



**SPECIAL REPORT:
ROLLOVERS FOR BUSINESS
START-UPS (ROBS)**

By David Nilssen, CEO & Co-founder, Guidant Financial

A LETTER FROM THE CEO

Dear reader,

Over the past 10 years, my company, Guidant Financial, has helped more than 11,000 entrepreneurs invest retirement funds into their own small business or franchise without taking a taxable distribution. These individuals created a path to wealth and are enjoying incomparable employee benefits, minimizing company debt, reducing overhead and recognizing tax benefits. They've created thousands of jobs, invested hundreds of millions of dollars into American small business and instigated billions in economic output.

The process is called Rollovers for Business Start-ups, also known as Rollovers as Business Start-ups or ROBS for short. Utilization of this business financing strategy has increased significantly over the last decade, and the small business and franchise industry has grown to accept — even embrace — it. Since 2009, the number of new ROBS transactions at Guidant Financial has increased approximately 112 percent, and we estimate the market as a whole has experienced as much as 75 percent growth over the same time period.

On the other hand, a serious debate rages on in the financial community over the legitimacy of using retirement funds for this purpose. Add the rising level of inaccurate or twisted information provided by bloggers and others, and people are justifiably concerned.

This 'Special Report' was written to provide accurate information to entrepreneurs and financial professionals alike seeking to better understand how one can use Rollovers for Business Start-ups to invest in a franchise or business. I'll provide a high level look at how the process works, share an overview of the internal memorandum sent to IRS agents, and explain the basics of setting up a ROBS plan that meets legal and tax requirements. This information is universal, and any ROBS provider should follow the same protocol. But like many things, the concepts are simple, but execution can be complicated.

Guidant has invested a significant amount of time and money in productive dialogue with the Internal Revenue Service (IRS) and the Department of Labor to ensure we thoroughly understand the guidelines and requirements surrounding ROBS, as well as where concerns lie. But we strongly recommend you engage your own independent counsel before making any investment decisions.

Sincerely,

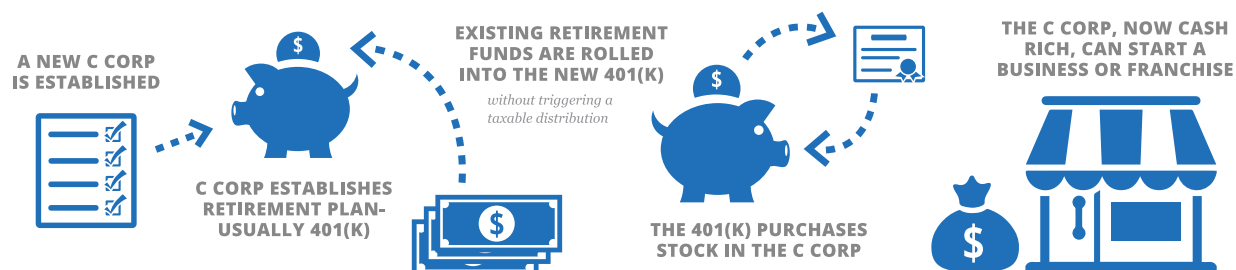
A handwritten signature in black ink, appearing to read 'D. Nilssen', with a stylized, cursive flourish at the end.

David Nilssen

CEO & Co-founder, Guidant Financial

ROBS BASIC FORMATION

The Rollovers for Business Start-ups structure must be formed correctly in order to qualify under IRS code and generally involves four or five steps. Although complex, these steps can usually be completed in less than three weeks. Here's how it works:



1. The rollover provider creates a private C corporation for the client.
2. The provider then creates a new qualified retirement plan — most commonly a 401(k) — for the corporation.
3. Funds from the client's existing retirement account are rolled into the new retirement plan without triggering a taxable distribution.
4. The new plan then purchases stock in the C corporation.
5. The corporation, in turn, uses the investment proceeds to acquire a small business or franchise, and the 401(k) becomes one of the shareholders in the corporation.
6. The new business now is cash-rich and debt-free.

Now, let's look at a real-world example: say an aspiring entrepreneur wants to start a new business or purchase a franchise. After reviewing her financing options, she decides the money currently sitting in her retirement account is the perfect way to generate needed seed capital.

Using the help of a company like Guidant, she forms a C corporation. After incorporation, her new business adopts a 401(k) plan that explicitly allows its trustee(s) to acquire and hold employer stock in a private business. The plan allows eligible employees to roll funds over from their eligible retirement accounts into the new 401(k) plan.

