

RETIREMENT

How To Use Your 401(k) Funds To Start A Business

Chris Carosa Senior Contributor 

I help families/small businesses discover wealth-building strategies.

Follow

Nov 1, 2022, 01:26pm EDT

0 

Listen to article 7 minutes



GETTY

November is [National Entrepreneur Month](#). With [studies showing 30% of new businesses](#) are started by people above the age of 50, you might be wondering how they do it.

One of the biggest challenges entrepreneurs face, after coming up with their idea, involves financing that new business. If you've been working for some time, you've no doubt had the opportunity to set

aside some money to use for this purpose. On the other hand, that savings may not be enough.

You might consider looking for money from the usual sources: family, friends or your neighborhood bank.

But did you know there might be a source closer to home?

It's sitting right there in your 401(k) plan. This strategy is referred to as "Rollovers As Business Startups" or "ROBS." Despite the unfortunate acronym, there are circumstances where this strategy makes sense.

What is a ROBS?

You're already familiar with the fundamental aspect of it: rolling over your 401(k) from your old employer. There's a twist, though. Instead of investing in publicly traded companies, you use the money to invest in the private company you're about to start.

MORE FOR YOU

The Inside Story Of Papa John's Toxic Culture

E.T.'s New Home? Mechanical Alien Model From Spielberg Film Is Up For Sale

Georgia Congressman Used Donor Funds To Fight Subpoena Over Subverting Election

"ROBS are a marketing tool designed to allow individuals to leave corporate America and access their retirement plans to fund a new business or franchise," says Herman (Tommy) Thompson, Jr., a Financial Planner at Innovative Financial Group in Atlanta. "The idea is that instead of investing your retirement funds in publicly traded companies, you can use your retirement funds to purchase shares of your own company."

Investing Digest

Discover what's moving the financial markets and what smart money is buying.

Sign up

You may opt out any time. [Terms and Conditions](#) and [Privacy Policy](#).

Can I use ROBS to start a business?

If you're looking into starting a new business, a ROBS might be an attractive option.

“ROBS are unique 401(k) rollovers for an employee who has left their employer and would like to start a business,” says Ryan Shuchman, Investment Advisor Representative and Partner at Cornerstone Financial Services in Southfield, Michigan.

“Effectively, the 401(k) funds can be used as the startup capital for a new business or to acquire an existing business.”

There are specific rules you must follow if you're going to apply the ROBS strategy to your situation. This is where you may be entering uncharted territory.

“A ROBS is an arrangement in which prospective business owners use funds from their tax qualified plans to pay for new business start-ups,” says Marcia S. Wagner, Managing Member of The Wagner Law Group in Boston. “The ROBS plan then uses the rollover assets to purchase the stock of a new C-Corporation. That is, the taxpayer is rolling his or her funds over into a shell corporation in which no equity interests have been issued. The plan document permits 100 percent of the shares held in the rollover account to be used to acquire the stock of the corporation. These

plans then typically file for a favorable IRS determination letter, although such a letter is only a determination as to the language of the plan document. Although there are a number of potential pitfalls associated with ROBS transactions, the benefit is acquiring a new business without being subject to any income or excise taxes.”

Just because you may have already rolled over your retirement assets from your former employer doesn't mean you've missed this opportunity. ROBS funding can come from your IRA, too.

“The technique here is that a small business establishes a 401(k) plan and the owner rolls over a sum of money from another qualified source such as an IRA or previous employer plan and that cash, once in the plan, is used to buy stock in that same business,” says Jason Grantz, Managing Director at Integrated Pension Services in Highland Park, New Jersey. “The plan is now the ‘owner/custodian’ of the stock certificates and the owner has now gotten out the cash without taxes being applied to them. You'd use them as a form of cheap financing for a small business, and especially for owners who can't find or qualify for quality financing elsewhere.”

Is a ROBS a good idea?

Utilizing the ROBS options for financing a new business has several advantages. Remember, this is like buying any other stock in your retirement plan. It's not like taking a loan out of your 401(k) account. If you go through the hoops, you'll have access to your retirement funds tax free and without the requirement to pay interest.

“A ROBS can be a great way to fund your business without having to take on debt or give up equity in your company,” says Linda

Chavez, Founder & CEO at Seniors Life Insurance Finder in Los Angeles. “Essentially, a ROBS allows you to use your retirement savings to start or grow your business. There are a few requirements for using a ROBS. First, you must have a 401(k) or other eligible retirement plan. Second, your business must be a C-Corporation. Finally, you must use the funds from your retirement account to purchase stock in your company. Once you’ve met these requirements, you can roll over your retirement savings into your company’s 401(k) plan. This will allow you to take advantage of the tax benefits of a retirement account, while also using the funds to grow your business.”

What can a ROBS be used for?

The fact that a ROBS requires the creation of a C-Corporation means your new business won’t have the benefit of walking before you run. You will need to be familiar with all the reporting requirements this entails.

“No other business entity can use ROBS since it necessitates buying private stock,” says Hamza Usmani, Head of Content at Believe Money, in Karāchi, Sindh, Pakistan. “Work with a professional to make sure all the details are handled as corporations do require more paperwork to set up and manage than sole proprietorships or LLCs.”

Here’s another twist: what if your new company hires employees?

“In accordance with the ROBS framework, the company must also manage a retirement plan and make it accessible to all qualified employees,” says Tiffany Payne, Head Of Content at PharmacyOnline in Burnley, England. “This means that you may have to submit a form 5500 each year detailing the actions of the plan. The majority of ROBS providers can assist you with these

duties for a monthly cost but maintaining it correctly does take more time and work.”

The bottom-line is ROBS can be a viable financing alternative, but it will require a unit of work you may not be prepared for.

Follow me on [Twitter](#) or [LinkedIn](#). Check out my [website](#) or some of my other work [here](#).



Chris Carosa

Follow

Hamburger History Expert and Child IRA advocate, he's the author of the "The Parents Guide To... **Read More**

[Editorial Standards](#)

[Reprints & Permissions](#)

Join Our Conversation

One Community. Many Voices. Create a free account to share your thoughts. Read our community guidelines [here](#)

Commenting as **Guest**  [Log in](#) [Sign up](#)

Be the first to comment...