Trending Now: The ROBS Plan

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By:

Bart A. Basi

Dr. Bart A. Basi is an expert on closely held enterprises. He is an attorney, a Certified Public Accountant, and the President of the Center for Financial, Legal & Tax Planning, Inc. He is a member of the American Bar Association's Tax Committees on Closely-Held Businesses and Business Planning.

And

Marcus S. Renwick

Marcus Renwick is an attorney and the Director of Research and Publications with the firm.

Introduction

Many people dream of owning their own business. They see setting their own hours, getting the deal, making cases of money, and early retirement in their future. Other people (the realistic people) attach a time frame to it and make it happen. They realize that if they are to succeed, “setting their own hours” will involve working until midnight.To them, they know that “making money by the case load” will also mean paying out an even bigger case of money. Quite simply, they realize this is going to require hard work, money, and a lot of it to start a business.

From legal fees, to purchasing equipment, to leasing a building, it all takes capital to do so. There are all kinds of methods to get the necessary funds. People will turn to their home equity, friends, and even credit cards to get them going. There is also another way of funding under what is known as the Rollovers as Business Start-Ups or ROBS plan. Many people have never heard of this. The first business funded with a ROBS plan was done successfully in 1983 by a full service retirement plan design firm named Benetrends, Incorporated.Since 1983 tens of thousands of entrepreneurs have used this program successfully to start, acquire or grow their business.

The ROBS Plan

The name is derived from the Internal Revenue Service program known as, “rollovers as business start-ups”, which began in December of 2009 and ended in September of 2011.The acronym of “ROBS” is not coincidental given the former light the IRS cast these programs. Under the ROBS plan, individuals can utilize money from their retirement plans in order to aide them in starting a business. It is not a loan, it is **not aprohibited transaction** when properly structured and maintained by professionals through a company retirement plan and not as an investment directly from an Individual Retirement Account (IRA) into one’s business.The transaction itself is actually more synonymous with an ordinary investment any qualified retirement account would get into.Instead of one investing in mutual funds or other securities, the entrepreneur may invest part or all of their funds from many types of retirement funds from a 401(k), 403(b), IRA, TSP and several other qualified retirement plans into the stock of their own business (Roth IRA, Non-Spousal Inherited retirement funds, and some other types of plans may be prohibited, annuities sometimes may have smaller early withdrawal fees). Legitimate investments for an IRA for instance might include land, buildings, publicly trade stocks, bonds, currencies, and even collectibles such as gold, silver, art, ancient publications and the like.

However, regulatory statutes prohibit investing from an IRA directly into a business where the owner will have a majority ownership interest or receive a salary.   With a ROBS plan, the retirement funds within a ‘company’ retirement plan can be used to invest into a business of which the owner can operate and receive compensation.

IRS Alert Memorandum

Late in 2008 the IRS had noted a significant rise in compliance related issues and issued an IRS alert memorandum in October of 2008 noting several compliance concerns. For almost twenty five years this resource was available to the marketplace and there were no significant compliance issues when these programs and plans were being established by full service retirement design firms.This suggests that all plan providers may not offer the same type of plans or may provide lower levels of ongoing expertise and limited advisory services.

What changed?

Between early 2000 and 2008 the industry saw the entry of numerous financial and funding firms (often these were NOT experienced full service retirement plan design firms). They often offered similar, more simple but usually not the same exact vehicles offered by existing providers. These plans were often standard document plans and as such lowered the cost for the provider to offer (but often not a lower cost to the clients) and technically provided a way to simply fund a business. These firms often only offered one type of plan or hybrid plan… most offered a relatively simple 401(k) or 401(k)/Profit Sharing Plan hybrid designed to fund the business. While these simpler, lower cost plans allowed people to legally access their retirement funds they may not be the best fit long term for a small business or provide the best protection from the double taxation risks in a C corporation.

These types of plans have garnered the nickname of ‘401(k) mousetraps’ or tax-traps. The cheese, in this case,refers to access to retirement funds tax deferred, penalty and debt free but often provides limited protection from the potential increased taxation traps as profits rise and subject the client to potential double taxation and are not often recommended for many start up or smaller businesses. In addition, while 401(k) were designed to primarily benefit the employee… customized plans can often better benefit the employer by reducing significant administrative work and hidden costs. Furthermore, customized plans can help avoid payroll taxes associated with 401(k)s potentially resulting in very significant loss in long term wealth accumulation and protection. Finally, custom full service design firms can often adapt or design plans that can provide tens and even hundreds of thousands of dollars ‘annually’ in profit and tax protection allowing one to accumulate, accelerate and protect much more pretax wealth.