Once retirement funds are rolled over into the company 401(k) plan, the plan invests up to 100 percent of those funds (assuming the terms of the plan so allow) into the purchase of company stock. In effect, the money in the owner's 401(k) plan is transferred to the corporation in exchange for most or all of the company's stock.

In many ways, the transaction is similar to purchasing, for example, Microsoft stock: An investor gives Microsoft money in exchange for stock certificates; Microsoft is then free to use those funds as they see fit. The stock serves as a form of collateral for the investment. The only real difference, where ROBS is concerned, is that the investment is made in a privately held company instead of a publicly held company like Microsoft.

Once the investment is made, the 401(k) plan owns stock in the business, and the corporation holds the cash. The corporation then uses that cash to rent space, buy equipment, buy supplies, hire employees, etc. — basically any legitimate business expense. As the owner of the company, our investor still controls her investment; the only difference is her original retirement funds are now invested in her new business instead of in traditional IRA investment vehicles.

Why does a ROBS make sense for our entrepreneur? First, she believes investing in herself is a great way to grow her retirement funds. After years of spending her time and energy working for someone else, she decides to invest in her own knowledge, her own talent, her own individual core competencies and work ethic. As the company thrives, the value of her investment rises too — just like in a conventional stock purchase. Entrepreneurs confident in their ability to lead and grow a business naturally feel confident investing their own money in their own future — and our investor is no different.

Plus, a ROBS arrangement allows our entrepreneur to defer income into a retirement account, grow wealth invested in the company on a tax-deferred basis and invest in a wide array of business ventures. She is no longer limited to investing retirement funds in stocks, bonds, mutual funds or money market accounts.

Our entrepreneur also understands the greatest risk she faces in starting a small business is being under-capitalized. The average business gets off the ground only after acquiring a mountain of debt. When those businesses start to generate cash flow, a major portion of that cash flow goes to paying off loans instead of building wealth.

Investing retirement funds in a business is different. The investment isn't a loan (no repayment is involved), and it doesn't require collateral. When the business generates cash, that money can be reinvested back into the business. Even if our entrepreneur doesn't have sufficient retirement funds to completely finance her new venture, a ROBS can be used to supplement bank financing or SBA loans. She then enjoys the advantages of ROBS while reducing her risk and debt exposure.

This type of plan is in many ways similar to an Employee Stock Ownership Plan, or ESOP. Tax code explicitly encourages ESOPs and exempts ESOPs from “prudent investment rules” that other retirement plans must comply with. Why? Congress wants employees to own stock in their employer through their retirement plan.

BENEFITS OF ROBS

Rollovers for Business Start-ups are not likely to be the primary source of funding entrepreneurs seek. Generally, aspiring business or franchise owners consider more traditional forms of financing, such as SBA loans, unsecured credit or even portfolio loans. There are, however, many benefits of ROBS that a business owner may value. These benefits include, but are not limited to:

- **A 401(k) plan for the business**, which is an attractive employee benefit that is increasingly rare in small business today.
- **Control over investment performance.** Unlike the stock market, private stock ownership gives an individual the opportunity to create and grow their retirement asset values as they see fit.
- **A debt-free beginning.** ROBS don't accrue interest, can reduce overhead and potentially allow a businessperson to reinvest more into growing their business because they don't have to repay debt.
- **The ability to use retirement funds** as a down payment for a business loan— often providing entrepreneurs liquidity to invest in larger, more established businesses.
- **No collateral to qualify.** Obtaining funding without using one's home or personal credit as collateral.

According to a 2012 Guidant Financial customer survey, business owners considered minimizing debt and controlling investment performance to be the two most important benefits of buying a business with retirement funds.

*Guidant's 6,000 active ROBS customers
employ more than 60,000 people.*



INTRODUCTION TO PROHIBITED TRANSACTIONS

The self-directed IRA industry, which ROBS fall under, has tremendous momentum. A growing number of entrepreneurs have chosen to take all or a portion of their retirement assets and invest them outside the stock market into investments such as real estate, tax liens, gold and even small business or franchise establishments. As of 2011, the [North American Securities Administrators Association \(NASAA\)](#) reported that investors held 2 percent, or \$94 billion, of IRA retirement funds in self-directed IRAs.

