urgent window for high-net-worth individuals and business owners to act.[2]

However, the OBBBA, signed into law on July 4, 2025, dramatically altered this outlook. The new legislation permanently increased the estate, gift, and generation-skipping transfer ("GST") tax exemptions to $15 million per individual (or $30 million for married couples), starting in 2026, indexed for inflation.[3] This repeal of the TCJA's sunset provisions eliminated the urgency to complete large transfers before year-end 2025 and provides long-term certainty for estate planning. While ESOPs remain a valuable tool for liquidity and ownership transition, the immediate pressure to implement them to capture the higher exemption has eased. Instead, ESOPs now can be considered more strategically for their broader benefits—employee engagement, business continuity, and potential income tax advantages.

Implication of the OBBBA

Starting January 1, 2026, the OBBBA's permanent increase of the estate tax exemption provides a predictable

framework for wealth transfer strategies. Moreover, the OBBBA maintains several foundational features of the U.S. transfer tax systems. Although these provisions were not scheduled to expire under the TCJA, their continued application in accordance with the permanently increased exemption reinforces the importance of long-term planning. For example, under the OBBBA, the maximum estate, gift, and GST tax rate will remain at 40 percent.[4] Portability of unused estate and gift tax exemptions between spouses also will be preserved, allowing a surviving spouse to apply any unused exemption from a deceased spouse to their own taxes.

The annual gift tax exclusion, which permits individuals to transfer a specified amount to any number of recipients each year without incurring gift taxes or reducing their lifetime exemption, remains at $19,000 per recipient, indexed for inflation going forward.[5] Additionally, the step-up-in-basis rule was preserved under the OBBBA, meaning inherited assets receive a basis adjustment to their FMV at the decedent's date of death, significantly reducing any potential capital gains tax for heirs.

SELLING SHARES TO AN ESOP CONVERTS ILLIQUID BUSINESS EQUITY INTO CASH, ENABLING OWNERS TO DIVERSIFY THEIR ESTATE AND REDUCE CONCENTRATION RISK.

The Gift and Estate Transfer Process

With the current gift, estate, and GST tax exemption becoming permanent, those wishing to transfer their wealth may begin to consider the most optimal way of going forward. ESOPs are one option. As noted, ESOPs allow owners to sell all or part of their company to a qualified retirement plan for employees, creating a structured mechanism for ownership transfer while preserving the company's culture and continuity. This approach offers several advantages over traditional third-party sales, particularly for closely held businesses where liquidity and legacy are primary considerations.

From an estate planning perspective, ESOP transactions provide significant tax benefits and liquidity opportunities. Selling shares to an ESOP converts illiquid business equity into cash, enabling owners to diversify their estate and reduce concentration risk. For C corporations, Internal Revenue Code ("IRC") Section 1042 allows sellers to defer capital gains tax on the sale of stock to an ESOP if certain conditions are met, such as reinvesting proceeds into a qualified replacement property. In addition, contributions of stock or cash to the ESOP are tax deductible for the company, and S corporations owned by ESOPs enjoy significant income tax advantages because ESOP-owned shares in those companies are exempt from federal income taxes.

However, although exemptions are "permanent," they are not immune to future legislative change. Congress, in conjunction with future administrations, possesses the authority to alter or rescind current exemption amounts, rendering their long-term continuity uncertain.

For business owners, this underscores the importance of implementing a flexible strategy, such as an ESOP, that can provide both immediate benefits and adaptability in the face of potential policy shifts.

Comparing ESOPs to Other Strategies

Business owners have several succession planning options, including outright gifting, family partnerships, or grantor annuity trusts ("GRATs"). ESOPs, which offer a fundamentally different approach, provide distinctive advantages that may be considered.

> ESOPS CONVERT EQUITY INTO CASH WITHOUT FORCING A SALE TO OUTSIDERS.

Rather than transferring ownership solely within the family, an ESOP creates a market for shares through a retirement plan for employees. This structure delivers liquidity to the selling shareholder, preserves company culture, and provides substantial tax advantages, such as potential capital gains deferral under IRC Section 1042 and corporate deductions for contributions.

Unlike GRATs or partnerships, ESOPs align succession planning with workforce engagement, allowing employees to become stakeholders, which theoretically encourages employees to increase revenue and reinforces the long-term stability of a company.

ESOPs also provide more flexibility in the ownership transfer process relative to other common succession strategies, such as outright gifting, which might require an immediate transfer. ESOPs convert equity into cash without forcing a sale to outsiders. This enables owners to diversify their estate while maintaining operational continuity. This liquidity also can fund other estate planning vehicles, such as charitable trusts, without dismantling the business.

Summary

Succession planning for privately held business owners is in a transitional phase. The OBBBA's permanent increase in estate and gift tax exemptions reduced short-term pressure for planning; however, given the historical volatility of U.S. tax policies, it did not eliminate the need to be proactive. Business owners should adopt flexible strategies that can withstand future legislative shifts.

ESOPs provide an attractive exit strategy for owners who have spent years building their business, providing a path to liquidity while preserving business continuity and delivering unique tax advantages. ESOP valuations, however, depend on professional analysis and independent expertise, making the role of an experienced valuation professional critical to ensure fair and defensible results.

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References:

1 Treasury Regulation § 25.2512-1.

2 Congressional Research Service, "Expiring Provisions of P.L. 115-97 (The Tax Cuts and Jobs Act): Economic Issues," March 2025, congress.gov.

3 Congressional Research Service, "The Estate and Gift Tax: Overview," July 2025, congress.gov. GST applies to individuals transferring wealth to someone two or more generations below them (e.g., grandchildren or individuals at least 37.5 years younger).

4 Ibid.

5 Ibid.