Guidant

Thank you for taking the time to speak with me! Our Rollovers forBusiness Start-ups structure can provide you with a qualified retirement plan that allows you to invest in your small business. To comply with all regulations and guidelines, you must meet certain requirements and fulfill ongoing responsibilities. We've already covered these topics in detail on our call - below is a quick summary. You'll also find more details with the Five Pillars of ROBS, a guideline explaining what you need to do as a ROBS client.

Structural Requirements

Your business must be an operating company.
Your business must be actively engaged in the buying or selling of any product or service with the exception of the investing of capital (e.g., a moneylending business.) Your company may purchase, hold, a nd sell real estate as its primary profit center.

Your business entity must be a C-corp.
Only a C-corporation has the appropriate type of stock to enable an investment of qualified 401(k)monies. "Pass-through" entities, such as an LLC or S-Corporation, aren't permitted.

Your retirement account must be a qualified plan.
Guidant uses a 401(k) as the qualified plan because of the flexibility to match or profit share at the discretion of the employer.

Your Personal Responsibilities

You have a fiduciary duty to act in the best interest of the 401(k). Your due diligence must validate that purchasing stock in your business is a good investment and in the best interest of your 401(k) plan.

You must manage the 401(k) plan to the benefit of all employees. You must encourage all eligible employees to participate in the 401(k) plan and may be required to offer them the option to invest in the stock of your business

Your compensation may never be more than what is fair and reasonable for the position and industry.

Additional Considerations

Only bonafide employees of the business can invest through the 401(k).
An employee must work 500 hours or more annually (~20 hours/week) to be eligible to participate in the 401(k) and invest in employer stock.

Stock must be purchased for adequate consideration.
To ensure the 401(k) pays fair market value for the purchase of stock, your business must be appropriately valued. If you're investing in your existing business, this will require an appraisal. In general, if you are starting a new business or franchise or purchasing a business from someone who won't retain a financial interest in the business and is not a direct family member, no appraisal is required.

Guidant

The Five Pillars of ROBS

Maintaining Conditions for ROBS Compliance

Pillar #1 - Client's Duty of Prudent Investment

The initial decision to utilize retirement funds for this investment must be consistent with the client's fiduciary duties under ERISA § 404.

As a trustee and fiduciary of the retirement plan, you have a duty to act in your retirement fund's best interest. In other words, you must wisely invest the retirement assets in the plan. Any investment carries an inherent risk and may or may not turn out to be beneficial to your retirement plan. So how do we determine if you are fulfilling the requirements of the first pillar?

The Department of Labor (DOL) states that fiduciaries of the plan must act prudently and solely in the interest of the plan's participants and beneficiaries when deciding what investment options are available for the plan assets. The trustee should look at how they think the business will do and the likely growth the business may experience to determine if ROBS is a prudent investment.

Pillar #2 - Adequate Consideration for Fair Market Value

The Qualifying Employer Securities (QES) must be purchased by the plan for no more than "adequate consideration" as required by ERISA § 408(e).

The 401(k) plan cannot pay more than Fair Market Value (FMV) for the stock it purchases in the C corp.FMV is defined as a price determined between a willing buyer and a willing seller, where both parties are familiar with the essential facts of the deal. They aren't under any "extraordinary compulsion" to buy or sell and aren't related to each other.

If the buyer and seller are related in some way (familial or the client is refinancing her own business), it's important to have FMV determined by a third-party appraiser. By doing this, it ensures that a fair price is set for both the buyer and the seller.

Pillar #3 - Business Must Bean Operating Company

The corporations' activities must meet the "operating company" or "real estate operating company" definition within ERISA Reg. § 2510.3-101.

The business that you're starting or buying must be an operating company. The DOL defines an operating company as:

An entity that is an active trade or business (more than just a hobby)...
...that is primarily engaged (the main function of your business)
...directly or through a majority-owned subsidiary (more than 50 percent owned)
...in the sale of a product or service (selling goods or charging for delivering a service)
...other than the investment of capital (can't make money off lending or investing the funds).

Most small businesses and franchises meet this requirement without issue. Types of businesses that run into a problem with this pillar are factoring companies (which the IRS considers to be an investment of capital) or more passive investments like a single real estateproperty you intend to rent out.

Pillar #4 - EmployerMustNot DiscriminateAgainst Non-HighlyCompensated Employees (NHCE)

The right to purchase employer securities must be made effectively available to all the corporation's rank-and-file employees.

NHCE stands for "Non-Highly Compensated Employee." The opposite is an HCE: Highly Compensated Employee. HCEs are defined as anyone who makes over a certain dollar amount each year. The IRS sets this dollar amount and may change it on an annual basis.

The fourth pillar says the employer must offer each employee the ability to buy stock in the company with their own retirement funds. It might sound scary at first – it's your company, and you don't want shareholders taking control away from you. But here's the thing: it's probably not going to happen. You're required to make the offer when the employee is hired, but the employee likely won't accept it. Of the over 35,000 clients that Guidant has worked with since 2003, all have offered this stock purchase to their employees. Only a handful have accepted.

Why is that? It can be challenging for an employee to deal with. The employee might not have retirement funds to use to buy stock. They might have the funds, but they've already invested in publicly held companies through an investment firm. Plus, the employee would be shifting from a liquid asset (their publicly traded stock) to an illiquid asset (stock in your privately-owned business). In other words, the employee would have to wait on you to sell your company before they would get their money back. So, while it's important to make the offer (to fulfill the pillar's obligation and not discriminate against any of your employees), it's unlikely they'll accept.

Pillar #5- Rollover Participants Must be Bonafide Employees

The client and anyone else who rolls money into the plan must be bonafide employees of the corporation; otherwise, it would be a violation of the exclusive benefit rule.

401(k) plans must benefit the employees of the company that sponsors the plan. To be able to roll money and participate in the plan, you must be an active employee of the business. This means you can't be a silent investor.

In practice, this translates to the owner of the business participating in the business somehow. The way you can participate varies broadly. You can be management, do bookkeeping, or even make coffee and take out the trash. We recommend the "bonafide" employee work at least 500 hours per year for their company. That's about twenty hours per week.

Have Questions? That's What We're Here For.

While the requirements for investing your retirement funds into your small business may seem daunting, I'm always available to help you understand and comply with these requirements, responsibilities, and considerations. Don't hesitate to give me a call!