Hybrid 401(k) plans are often less costly to initially implement but may be significantly more costly for the plan holder or business owner years down the road. In some cases, a 401(k) may actually make sense. Having a firm that offer a variety of options that can better discuss different options makes a lot of sense.

An important distinction is that a full service design firm also offers this simple type of 401(k) plans and hybrid options but provide other options as your business grows and your revenue, profitability and personal needs change. Rather than simply focusing on ‘funding’ your business, a design firm can often provide more options to help you build a profitable and successful business, protect wealth and strategically plan for your future exit from the business.

Not as Easy As It Sounds!

Prohibited transactions (in qualified plans) generally include the following transactions:

1. A disqualified person’s transfer of plan income or assets to, or use of them by or for his or her direct benefit. An exemption occurs when this is used in the normal course of business for a corporation (ROBS require a C corporation structure)

2. A fiduciary’s act by which he or she deals with plan income or assets in his or her own interest

3. A fiduciary’s receipt of consideration for his or her own account in a transaction that involves plan income or assets from any party dealing with the plan

4. A transaction occurring strictly for investment purposes and not to fund a business providing a good or service

5. Any of the following acts between the plan and a disqualified person:

    - Selling, exchanging, or leasing property

- Lending money or extending credit
- Furnishing goods, services or facilities

Thank you Internal Revenue Service! You can now see why the IRS used the acronym ROBS. Unfortunately, in the past, the IRS suspected abusive transactions and adopted a wait and see approach. Unfortunately, when the IRS takes a wait and see approach, it is synonymous to a cat crouching down and not blinking while staring at a single object. (You get the picture!)

Unfortunately!

The ROBS plans are still in the cross hairs of the IRS. While the IRS has recognized the set up of these plans as legal, a primary concern continues to be ongoing “operational compliance” and in light of past and continuing compliance problem, it becomes imperative to use experience firms with decades of expertise illustrated by

1. A large number of routine audits that have resulted in no change orders (it can often take 6-8 years for an audit to occur)
2. A complete complement of in-house certified experts
3. Firms that provide audit protection
4. Firms that guarantee their work from fines, penalties and interest charges..

The use of ROBS plan do not justify investing in any business. As with any investment a prudent investor should fully research the potential success and return of any investment. Small studies have been done and have identified that many of these start-ups utilizing ROBS plans are failing or near failure. However, this is often the case with any start-up (Remember the starry-eyed mentioned in the first paragraph?). Many are finding that having a debt free or reduce debt form of funding can actually increase their potential for success.

It is likely that more rules are coming with regard to the ROBS plans to better protect consumers and they will continue to face scrutiny from the IRS. Additionally many promoters are able to get favorable determination letters, but don’t follow through with the entire project or provide adequate ongoing operational counsel. This gains the ire of the IRS!

Fortunately!

The IRS has issued thousands of determination letters or DLs to business owners regarding ROBS plans that they now utilize in their businesses as capital. Many individuals have utilized ROBS plans to purchase franchise operations, others their own independent click, brick and mortar businesses. The better thing is that the IRS has respect for the ROBS plan now as opposed to when they first came on IRS radar. Benetrends, Inc. is the company that discovered the legal pathway to enable entrepreneurs to access their retirement funds in 1983 and is the tenured and respected expert in the industry. While I do not endorse companies such as Benetrends directly, I will say that companies such as this run through the entire transaction and get the forms and calculations into proper form.

Conclusion

While a ROBS plan is not for everyone (starry eyed dreamer), ROBS plans can get the hard working individual who needs funding into a business that they can operate for a reasonable return. BIG WORDS OF CAUTION:

1. When shopping around for an administrator, be sure they know what they are doing and they will carry through with the entire endeavor. It is easy to make a mistake. It requires diligence to be mistake free.
2. How long have they been providing their services (in light of recent issues, experience counts)?
3. Are they a full service retirement plan design firm or do they simply provide the resource to fund businesses?
4. Do they staff a full complement of certified retirement specialists?
5. What other services do they provide to help you grow a profitable business?
6. Do they provide more than one product or hybrid product to allow you to accumulate, accelerate and protect more profits from double taxation and other potential costs?
7. Do they provide audit protection?
8. Do they guarantee protection against potential fines and penalties?

If they do not, I would steer clear of anyone promoting a ROBS plan. They gain, you can lose everything and your retirement in the process. When choosing a ROBS plan, go with a plan administrator with experience and leadership in the industry. If you have any questions on this or any other retirement issue, be sure to contact the professionals at The Center at 618 997 3436.