

## PEO and Client ESOP FAQs

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***Q. What is an ESOP?***

- A. An ESOP is an Employee Stock Ownership Plan. It is a tax-qualified retirement plan and is exempt from taxation under Code Section 501(a), but only if the plan meets various criteria set forth in Section 401(a). One such criteria is that there must be an employer-employee relationship between the participants of the ESOP and the sponsor, and that the plan must be for the *exclusive benefit of the employees of the plan sponsor*.

***Q. What effect does a PEO co-employment relationship have on an existing ESOP plan?***

- A. There are no laws or IRS regulations that specifically address this issue; however, it is clear that the issue is which party in the relationship is the “employer”. It is also clear that the test for determining the “employer” in an ESOP is based on what is commonly referred to as the 20 point, “common law employer” test. Thus, in order for the ESOP to remain tax exempt, the client must be considered to be the common law employer.

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