



5 Mistakes People Make When Funding A Business With 401(k) Financing — AKA ROBS?

Read this before using 401(k) business financing, also known as [Rollovers for Business Startups \(ROBS\)](#).

The usage of **Rollovers for Business Start-ups, or ROBS**, is growing at a rapid pace, and sadly, many financial professionals attempting to provide oversight don't properly understand the ERISA and Internal Revenue Code guidelines. Working with inexperienced firms comes solely at the retirement plan owner's risk and can easily be avoided by working with a reputable, experienced firm.

As the largest provider of these services in the country — helping more than **35,000 entrepreneurs** invest **over \$5 billion dollars** in small business and franchising with 401(k) business financing — we've put together the top five mistakes we see people make and how you can avoid them:



Using a profit sharing plan instead of a 401(k) plan

Why would you buy a Hummer as a commuter car? It's way more than you would need and very expensive to maintain. It's the same with a profit-sharing plan. It's expensive to maintain, mandates contributions and 99 percent of the companies we serve won't utilize its benefits. However, a 401(k) plan is much more practical. This type of retirement plan makes your contributions and matching flexible, is less expensive to maintain, and is completely adequate for saving significant monies for your retirement.

Profit sharing sounds enticing, but it doesn't provide a tangible benefit to most companies. Firms have the option to charge a premium to offer a profit-sharing plan, but it is our belief that it's in our client's best interest to use a 401(k) plan instead.



Taking incompetent or unethical legal advice

It's baffling that many companies who help individuals form ROBS arrangements have no in-house legal personnel. Most that do are limited to one attorney. It's clear that someone who's not an attorney cannot provide legal advice, yet some providers claim to offer unlimited legal support. By deliberately using the term "support," they're intentionally misleading clients into believing that their in-house team can give them advice. They cannot. They are not a law firm and their team of attorneys represents their company, not their customers. There is a clear conflict of interest. In fact, this is considered unethical under the Rules of Professional Conduct (RPC).

Guidant Financial is not a law firm, and we do not provide legal advice to any client — ever. However, we have the largest team of in-house attorneys in this industry, and they're available to answer your questions any time, providing unlimited support, but not legal advice.

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Paying yourself a salary before generating revenue

Many organizations promote the fact that in the ROBS arrangement, you can pay yourself a salary from day one. That is only half true, and as you'll see, it's for marketing purposes, not structural integrity. The reality is that you must qualify as an operating company (being open and engaged in the sale of exchange of a product or service) before you can pay yourself a salary.

In addition, there is a common sense issue that is rarely addressed by ROBS providers. A salary is subject to federal employment taxes at a rate of 15.3 percent, plus federal income tax. In contrast, a client who takes a taxable distribution from the plan will pay federal income tax plus a 10 percent early distribution penalty if under the age of 55. Thus, from a tax perspective, it is not optimal for the individual to roll over the distribution and then take the plan benefits as salary.

Our recommendation is that you wait to take a salary until your business is generating revenue. Work with the attorney in our outside counsel program to determine which option is best for you.

[Learn more about paying yourself a salary with ROBS here >>](#)



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Placing value in cash-basis appraisal

There is a growing trend of ROBS providers who promote a cash basis appraisal upon the initial formation of the structure as a tangible benefit to a client. In most ROBS arrangements, the plan is to acquire shares of a new business that has never sold anything.

The new business has no assets, no income, no customers — nothing. So at this time, the shares' value is equal to the sum paid in cash. Because there are no other assets or liabilities at this start-up phase, it is reasonable to assume that this simple exchange represents adequate consideration.

Therefore, the appraisal is unnecessary and of no added benefit.

[Learn more about business appraisals here >>](#)

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Misunderstanding the benefits of a C Corporation

Most tax advisors default to an S Corporation (S Corp) or LLC when setting up a new business, but C Corporations (C Corps) can be greatly beneficial for small business owners. In addition to fully deducting benefits, C Corps can lower the taxable income of the business by paying a salary to you as the owner — as your salary may be a write-off to the business before taxation.

In order to use ROBS, your business must operate under a C Corp. For that reason, you'll want to work directly with a tax professional who is willing and able to help you maximize the structure.



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