When invested appropriately, just like with traditional portfolios, self-directed IRAs can be remarkable wealth-building vehicles. While the most common investments held in self-directed IRAs are real-estate related, there are many other investment opportunities. The IRS doesn't provide guidance as to what investments are allowed; instead, in IRS Publication 590, they indicate those which are not. Those investments deemed as "prohibited" are life insurance and collectibles (i.e. art work, stamps, rugs, etc.). There are also many transactions that are disallowed under [Internal Revenue Code 4975](#). Prohibited transactions are summarized in [IRS Publication 590](#) as follows:

“Generally a prohibited transaction is any improper use of your IRA account or annuity for the benefit of you, your beneficiary or any disqualified person. Disqualified persons include your fiduciary and members of your family (spouse, ancestor, lineal descendant, and any spouse of lineal descendant).”

Many individuals search the Web looking for information on how to buy a business or franchise with a self-directed IRA. While technically it is possible, more often than not these people intend to work for the same business they buy. After some quick analysis of the prohibited transaction rules, they quickly realize buying a business with a self-directed IRA and working for that business won't work.

Instead, through Rollovers for Business Start-ups (ROBS), entrepreneurs can use their self-directed retirement funds to invest in a business or buy a franchise in which they intend to work. There are explicit exemptions in both the Internal Revenue Code and Employee Retirement Income Security Act of 1974 (ERISA) that were passed by Congress to encourage such investments in private/small business. These laws are defined in ERISA 408(e) and there is a parallel exemption in the [Internal Revenue Code 4975\(d\)\(13\)](#).

Used properly, ROBS can be a very sound business and wealth-building strategy. Let's take a look at what "properly" means.



ROBS: STRUCTURAL REQUIREMENTS

To meet IRS guidelines, every ROBS must adhere to specific requirements in terms of initial formation and ongoing maintenance:

C CORPORATION

There is a requirement that the individual start a C corporation to serve as the business entity. While most small businesses start as LLCs or S corporations, that isn't an option for those who choose to use ROBS. In order to meet the applicable exemptions, "stock" must be made available for purchase. LLCs have member units — not stock — so they're not eligible, leaving an S or C corporation as an option. Inside an S corp, if any "shareholder-employee" owns more than 5 percent, it loses the prohibited exemption that ROBS operate under. Because the 401(k)'s and owner's ownership are attributable, their ownership will always exceed 5 percent, which means S corps don't meet ROBS requirements either. By default, the C corporation is the only eligible business entity as it allows the sale of private Qualified Employer Securities. Guidant suggests you find a tax professional who is familiar with small businesses that operate as this entity-type to help you explore all of its benefits.

ELIGIBLE INDIVIDUAL ACCOUNT PLAN

Companies that use ROBS must maintain an "eligible individual account plan" in which owners-employees must make regular contributions. Section 407(d)(3) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, defines an "eligible individual account plan" (an "EIAP") as "an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on September 2, 1974, and which on such date invested primarily in employer securities." Bottom line, a 401(k) or profit-sharing plan meets this requirement.

While the cost to administer a profit-sharing plan is much higher, keep in mind that such a plan can be a tremendous wealth-building tool for larger and highly profitable enterprises.

Most companies use a 401(k) instead of a profit-sharing plan because a 401(k) is more than sufficient for small businesses and less expensive to maintain.

Once the 401(k) plan is established, the owner-employees must begin making ongoing contributions as soon as they are able. And owners must make this benefit available to any eligible employee. The company cannot discriminate and must offer all eligible employees the opportunity to contribute a portion of their salary to the 401(k). In basic terms, every employee must have the right to contribute to the company 401(k) plan and enjoy its benefits.

FAIR MARKET VALUE

The price paid for corporation stock in ROBS must be made at “adequate consideration,” which under ERISA means fair market value (FMV) when there is no recognized market for the asset. The textbook definition of FMV is “a value determined in an arms’ length transaction between unrelated parties, each of whom has knowledge of the material facts, and neither of whom is under an extraordinary compulsion to buy or sell.” In some cases, a business appraisal may be required to determine FMV.

HOW TO DECIDE IF A BUSINESS APPRAISAL IS NEEDED:

NEW BUSINESS OR FRANCHISE

In this case, the new entity is being initially capitalized by the retirement plan’s investment. It has no income, assets or clients and thus can only be valued based on the ‘cash in hand.’ Under those circumstances, two prominent authors observe that “[I]t would probably be unreasonable for a plan to incur the expense of obtaining an ‘appraisal’ of a start-up business whose only asset was cash.” (See the full article by Brian C. McManus and Mark Matthews in the [Daily Tax Report](#).)

