DRDA

a professional limited liability company

Using Retirement Funds as a Source of Equity

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DRDA CPAs & Business Consultants

- Full Service CPA Firm – Accounting and Audit, Tax, Consulting
- Consulting Services for Entrepreneurs
- Over 40 years of focus on Small to Mid-Sized Businesses and their Owners

Working to Improve Your future, Not Just Account for the Past

A Client's Story

What is a Self Directed 401(k) Plan?

Based in the Internal Revenue Code (IRC) and Section 408(e) of ERISA, a self-directed 401(k) plan allows individuals to access retirement funds

TAX and PENALTY FREE

If they are being used to buy, start, or recapitalize an ***active*** business.

WHAT'S IT CALLED??

- DRDA provides the BORSA™ Plan

Business

Owner's

Retirement

Savings

Account

ROBS is also an acronym – Rollover as Business Start up – what the IRS calls it

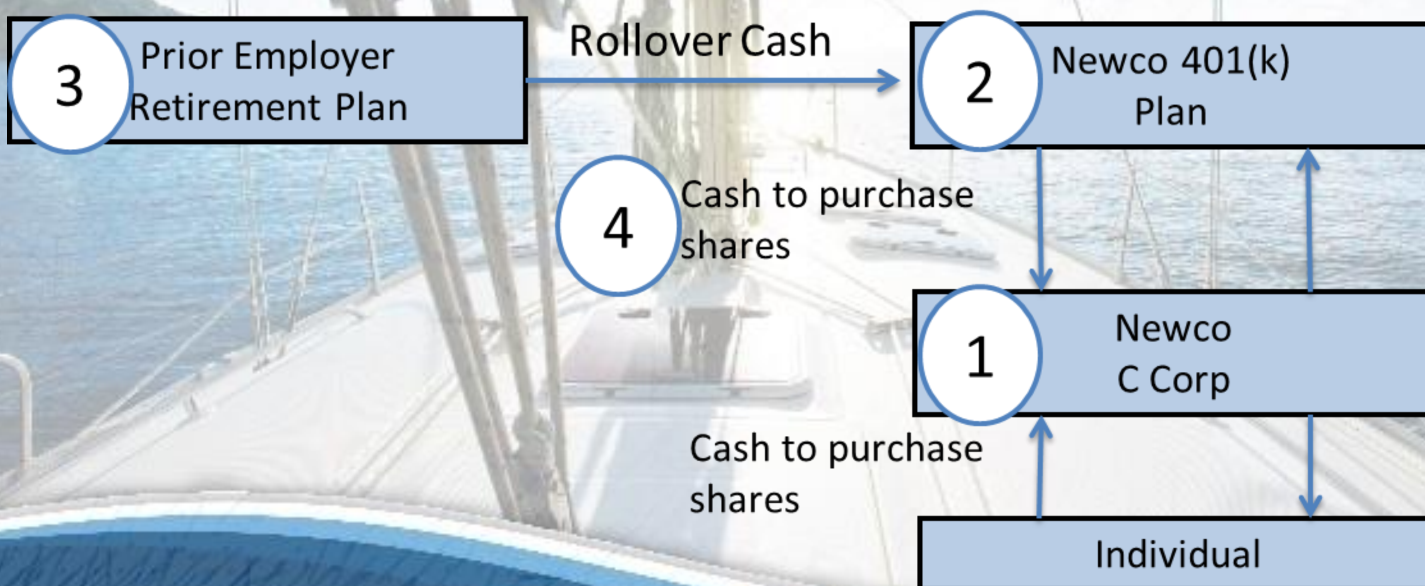
What Type of Funds Can Be Used?

