**What Tax Professionals say about Rollover Financing**

Benetrends has been at the forefront of developing 401(k)/IRA business funding without penalty. In fact, our founder, Len Fischer, was the original architect of this approach. While 401(k)/IRA business funding has been around for nearly three decades, quite often our clients find that early in the process of Rollover Financing, their professional advisors are not familiar with compliance issues. Whether it is their personal accountant, attorney or financial advisor, their local advisors may not be familiar with this funding strategy.

In order to summarize and highlight the process for these professionals, we have included a copy of “Practical Tax Strategies,” that specifically addresses 401(k)/IRA business funding, how it works and what the benefits are.

Important notes about the article......

- It was published in a well respected accounting industry publication in the October 2011 edition of “Practical Tax Strategies,” –not Benetrends.
  - *Practical Tax Strategies* alerts readers of timely tax issues, focusing on practical strategies to reduce client taxes and satisfy statutory and regulatory compliance mandates. Articles are written by tax practitioners who understand the real-world demands of servicing clients. Concise summaries of recent developments are arranged by subject areas and slice into the ever-changing tax scene.
  - The article was written by TWO tax specialists; both are partners at a prominent tax and legal practice.
- The article does not focus on one provider of rollover funding rather it focuses on the legality and structure of this funding option.

We have taken the liberty of including a copy of Practical Tax Strategies article on Rollover Financing for Start-Ups.

We advise you and your personal advisors to review this article to better understand the proper structure for Rollover Financing.
Compare Cost Recovery Options

Rollover Financing for Start-Ups

Estate Planning for Family Farms
USING RETIREMENT ASSETS TO FINANCE A NEW BUSINESS: COMPLIANCE IS THE KEY

KATHLEEN M. NILLES AND JONATHAN E. STROUSE

While rollover financings can help aspiring entrepreneurs in the economic downturn, they must be carefully structured and comply with IRS filing and other legal requirements to avoid IRS challenge.

Following the economic downturn, small businesses and aspiring entrepreneurs found it increasingly difficult to obtain conventional financing. Thus, it is not surprising that, in 2009, several thousands of start-up businesses were financed through retirement fund rollovers (rollover financings). According to a recent survey, most businesses financed through this mechanism has exhibited staying power and have been successful enough to hire additional employees. Rollover financings have been described as a "win-win situation" in a Forbes article because of their job creation ability.

However, even with these successes, rollover financings have become controversial—due, in large part, to IRS concerns about compliance and the potential for abuse. This article reviews the basic structure of these rollover financings, analyzes the IRS's concerns, and details how entrepreneurs and their tax advisors can satisfy the compliance requirements the IRS has identified. It also suggests how to deal effectively with an IRS inquiry (e.g., a compliance check or audit).

Rollover financings
Rollover financings are not new but have recently gained in popularity. The basic financing structure generally involves at least five discrete steps:
1. The entrepreneur forms a new business organized as a C corporation (New Business).
2. New Business adopts and sponsors a qualified retirement plan (Plan) covering all eligible employees. One of the investment options available to plan participants is the use of rollover money for investment in company stock (New Business stock).
3. Plan participants execute a plan-to-plan rollover of funds from their existing plan into the newly created plan.
4. Participants may direct some or all of their rollover funds to be invested in New Business stock—making such company stock one component of the participant's retirement portfolio.
5. Funds from the sale of New Business stock to the Plan can be used by New Business to purchase business assets such as a franchise license or pay start-up business expenses.

Under current tax law, neither the plan-to-plan rollover of retirement funds, nor the funding of the business through the Plan's purchase of New Business stock, is treated as a taxable distribution. In fact, because the funds are rolled over into a qualified plan, there is no dis-
tribution at all. As former IRS Deputy Commissioner Mark Matthews and tax attorney Brian McManus concluded when considering the legality of Rollover Financings:

[Rollover financings] are not tax shelters or unwise in anyway. Not are they per se noncompliant with the complex plan qualification rules. IRS officials have correctly recognized that a properly structured and administered rollover financing arrangement can satisfy both the requirements and spirit of the tax laws and serve legitimate tax and business planning purposes.5

Consistent with this recognition, the IRS has issued many favorable plan determination letters, including some prototype plan rulings. Recently, Treasury's Associate Benefits Tax Counsel called rollovers into plans investing in employer stock an "inherently imprudent investment," but conceded that the rollovers are "statutorily permitted."6

IRS reaction to rollover financings
As noted above, new business financings have become somewhat controversial over the past couple of years. The controversy was ignited by a 2008 IRS memorandum authored by Michael D. Julianelle, Director of Employee Plans.6

In the memorandum, Julianelle coined the now common term "ROBS"—as in "rollover as business start-ups"—for this type of plan. The memorandum discussed various potential administrative and operational failures, but it ultimately concluded that ROBS were legal and not abusive per se. Hence, the memorandum notes that the IRS compliance efforts must focus on the operational aspects, such as a lack of employee notice of plan benefits or failure to file required tax forms, to determine whether a plan remains "qualified" or not. However, almost all of the potential operational failures discussed in the memorandum apply equally to all qualified employee retirement plans, not just ROBS plans.