BUYING AN EXISTING BUSINESS OR FRANCHISE FROM AN UNRELATED PARTY

As discussed above, fair market value is what a ready, willing and able buyer will pay, assuming there is no conflict of interest. So if one is buying from an unrelated third party, then what they negotiate constitutes FMV by definition.

BUYING AN EXISTING BUSINESS FROM SOMEONE YOU KNOW

There are instances where an individual wishes to buy a business from a family member, friend or adviser. That can create a conflict of interest and thus “FMV” cannot be confidently established without an independent business appraisal.

PROMOTER FEES

Under the standard ROBS transaction, the IRS asserts the corporation may use part of the cash it raises from the sale of stock to pay a professional fee to the “promoter.” In this case, the promoter is considered to be the firm that ‘sold’ the entrepreneur on the idea, provided the prototype plan and other paperwork, and, in general terms, shepherded the transaction from start to finish.

Here’s what the IRS [says](#): “If the promoter meets these requirements, its status may rise to that of plan fiduciary,” in which case “this payment may be a violation” of the prohibited transaction rules.

The firms I know of, including Guidant, do not allow individuals to pay “promoter” fees using plan assets or the proceeds from the sale of the employer stock. The individual pays those fees personally and receives stock for fronting start-up costs; they are not reimbursed in cash for any fees. Handling the process this way avoids the promoter fee issue completely.

ROBS: OPERATIONAL REQUIREMENTS

In addition to the structural requirements, ROBS arrangements have ongoing operational requirements that the business owner must comply with and understand. These include:

THE BUSINESS MUST BE AN “OPERATING COMPANY”

An operating company is defined as an entity that is primarily engaged in the sale or exchange of a product or service instead of simply the investment of capital. For most of our clients, this is a non-issue. If you're starting or buying a legitimate business, you're engaged in the sale or exchange of a product or service. For example, if you purchase a sandwich store, you'll be engaged in selling a product — the sandwich. There are times, however, when we're approached by individuals who are looking to invest in a hobby. Hobbies are not active businesses and thus are not eligible for this method. Nor can a ROBS arrangement be used for a business for which the primary activity is deemed to be the investment of capital

FIDUCIARY RESPONSIBILITY

As owners, entrepreneurs who have discretionary control over business operations must still serve as a fiduciary of their 401(k) plan, meaning they must always do what is in the best interest of their plan. Used improperly, ROBS can create the possibility of running afoul of the fiduciary guidelines.

FUNDING FOR INVESTMENT PURPOSES AND NOT SIMPLY FINANCING

The goal of this guideline is to ensure the entrepreneur does not simply intend to pay themselves a salary from retirement funds or to purchase a struggling business only to help out a family member.

How can you avoid this conflict? Some advisers require an outside attorney to review the transaction. Others — including my firm — suggest the entrepreneur not pay themselves a salary out of the investment proceeds, instead recommending they wait until they have operating revenue. (Other advisers believe paying the owner's/employee's salary is a legitimate expense, regardless of where seed capital came from.) Ultimately, the individual entrepreneur and their tax advisers should decide how to proceed. Learn more in the section below.

SALARY ISSUES AND THE EXCLUSIVE BENEFIT RULE

The Exclusive Benefit Rule stands for the proposition that the plan is for the “exclusive benefit” of the employees or their beneficiaries. This means that everybody who rolls retirement money into this plan must be a bona fide employee of the corporation that sponsors the plan (more on this on page 12).

Although there is no requirement anywhere in the Internal Revenue Code that an employee must take a salary, the common practice is that most employees do take a salary. The requirement is that any salary taken must be “reasonable,” which translates into a salary that is not excessive given the nature of the business, the responsibilities of the employee and the services provided to the corporation by that employee.

Typically, we don't encounter problems with ROBS clients taking an excessive salary. Rather, some clients are reluctant to take any salary at all.

SALARY ISSUES, CONTINUED

This is not good either since we encourage clients to take a salary and then defer some portion of that salary into their corporation's retirement plan. Such salary deferrals confirm that the plan is being used for its intended purpose: as a vehicle to generate retirement savings.