A buyer can access funds from the following sources:

- 401(a)
- Pension
- Profit Sharing
- ESOP
- Annuities
- 401(k)
- 403(b) Teacher's Annuities
- 457 State, County & City
- Thrift Savings Plans
- IRAs – most all with the exception of ROTH IRA or Non-Spousal Inherited IRA

How it Works

1. Form a new c corp – Newco
2. Newco establishes a 401(k) Profit Sharing Plan
3. Existing retirement funds rolled over into new 401(k) Plan
4. Participant in 401(k) Plan invests in stock of Newco



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Meet Pizza Guy

- Pizza Guy has $95,000 in an old IRA
- Pizza Guy pays our fee of $5,000 personally
- He rolls $95,000 into his new 401(k) plan and then invests all $95,000 into his C Corp
- At that point the C Corp is worth $100,000 and has two shareholders:

  Shareholder #1: **Pizza Guy, Inc. 401(k) PSP fbo Pizza Guy 95%**
  Shareholder #2: **Pizza Guy Individually 5%**

Shareholder #1 owns 95% of the company representing the $95,000 that came thru the plan and Shareholder #2 owns 5% of the company representing the $5,000 that came from him.

Pizza Guy in Pictures

Pizza Guy's Old Retirement Plan = $95,000

Pizza Guy, Inc. 401(k) PSP fbo Pizza Guy = $95,000

Pizza Guy, Inc. = $100,000

Plan 95%
Guy 5%

Pizza Guy Individually = $5,000

If Using SBA Financing: Who Is the Borrower?

- Any shareholder of 20% or more must sign a personal guarantee
- As per the SOP when retirement funds are being used as a source of equity in an SBA loan the SBA recognizes that the plan cannot sign a personal guarantee.
- In lieu of that the person rolling the funds into the plan will sign his or her personal guarantee
- See SOP 50 10 (I) Subpart B, II Collateral B Guarantees item 5 pages 157 thru 158

The C Corp is your borrower and every shareholder of 20% or more must sign a personal guarantee which means anyone who rolls into the plan and their plan owns 20% or more of the company must sign a guarantee

Issues Related to EPC/OC Rules

The SOP goes on to state that when using retirement funds as a source of equity in an SBA loan the borrower cannot have the historic, traditional structure of:

Eligible Passive Company (EPC)/Operating Company (OC)

With the dirt and the building being the EPC and the active business the OC.

When using retirement funds in conjunction with SBA lending, the dirt, the building, and the business must all be contained within the C Corp.

Compliance Considerations

- **Fee** to establish structure must come from an individual(s)
- **Whoever** rolls into the plan must be a W2 employee of the C Corp and draw a salary
- **Whoever** rolls into the plan must continue to make regular, on-going contributions into the 401(k) plan for their personal future benefit
- **Business** Owner must maintain an Employee Census with the names, birthdate, SSN, hire date and termination date if applicable of all of their employees
- **Business** Owner must communicate the availability of the plan to eligible W2 employees
- **C Corp** must file Form 1120 with IRS annually
- **401(k)** must file Form 5500 with IRS annually
- **C Corp** must have an annual valuation
- **DRDA** Guarantee incentivizes the client to maintain compliance

Who Qualifies and What Can Roll?

Good Candidates for this vehicle are:

- People with PRIOR employer funds – they can't access 401k funds with their current employer.
- A minimum of $50,000 to roll
- A client can roll all or a portion or multiple plans without affecting the fee
- Several people can roll into the same plan

What It's NOT!

- A BORSA™ Plan is NOT a self-directed IRA
- You cannot own and operate a business through a self-directed IRA.
- The owner of a self-directed IRA cannot receive a salary or be involved in the management of a business.
- IRAs can be used but they must first roll into the 401(k) Plan.

What Does it Cost, How Long Does It Take?

- A BORSA Plan costs $4,995 for both entities turnkey
- Ultimately the cost of compliance will be $1,700 annually.
- The process takes 30 days from the client's engagement to funds in hand

How Does the Exit Work?

- Looking at Pizza Guy, his plan owns 95% of the company.
- A buyer offers him $1,000,000 for his business.
- If his structure is still intact it gives him the opportunity to tax defer 95% of those sales proceeds into his retirement vehicle
- He'll pay capital gains tax on the 5% that comes out to him individually.

Can He Exit Before He Sells?

- If the client desires he can exit this structure prior to the sale of his business.
- In order to do so, the 401(k) plan has to be bought out as a shareholder.
- Most clients will use post-tax dollars from the operation of the business to buy these shares away from the plan.
- Once the plan no longer owns stock in the C Corp the 401(k) funds can roll out into an IRA and the 401(k) plan dissolved.
- At that point the compliance considerations are eliminated and the entity type can be changed.

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