



U.S. Small Business
Administration

Massachusetts District Office
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Massachusetts Community & Banking Council

The Main Street Employee Ownership Act of 2018 was signed into law on August 13, as part of the John McCain National Defense Authorization Act.

It amends § 7(a)(15) and § 7(a)(35) of the Small Business Act (“the Act”) to expand the authority of the Small Business Administration (SBA) to guarantee loans for qualified employee trusts of a small business to purchase the stock of that business.

Timing of Changes:

Since the statutory changes described in H.R. 5236 & S. 2786 became effective on August 13, 2018 when the bill was signed into law, SBA loan applications may be processed now, before any revisions are made to regulations or SOP (no need for an “exception to policy”).

The law provides the SBA Administrator with the discretion not to require the mandatory minimum equity injection and delegated processing; If such a decision is made, it will be communicated through a policy notice or update to SOP 50 10, as appropriate. Until such time, all equity requirements apply to these loans and they must be processed non-delegated.

Employee Stock Ownership Plan

Simply put, an ESOP or Employee Stock Ownership Plan is a “qualified”, defined contribution, employee benefit (ERISA) plan designed to invest primarily in the stock of the sponsoring employer. ESOPs are "qualified" in the sense that the ESOP's sponsoring company, the selling shareholder and participants receive various tax benefits. ESOPs are often used to align the interests of a company's employees with those of the company's shareholders.

A trust established by a corporation which acts as a tax-qualified, defined-contribution retirement plan by making the corporation's employees partial owners. Contributions are made by the sponsoring employer, and can grow tax-deferred, just as with an IRA or 401(k) plan. Unlike other retirement plans, the contributions must be invested in the company's stock. The benefits for the company include increased cash flow, tax savings, and increased productivity from highly motivated workers.

The main benefit for the employees is the ability to share in the company's success. Due to the tax benefits, the administration of ESOPs is regulated, and numerous restrictions apply. The official IRS definition of ESOP refers to an employee stock ownership plan (or ESOP) that meets the requirements of section 407(d)(6) of the Employee Retirement Income Security Act of 1974 (the Act) and 29 CFR 2550.407d-6. It is **NOT** synonymous with “stock bonus plan.” Refer to IR 26 CFR 54.4975-11 for more details.

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The Main Street Employee Ownership Act of 2018, signed into law on August 13, as part of the John McCain National Defense Authorization Act.

It revises § 7(a)(15) of the Small Business Act (“the Act”) for loans to qualified employee trusts (“ESOPs”) in several ways:

- ❑ It will make it easier for employee-owned firms (both ESOP and employee-owned cooperatives) to access SBA financing already available to other small businesses;
- ❑ 7(a) loan can be made to the trust OR to the employer small business to re-lend to the ESOP to acquire at least 51% of the employer small business (the terms of the loan to the ESOP don’t need to match the terms of the SBA-guaranteed loan);
- ❑ Eligible uses of proceeds may include any transaction costs associated with purchasing a controlling interest in the employer (Employee Stock Ownership Plans and cooperatives), but not costs associated with setting up the ESOP or cooperative.
- ❑ For both ESOPs and cooperatives changes of ownership, any seller who remains an owner of the business, regardless of percentage of ownership, must provide their guaranty.

Code of Federal Regulations

20.351 Definitions.

Terms specific to ESOPs have the same definition for purposes of this section as in the Internal Revenue Service (IRS) Code (title 26 of the United States Code) or regulations (26 CFR chapter I).

20.352 Use of proceeds.

Loan proceeds may be used for two purposes.

(a) *Qualified employer securities.* A qualified employee trust may relend loan proceeds to the employer for purchasing qualified employer securities. The small business concern may use these funds for any general purpose.

(b) *Control of employer.* A qualified employee trust may use loan proceeds to purchase a controlling interest (51 percent) in the employer. Ownership and control must vest in the trust by the time the loan is repaid.

20.353 Eligibility.

A small business may assist a qualified employee trust (or equivalent trust) that meets the requirements and conditions for an ESOP prescribed in all applicable IRS, Treasury and Department of Labor (DOL) regulations. In addition, the following conditions apply:

(a) The small business must provide the funds needed by the trust to repay the loan; and

(b) The small business must provide adequate collateral.

20.354 Creditworthiness.

In determining repayment ability, SBA shall not consider the personal assets of the employee-owners of the trust. SBA shall consider the earnings history and projected future earnings of the employer small business. SBA may consider the business and management experience of the employee-owners.