There is one major caveat, however: we suggest that clients never pay themselves a salary out of the proceeds from the 401(k)'s purchase of employer stock. We believe it is best to wait until the business is actually open and generating revenue. At that time, the client can (and should) pay himself or herself a reasonable salary out of those operational revenues, and do so as soon as such operational revenues are available. This protocol demonstrates the employer stock purchase was made as an investment of plan assets and was solely in the best interest of the plan and its participants.

Waiting to pay oneself a salary until the business is generating operational revenue demonstrates fiduciary responsibility — in other words, that the business was purchased as a true investment, not as a means to take a salary.

TAX BENEFITS OF WAITING TO TAKE A SALARY

Let me pose a different salary-related issue: Is it fiscally responsible and "tax-efficient" to pay oneself a salary before operational revenues can support it?

Some of our competitors advocate that the client can take a salary right out of the box using the proceeds of the plan's purchase of employer stock. However, this approach not only triggers unnecessary legal risks (raising questions as to whether the client was acting in accordance with his/her ERISA fiduciary duty and whether the salary payment was a prohibited transaction), but the proposal does not make tax sense in any event.

A salary is subject to federal employment taxes at a rate of 15.3 percent (consisting of employer plus employee contributions of 6.2 percent for Social Security and 1.45 percent for Medicare). In addition, the client must pay federal income tax on the salary at his or her individual taxable rate.

In contrast to such a salary payment, a client who takes a taxable distribution from his or her retirement account will pay his or her individual tax rate on that distribution, plus an early distribution penalty of 10 percent if under the age of 59 ½, unless the client falls within certain limited exceptions.

Which is smaller: a tax bite of 15.3 percent or 10 percent? Obviously it is not tax-efficient for a client to roll over retirement funds and then take a salary from the proceeds of the plan's employer stock purchase; that's the 15.3 percent hit. Why not simply take a taxable distribution and save 5.3 percent on the tax?

Some might argue that taking a taxable distribution isn't what they would choose because the distribution loses its "tax-deferred status." In that argument, it would actually be better to take a loan from your 401(k) instead. That way you can pay the 401(k) back over time, repaying the principal to your 401(k) plan plus interest, providing additional profits to your plan.

ONGOING VALUATION

Both the Internal Revenue Code and ERISA require an annual report be completed and published for most employee benefit plans. This is accomplished through IRS Form 5500. Each year, this report calls for a valuation of the assets of the retirement plan. It is required that the amount reported on this informational return reflect a good faith effort on the part of the entrepreneur to calculate a fair market value. In many cases, this doesn't need to involve a formal appraisal, as the cost may be prohibitive for a small business.

At times where there is a transaction, such as a distribution, allocation or purchase of stock, a valuation should be performed by an independent appraiser to determine fair market value. Many ROBS providers, including Guidant, provide extensive tools for clients to help them easily meet the good faith requirement for determining a fair market value for the stock.

PERMANENCE

One of the requirements all qualified retirement plans must meet to remain qualified is permanence. ROBS are no exception. Although Treasury [Reg. Section 1.401-1\(b\)\(2\)](#) acknowledges that the business may terminate the plan for business necessity, that's a decision that should not be taken lightly. ROBS clients should keep their 401(k) plan active and contribute regularly. We recommend a minimum of 1 percent of the owner-employees compensation be deferred to the plan. Not only can you take advantage of the power of tax-deferment, but you can also ensure permanence is not an issue.

BENEFITS, RIGHTS AND FEATURES (BRF)

The IRS wants to ensure the plan does not discriminate in favor of "highly compensated employees" through its failure to provide "benefits, rights and features" in a non-discriminatory manner. It's important you make all BRFs effectively available to your team at the time they are deemed eligible.

EFFECTIVE AVAILABILITY

One of the fundamental requirements of a tax-qualified plan, such as a 401(k) that's part of a ROBS arrangement, is that the corporate owners cannot provide disproportionate benefits from the plan to themselves. See [IRC § 401\(a\)\(4\)](#).

The non-discrimination rules place all employees into one of two categories: either a Highly Compensated Employee (HCE) or a Non-Highly Compensated Employee (NHCE). Although the specifics of all the non-discrimination rules are beyond the scope of this article, the general rule for ROBS purposes is that the benefits, rights and features of a plan that are available to the HCEs need to be both (a) currently available and (b) effectively available on a non-discriminatory basis to the NHCEs. See [Treasury Reg. § 401\(a\)\(4\)-4\(b\)](#) for more on current availability, and [§ 401\(a\)\(4\)-4\(c\)](#) for more on effective availability.

