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Want to own your business?

ROBS your 401(k)

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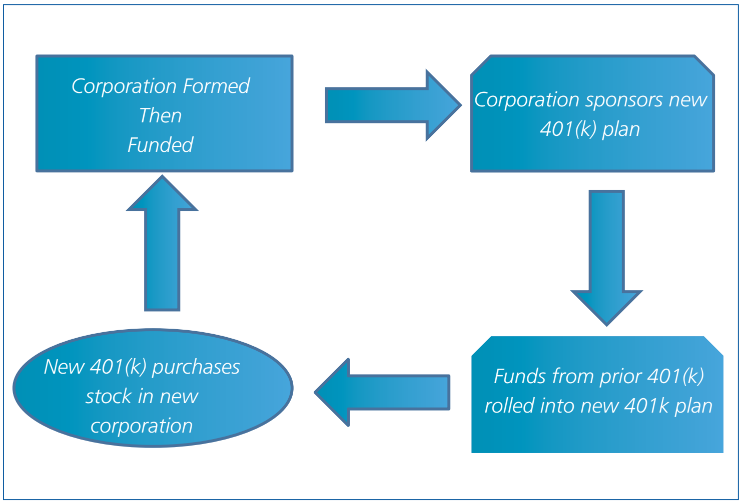
You don't have to ride in many elevators to know there's no shortage of new business ideas. Many people for many good reasons want to own their own business. Unfortunately, start-up capital and initial working capital is in shorter supply. In this event, the would-be entrepreneur should consider a ROBS of their 401(k).

The rollover-as-a-business-startup, or ROBS, is a tax-friendly method for an individual to access their existing 401(k) in order to start a business or to buy a franchise. With a ROBS, the entrepreneur forms a corporation, the corporation starts its own 401(k) plan, the old 401(k) funds are rolled over into the new 401(k) plan, and the new 401(k) plan purchases shares in the newly formed corporation. The result is that the corporation is flush with equity investment from the new 401(k) and the new 401(k) is a shareholder in the corporation.



Going forward, the business can offer participation in the new 401(k) plan to its employees, which is an attractive benefit to acquire talent in today's economic environment. To date, billions of dollars have been reallocated and thousands of businesses have started as a result of ROBS transactions.

The ROBS arrangements are not tax shelters or loopholes. From a tax perspective, there is nothing fundamentally unusual or improper in their use. That said, nothing is simple and the ROBS approach is actually a precise process that must meet IRS scrutiny. As a result, an improper ROBS subjects the business owner with the potential to lose their entire savings to the IRS.

For example, in order to have a valid ROBS arrangement, the entrepreneur must intend to use the funds for legitimate business operations. The entrepreneur must intend to permanently form and administer a plan and the entrepreneur must reasonably believe that the plan's acquisition of corporate securities is an appropriate investment of the plan assets. If an individual engages in a ROBS arrangement and does not actually establish an operating business, then the entire plan could be disregarded for tax purposes.

This harsh penalty is to deter individuals from avoiding tax payments on early distributions from qualified plans simply by channeling the distribution through an improper plan or to a corporate shell. Also, the entrepreneur cannot use retirement assets to support hobbies or personal activities without the risk that the entire arrangement will be disregarded for tax purposes. To keep a ROBS transaction compliant, the entrepreneur must be mindful of IRS, Department of Labor, and ERISA rules and requirements. As a result, prospective business owners should seek the professional advice of a benefits expert.

In short, a ROBS strategy is a viable funding strategy if the entrepreneur follows all of the legal requirements for establishing and operating 401(k) plans and for offering qualified employer securities to employees. A ROBS arrangement that is properly structured and administered will comply with the tax laws and it will serve legitimate tax and business planning purposes. It is critical, however, that entrepreneurs who fund their businesses through ROBS arrangements understand the possible legal pitfalls and that they are steadfast in their ongoing responsibilities as fiduciaries of their companies' retirement plans.

The foregoing does not represent and is not intended to be construed as legal or tax advice. To learn more about a ROBS arrangement, please contact a professional with knowledge in this area, including Philip Josephson, the founder of Sterling Business Law. Philip and the firm deliver corporate legal and business advisory service to clients across the United States. Philip holds a Finance degree and a J.D. from the University of Miami, an M.B.A. from Columbia University; is a member of the Florida Bar, the Arizona Bar, and the Federal Communications Bar; is a Registered Investment Advisor and is an avid golfer. You may contact him at pjosephson@sterlingbusinesslaw.com.