More IRS Rumblings About Rollovers as Business Start-Ups

2/16/2011
Justin W. Stemple

Rollovers as Business Start-Ups – affectionately referred to by the IRS as ROBS – are arrangements in which someone uses existing retirement funds to purchase a business without taking a taxable distribution from an IRA or retirement plan. In many cases the retirement funds are the only significant source of personal assets that an entrepreneur has available to fund the acquisition of a business. ROBS may be structured in a way that complies with IRS regulations; however, over the past few years the IRS has made it very clear that it will closely scrutinize ROBS for compliance.

In the past year the IRS initiated a ROBS project to identify common compliance failures, to identify noncompliant ROBS and to design compliance strategies. The project focused on ROBS that applied for and received an IRS determination letter on the form of their retirement plan but did not file a Form 5500 annual report. The IRS contacted the plan sponsors and requested certain recordkeeping and administrative information, including:

- Whether the plan continues to exist
- Whether contributions had been made
- Information on the rollover of assets into the ROBS plan
- Participant information
- Stock valuation and stock purchase records
- General business information
- Why no Form 5500 was filed

The preliminary results of the ROBS project showed that there have been some ROBS success stories where the acquired business was sustainable; however, the IRS found that most had failed or were on the way to failing. The arrangements led to a very high rate of bankruptcy, both personal and business. In those cases the entrepreneur lost both the business and the retirement savings.

The IRS also reported the common compliance failures that it found with ROBS:

- Plan sponsors failed to file Form 5500. The IRS found many plan sponsors believed they were exempt from the Form 5500 filing requirement because of an exemption for single individual plans with assets under a certain dollar amount. That exemption does not apply when the plan itself, through its employer stock investments, owns the business.
- After the initial employer stock investment, plans were amended to prevent other participants from purchasing employer stock, which may be discriminatory.
- Plan sponsors failed to value the employer stock in the ROBS plan.
- Plan sponsors failed to file Form 1099-R for rollovers into the ROBS plans.

ROBS arrangements are often an attractive source of funds for potential small business owners, but they must be implemented and administered carefully to remain in compliance with IRS regulations. The ROBS project is ongoing and we will keep you apprised of new developments. In the meantime, if you have a ROBS arrangement or are considering one, you need to be aware that the risk of these arrangements is higher than ever and maintaining the plan in compliance with IRS requirements has become more important than ever. Please contact us if you would like to discuss ROBS arrangements.