These rules are significant in a ROBS context because there are at least two common BRFs available to HCEs that also need to be available to NHCEs. The first is the ability to make rollover contributions into the 401(k). The second is the ability to acquire employer securities with retirement monies in the participant's individual account plan.

The most common non-discrimination issue that arises in a ROBS arrangement is effective availability with respect to the right to purchase Qualified Employer Securities (QES). Effective availability is a facts and circumstances test [see [Treasury Reg. § 401\(a\)\(4\)-4\(c\)\(1\)](#)].

EFFECTIVE AVAILABILITY, CONTINUED

Hence the task for a ROBS client is to fashion the stock offering for QES to NHCEs so that the right to purchase QES is effectively available in light of the facts and circumstances for that particular situation.

Some employers choose to make open-ended stock offerings to NHCEs in order to satisfy the effective availability requirement, even though there is no explicit requirement in the Internal Revenue Code, regulations or case law that such open-ended stock offerings are mandatory. However, as long as the initial offering and any subsequent offerings are effectively available to the NHCEs, the non-discrimination requirement should be met. The best approach is for a ROBS client to discuss the effective availability requirement with his or her tax and ERISA attorney, explore the client's particular set of facts and circumstances, weigh the legal issues against the client's risk tolerance level, and then come up with an effective availability plan for employer stock offerings that will meet the client's business needs while satisfying the non-discrimination requirements.

BONA FIDE EMPLOYEE

One of the fundamental, definitional requirements of a qualified plan is that it is a trust for the exclusive benefit of the employees or their beneficiaries. This is what is known as the "Exclusive Benefit Rule," phrased in ERISA as the "Exclusive Purpose" rule. Since the Exclusive Benefit Rule requires coverage only of employees, the Exclusive Benefit Rule is violated if non-employees — such as independent contractors or silent investors — are allowed to participate. If there is a violation of the Exclusive Benefit Rule, it could disqualify the plan.

To comply with this legal requirement, Guidant developed a protocol that anyone rolling retirement monies into the plan must be a bona fide employee of the business. This protocol is designed to avoid scenarios involving 'ghost employees' (people who are placed on payroll but never show up, never provide any actual service to the corporation and are really not employees). It's also designed to avoid the situation where someone really intends to be a silent investor in which they roll retirement money into the plan with no intention of actually working in the business. Either scenario would violate the Exclusive Benefit Rule and hence must be avoided.

To meet the Exclusive Benefit Rule established by ERISA, Guidant suggests business owners who use ROBS work at least 1,000 hours in their business per year. This avoids a violation that could lead to plan disqualification.

Since the Internal Revenue Code doesn't define what work requirements must be met to qualify as a "bona fide" employee, Guidant established internal protocol by which a "bona fide employee" is one who works a minimum of 1,000 hours within a 12-month period. This standard boils down to someone who works in the business about half-time. The 1,000-hour standard is not specifically required by the IRS, but over the course of 10 years working with the ROBS product, we've found it effectively accomplishes what is necessary — to keep non-employees out of the plan and to avoid disqualification of the plan due to a violation of the Exclusive Benefit Rule.

ANNUAL PLAN ADMINISTRATION

In addition to reporting the value of the plan assets, the plan must keep an accurate recordkeeping system that will track and properly determine participation in the plan, as well as attribute contributions, earnings and losses, plan investments, expenses and benefit distributions. The recordkeeping requirements for 401(k)s or pension plans can be a challenge, which is why it's so important to work with a qualified firm to assist you. As part of their program, recordkeeping firms should include:

- ✓ Form 5500 preparation.
- ✓ Annual estimated business value report.
- ✓ Audit protection.
- ✓ Annual industry report, benchmarking data.
- ✓ Participant deferral and contribution accounts.
- ✓ Mandatory amendments.
- ✓ Account reconciliation.
- ✓ Computation of profit-sharing allocations.
- ✓ Annual non-discrimination testing.
- ✓ Annual top-heavy, additions & coverage testing.
- ✓ Annual participant statements.
- ✓ Compilation of annual company report.
- ✓ Monitory contributions vesting.
- ✓ Annual allocation of employer contributions.

At a basic level, meeting plan operational guidelines are relatively straightforward and not specific to ROBS (any business with a 401(k) must follow these guidelines). The plan must properly notify all employees of its existence, offer each employee the option to participate, file reports on time, not use plan funds to buy personal recreational vehicles and so on.

