

"Rollovers as Business Start-Ups" mostly fail, IRS says

Preliminary results from the Rollovers as Business Start-Ups (ROBS) Compliance Project, initiated by the IRS's Employee Plans (EP) unit, indicate that most ROBS businesses either failed or were on the road to failure with high rates of bankruptcy, liens, and corporate dissolutions.

ROBS arrangements

ROBS is an arrangement in which prospective business owners use their retirement funds to pay for new business start-up costs. ROBS plans, while not considered an abusive tax avoidance transaction, are regarded by the IRS as "questionable" because they may solely benefit one individual - the individual who rolls over his or her existing retirement funds to the ROBS plan in a tax-free transaction. The ROBS plan then uses the rolled over assets to purchase the stock of the new business.

ROBS arrangements are aggressively marketed to prospective business owners. In many cases, the company will apply to the IRS for a favorable determination letter as a way to assure their clients that the IRS approves the ROBS arrangement. However, the IRS has cautioned that it issues a determination letter based on the plan's terms meeting Internal Revenue Code requirements. Determination letters "do not give plan sponsors protection from incorrectly applying the plan's terms or from operating the plan in a discriminatory manner," the IRS states.

ROBS compliance project

In 2009, the IRS's Employee Plans (EP) unit initiated a ROBS Compliance Project to define traits of compliant versus noncompliant ROBS plans and identify ROBS plans that are noncompliant and take action to correct them. Using compliance checks, EP initially focused on companies that sponsored a

plan and received a determination letter but failed to file a Form 5500 or 5500-EZ and/or a Form 1120 (U.S. Corporation Income Tax Return).

Preliminary results from the Compliance Project indicate that, "although there were a few success stories, most ROBS businesses either failed or were on the road to failure with high rates of bankruptcy (business and personal), liens (business and personal), and corporate dissolutions by individual Secretaries of State." According to the IRS, some of the individuals who started ROBS plans "lost not only the retirement assets they accumulated over many years, but also their dream of owning a business."

The IRS found that many ROBS sponsors did not understand that a qualified plan is a separate entity with its own set of requirements. Promoters incorrectly advised some sponsors they did not have an annual filing requirement because of a special exception in the Form 5500-EZ instructions. The exception applies when plan assets are less than a specified dollar amount and the plan covers only an individual, or an individual and his or her spouse, who wholly own a trade or business, whether incorporated or unincorporated. In a ROBS arrangement, however, the plan, through its company stock investments, rather than the individual, owns the trade or business. Therefore, this filing exception does not apply to a ROBS plan and the annual Form 5500 or 5500-EZ (5500-SF for filing electronically) is still required.

Source: IRS Retirement News for Employers, Fall 2010.