

# ESOP OWNER INSIDER

Q1 2026 Industry Update | For Business Owners Considering Employee Ownership

March 2026

## A message for business owners:

If you have been watching the ESOP space from the sidelines, Q1 2026 has delivered some of the most business-friendly signals the industry has seen in years. A quieter regulatory environment, favorable financing conditions, and bipartisan Congressional support are converging in ways that make this an important time to evaluate whether an ESOP belongs in your succession or tax strategy. Here is what you need to know.

## 1. Regulatory & Legislative Updates

### The Government Steps Back — In a Good Way

In one of the most significant regulatory shifts in two decades, the Department of Labor's Employee Benefits Security Administration (EBSA) removed ESOPs from its national enforcement priority list on January 15, 2026. This marks the first time since 2005 that ESOPs have not been on that list.

For years, ESOP advocates described the agency's approach as an aggressive, often unpredictable "war on ESOPs" that created real hesitation among business owners exploring the structure. That headwind has now materially changed.

*Bottom line for owners: The end of heightened EBSA scrutiny means smoother transactions, more consistent trustee decision-making, and fewer deals stalled by regulatory uncertainty. If you delayed exploring an ESOP due to compliance concerns, 2026 deserves a second look.*

### Congress Acts with Rare Bipartisan Support

On the legislative front, the U.S. Senate unanimously passed two significant ESOP bills in late 2025 that are now moving through the House:

- Retire Through Ownership Act — Provides safe harbor protections for ESOP fiduciaries and trustees who follow established valuation guidelines under IRS Revenue Ruling 59-60, reducing the litigation risk that has long shadowed ESOP transactions.
- Employee Ownership Representation Act — Creates a formal advocacy role for ESOPs within the Department of Labor, giving the industry a permanent seat at the policy table.

Both bills passed the Senate HELP Committee unanimously and represent the strongest Congressional support for employee ownership in recent memory.

## Plan Amendment Deadline: Act Before Year-End 2026

If you already sponsor an ESOP, there is a compliance task on the horizon. Stemming from the original SECURE Act (2019) and SECURE 2.0 (2022), all qualified ESOP plans must adopt "good faith amendments" by December 31, 2026 to maintain tax-qualified status. Key changes include:

- Required Minimum Distribution age updated to 73
- Cash-out limit increased from \$5,000 to \$7,000
- Mandatory Roth catch-up contributions for employees earning over \$150,000 (effective 2026)
- New "super" catch-up contribution rules for employees aged 60 to 63

If you have a KSOP (an ESOP combined with a 401(k) feature), coordinate with your plan administrator now — many of these changes require process updates before the December deadline.

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## 2. Market Trends & Valuations

### What the Markets Actually Mean for Your Company

The S&P 500 closed 2025 up 18.1% — but that headline number can be misleading for business owners. The gains were heavily driven by large-cap technology companies. The S&P 600, which better reflects middle-market companies like those that typically form ESOPs, finished the year up just 4.2%.

The practical takeaway: your company's ESOP valuation will be driven primarily by your own financial performance — revenue, profitability, and growth trajectory — rather than broad market sentiment. Valuation multiples for middle-market firms remained steady, consistent with where they stood in late 2023.

*What this means for you: Middle-market valuations are stable and predictable right now. For owners thinking about a sale or partial liquidity, this is a moment of relatively low volatility — a good environment in which to plan and transact.*

### Financing Conditions Are Favorable

ESOP transactions — particularly leveraged buyouts using bank financing — are benefiting from improving capital availability in 2026:

- Total leverage in middle-market transactions held steady at approximately 3.2x EBITDA
- Lower SOFR rates have reduced borrowing costs on floating-rate debt compared to 2024
- Alternative capital sources, including SBA 7(a) lenders and mezzanine investors, are expanding their ESOP lending activity

For owners considering a leveraged ESOP — where a bank loan is used to fund some or all of the purchase price — the current environment supports deal execution. More lenders are engaged in the ESOP space, and transactions that might have stalled in prior years due to financing gaps are getting done.

## Valuation Guidance From the DOL Is Still Coming

One item to watch closely: the Department of Labor is expected to release updated regulations governing how ESOP valuations are conducted. The previous administration withdrew proposed rules in January 2025. The current DOL leadership has pledged a more ESOP-friendly approach, but formal guidance has not yet been issued as of this writing.

When these rules arrive, they will be significant — the industry has operated without formal valuation guidance since ERISA was enacted in 1974. Stay in close contact with your ESOP advisor as this develops.

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## 3. Tax & Financial Planning Tips

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### The Tax Case for an ESOP Remains Compelling

Regardless of broader policy changes, the core tax advantages of an ESOP are structural and durable. Here are the most important ones for business owners to understand:

#### For C-Corporation Owners: Section 1042 Capital Gains Deferral

If you own a C-corporation and sell 30% or more of the company to an ESOP, you may be eligible to defer — not just reduce, but defer — federal capital gains taxes on the sale proceeds by reinvesting them into qualified replacement property (domestic stocks and bonds). This can be a powerful wealth-building strategy: your capital continues to grow tax-deferred in a diversified portfolio rather than being reduced by a large tax payment at closing.

*Example: An owner with \$5 million in gain from an ESOP sale could defer the entire federal capital gains tax bill by rolling proceeds into a qualified portfolio — potentially preserving hundreds of thousands of dollars in capital.*

#### For S-Corporation Owners: Federal Tax Reduction or Elimination

A 100% S-corporation ESOP pays zero federal income tax. Because an ESOP trust is a tax-exempt entity, its proportional share of S-corp income is not subject to federal taxation. For a company earning \$2 million in annual profit, the savings on federal taxes alone can fund the deal and accelerate loan payback dramatically.

Even a partial ESOP sale — say, 30% to 50% of the company — can meaningfully reduce the effective tax rate on S-corp distributions. Many owners use a staged sale approach: sell a portion now, retain control and income, and sell more over time as circumstances evolve.

## 2026 Plan Limit Updates Worth Knowing

New IRS contribution limits for 2026 provide additional planning opportunities for ESOP companies with 401(k) features (KSOPs):

- 401(k) deferrals increased to \$24,500 (up from \$23,500)
- Regular catch-up contributions (age 50+) increased to \$8,000
- Maximum total contribution limit increased to \$72,000
- ESOP large account distribution threshold increased to \$1,455,000

For owners who also participate in their company's KSOP, the 2026 limits provide more room to shelter compensation. Talk with your financial advisor about maximizing contributions in the current plan year.

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## The Takeaway for Business Owners

The first quarter of 2026 is shaping up as one of the more favorable environments for ESOP formation in recent years. The regulatory headwinds that slowed deal activity have eased, financing is accessible, valuations are stable, and Congress is moving supportive legislation. The tax advantages that have always made ESOPs attractive remain firmly in place.

If you have been considering an ESOP as a succession strategy, a tax reduction tool, or a way to reward and retain your workforce — now is a good time to have that conversation with a qualified ESOP advisor. The window may not stay open indefinitely.

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