Primary compliance issues
Based on the authors' experience and review of IRS guidance in the memorandum and subsequent IRS website postings, most compliance failures can be traced back to one of four main, easy-to-avoid problems.

Filing requirements. Newly incorporated businesses have various annual filing requirements, but two obligations in particular have caught the attention of IRS.

• As a C corporation, New Business is required to file a Form 1120 (U.S. Corporation Income Tax Return). The return is due two and a half months after the tax year ends (March 15th if the New Business uses a calendar year).8
• As a plan sponsor, New Business also must file a Form 5500 (Annual Return/Report of Employee Benefit Plan) because it is sponsoring a qualified retirement plan.9 This form is due by the last day of the seventh month following the end of the plan year (July 31st if New Business uses a calendar year).10

An IRS compliance check program has targeted new businesses that failed to file either the Form 1120 or the Form 5500. Advisors should remind clients that both forms should be fully and accurately completed and timely filed.

Plan non-discrimination/rollover options. Qualified plans are prohibited from discriminating in favor of highly compensated employees (HCEs).11 Of course, such non-discrimination rules apply only when a plan has both HCEs and non-HCEs. In many cases, a new business will not be subject to these rules—either because the entrepreneur is the only employee or because his or her salary is below $110,000 per year.

However, assuming the rules do apply, the IRS appears to be particularly concerned about whether a plan's benefits, rights, and features effectively are made available to all participants in a nondiscriminatory manner.12 The "right" at issue here is the use of rollover funds to purchase employer stock. The Plan could poten-

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7. Section 6012(a)(2); Reg. 1.6012-2(a)(3).
8. Section 6072(b).
9. Section 6056(a).
10. Reg. 1.6058-1(a)(4); Instructions for Form 5500.
11. Section 6012(a)(4).
Currently, the IRS is conducting compliance checks on a number of different employee plans.

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employer immediately pays professional fees to the transaction advisor out of the plan assets. If a transaction advisor meets the requirements of a fiduciary pursuant to Section 4975(e)(3), paying the advisor's fee from plan assets is prohibited. However, this prohibition is easily surmounted by having the entrepreneur pay the advisor's fee from non-retirement funds or by making sure that the transaction advisor avoids rendering investment advice.\footnote{Julianette, supra note 6 at 9. It should be noted that transaction advisors are not "promoters."}

**Issuing Forms 1099-R.** The IRS has stated that Forms 1099-R (Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs) often fail to be issued. However, any such failures are rare in the authors' experience. In any event, these are the former employers' failures, not the obligations of the New Business or the Plan. Of course, if the Plan were to be dissolved, a Form 1099-R would need to be issued with respect to any and all distributions made to plan participants.

**If the IRS does call**

If an entrepreneur and his or her tax advisor have followed the rules applicable to plan rollovers and employer stock purchases by qualified plans (as outlined above), they should have nothing to fear from an IRS compliance check or even a formal plan examination. (Currently, the IRS is conducting compliance checks on a number of different employee plans, and has recently completed compliance check programs on 401(k) plans and ROB plans.\footnote{Section 4975(e)(3) prohibits a fiduciary from dealing with the assets of the plan in his or her own interest or for his or her own account. In Section 4975(e)(3), the definition of a "fiduciary" includes a person who renders investment advice for a fee. A person will be deemed to be rendering "investment advice" if a person renders advice on "the value of securities or other property" or makes recommendations on "buying, selling, or retaining securities or other property" in which such person has discretionary control or, on a regular basis, renders individualized advice that serves as the primary basis for the investment of plan assets.} However, if an entrepreneur is contacted by an IRS agent for either type of examination, it is best to enlist expert assistance at the outset. Someone with experience handling small employee plan audits and knowledge of the legal basis for these rollovers will be best equipped to prevent the IRS agent from going down the wrong track.

**Conclusion**

Using retirement funds to start a business can be a practical solution in these tough economic times. Such funds are accessible, inexpensive, and the rollover transaction (if correctly executed) allows the retirement assets to stay within a qualified plan. If the rollover-financed business succeeds, it will create jobs and provide financial security for the founders. However, no matter how good the idea or successful the new business, compliance is the key to using rollover retirement assets in the current environment.\footnote{See www.irs.gov/retirement/article/0, id=216613,00.html.}