The problem is many entrepreneurs are great businesspeople but not experts on tax law or retirement plan administration. Much of the confusion about the validity of ROBS has been caused by entrepreneurs who recognized how powerful this form of financing can be but did not seek qualified advice and, as a result, failed to meet basic requirements. Experienced ROBS providers will educate clients upfront, provide documentation and help clients test for problems and potential pitfalls at the end of each tax year. The key is to develop an ongoing relationship with an administration firm to ensure the plan stays in compliance and consistently meets plan operation guidelines.

PER THE INTERNAL REVENUE SERVICE

For years, entrepreneurs have used retirement funds to invest in a small business. As interest in and execution of this method of funding grew, the IRS published an [internal memorandum](#) (one the public cannot rely on but can learn from) on Oct. 1, 2008, which is still highly regarded today. The memo regarded qualified plan structures that allow participants to invest in business start-ups. It recognized that ROBS arrangements were not illegal when properly operated, but their initial review determined that many ROBS plans had operational/structural challenges, which is why it's so important to work with a qualified firm who can guide you on these requirements.

In December 2009, the Employee Plans Compliance Unit (EPCU) was tasked with developing a project to acquire information on ROBS plans to give them a better understanding of that industry. Their goals were to:

- Find ROBS plans that were out of compliance and take corrective action.
- Determine common traits of noncompliant plans.
- Design better compliance strategies when dealing with ROBS arrangements.

RESULTS (IN MY WORDS)

The IRS completed its investigation of ROBS compliance checks and acknowledged [varying results](#). They indicated some ROBS arrangements were successful while others “had gone out of business within the first three years of operation.” And, “since many of the ROBS we contacted had just started their business within the last few years, it was difficult to get a long term view of the characteristics of successful ROBS and those that failed.”

The following excerpt was taken directly from [IRS.gov](#):

The ROBS plans we looked at spanned a cross section of businesses, including those in senior care, cleaning services, fitness, health food, real estate, machinery, daycare, pet products and services, and consulting. Some ROBS were start-ups while others were purchases of existing businesses. Most of the ROBS were not part of an affiliated service group or controlled group. Some of the ROBS were franchises while others were stand-alone businesses. Some of the ROBS were started by individuals who had worked in that same field before starting a business of their own, while others had just started a business for the first time.

Most of the ROBS plans were pre-approved (Master & Prototype or volume submitter) Code section 401(k) plans. The ROBS plan typically had only one participant, the individual that completed the rollover and who was the sole employee. However, some of the successful ROBS had gone on to hire additional employees. Regarding employer contributions to the ROBS plans, many sponsors indicated none had been made beyond the initial rollover due to profitability concerns, however, some sponsors anticipated they would be making additional contributions shortly or within the next few years of operation. Many of the sponsors had assistance from their ROBS adviser with completion of the compliance check.

Ultimately, the IRS said they would review each Rollover for Business Start-up arrangement on a case-by-case basis. Since then, the IRS has not made any additional comments about the ROBS industry or further investigation. ROBS continues to remain a legal and viable option for entrepreneurs to invest in a small business.

THE BOTTOM LINE

IRA and 401(k) business financing is intended, by law, to be free of taxes and penalties. Nowhere in the Internal Revenue Code is it written that rollovers are valid only if they go to a plan that invests in marketable securities and not if they go to a plan that invests in employer stock.

ROBS share some similarities with Employee Stock Ownership Plans (ESOPs) in that they both have employer stock as a primary asset of the retirement plan. ESOPs are widely used to spread ownership of the employer among all employees; many companies, including Johnson & Johnson, have used ESOPs to fund company operations, adding to the long-term financial benefit of employees. Buying stock in a privately-held company is a completely legitimate form of investing. Congress wrote these rules and exemptions into law specifically to encourage such investments. And, these plans have helped tens of thousands of entrepreneurs open a business or franchise in all 50 states.

Investing retirement plan funds to start a new enterprise allows for investments in small business, creates jobs and builds additional retirement savings for investors and their employees. Entrepreneurs simply have to know the rules — and consistently follow them.

ROBS plays a growing role in helping us reignite America's job creation machine: small business.



Disclaimer: Guidant's analysis of this topic should not be construed as legal or tax advice to you. Should you have any legal or tax questions regarding a Rollovers as Business Startup (ROBS) arrangement to your personal situation, we encourage you to consult with your own adviser.