Amendments to Section 7(a) of the Small Business Act

in paragraph (15) — subparagraph (A)

by striking “this subsection to qualified employee trusts” and inserting “this subsection—
“(i) to qualified employee trusts”;

in clause (i), as so designated—

(I) by inserting “, and for any transaction costs associated with purchasing,” after
“purchasing”;

(II) by striking the period at the end and inserting “; and”; and

by adding at the end the following:

) to a small business concern under a plan approved by the Administrator, if the proceeds
m the loan are only used to make a loan to a qualified employee trust, and for any
nsaction costs associated with making that loan, that results in the qualified employee trust
ning at least 51 percent of the small business concern.”;

subparagraph (B)

in the matter preceding clause (i), by inserting “or by the small business concern” after “the
stee of such trust”;

in clause (ii), by striking “and” at the end;

in clause (iii), by striking the period at the end and inserting “, and”; and

Amendments to Section 7(a) of the Small Business Act

cont'd

in paragraph (15) —

by adding at the end the following:

) with respect to a loan made to a trust, or to a cooperative in accordance with paragraph (15) —

a seller of the small business concern may remain involved as an officer, director, or key employee of the small business concern when a qualified employee trust or cooperative has acquired 100 percent of ownership of the small business concern; and

) any seller of the small business concern who remains as an owner of the small business concern, regardless of the percentage of ownership interest, shall be required to provide a personal guarantee by the Administration.”; and

small business concern that makes a loan to a qualified employee trust under subparagraph (A)(ii) is required to contain the same terms and conditions as the loan made to the small business concern that is guaranteed by the Administration under such subparagraph.

with respect to a loan made to a qualified employee trust under this paragraph, or to a cooperative in accordance with paragraph (35), the Administrator may, as deemed appropriate, elect to not require mandatory equity to be provided by the qualified employee trust or cooperative to make the

n ”. and

Amendments to Section 7(a) of the Small Business Act

cont'd

LOANS TO COOPERATIVES

(A) DEFINITION.—In this paragraph, the term ‘cooperative’ means an entity that is determined to be a cooperative by the Administrator, in accordance with applicable Federal and State laws and regulation.

(B) AUTHORITY.—The Administration shall guarantee loans made to a cooperative for the purpose described in paragraph (15).”.

Delegation of authority to preferred lenders.—Section 5(b)(7) of the Small Business Act ([15 U.S.C. 634\(b\)\(7\)](#)) is amended by inserting “, including loans guaranteed under paragraph (15) or (35) of section 7(a)” after “deferred participation loans”.

7(a) Loans to ESOPs and Co-ops

The Main Street Employee Ownership Act of 2018, signed into law on August 13, as part of the John McCain National Defense Authorization Act.

adds new § 7(a)(35) to the Act to provide the Administration with the authority to guarantee loans to cooperatives (“Co-ops”) for the purpose described in 7(a)(15) of the Act, including:

- Permits SBA-guaranteed loans to employee-owned Co-ops to purchase the stock of a small business concern under a plan approved by the Administrator that results in the Co-op owning at least 51% of the stock of the concern;
- Eligible uses of proceeds may include related transaction costs;
- The Seller may remain an officer, director, or key employee of the small business concern when the Co-op has acquired 100% of the ownership;
- Any Seller who remains must provide a personal guaranty, regardless of any ownership %; and
- Provides the Administrator with the discretion to not require mandatory equity injections from a Co-op.

7(a) Loans to ESOPs and Co-ops, cont'd

Certain ESOP loan requests are eligible for SBA 7(a) financing, and what constitutes an ESOP deal is dependent on the use of proceeds. If the request is for a change of ownership, with the ESOP purchasing a control interest in the business by acquiring at least 51% of the employer small business, the ESOP trust OR the employer small business can be the borrower.

ESOP transactions *cannot* be processed under delegated authority (PLP or Express) and must be submitted to the Standard 7(a) Processing Center because of their complexity and need for legal review. There are no current exceptions to this policy. ESOP transactions are creatures of statute and impose on the Agency an annual reporting responsibility to Congress.

An ESOP deal involving 100% ESOP trust ownership will not have a guarantor (there is a blanket waiver in the SOP), but if there is any ownership outside of the ESOP, that owner must be a guarantor.

ESOP applications cannot be structured as an EPC/OC. Per **13 CFR § 120.111(a)(6)** Eligible Passive Company (EPC) /Operating Company (OC) transactions require 20% or more owners to be guarantors, and the regulation does not provide for an exception therefore, ESOP and EPC/OC deals don't mix.

7(a) loan requests, where there is 100% ESOP ownership in existence at the time of application, is not considered an ESOP deal authorized by the Small Business Act at section 7(a)(15), with its restricted uses of loan proceeds, and as a result, the reporting requirement

Questions?

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