Using Your Retirement Savings to Start-Up a Business: Too Good To Be True?

There have been recent news articles discussing the use of retirement savings from a 401(k) Plan or personal IRA to finance the start of a small business. While the concept sounds like a good idea to seed the startup of a business, there are many complicated tax and legal rules that must be complied with in order to implement this strategy. In addition, the IRS is "looking at these types of transactions because they raise complex tax and benefit issues*". You need to understand the many disadvantages to using this approach.

**From an October 1, 2008 article in the New York Times titled "Betting Your Retirement on Your Start-Up" by David S. Joachim.*

This is how the plan is supposed to work:

- You will need to have a tax deferred account balance in a qualified retirement plan that allows rollovers when you retire or terminate employment.
- You would then need to set up a C Corporation for your new business. An S Corporation will not work.
- The newly established C-Corp would have to set up its own qualified pension plan (401(k) or profit sharing plan).
- You will then need to roll your retirement account into the new qualified plan. The plan would then purchase stock in the newly formed C-Corp.
- This money would then be deposited into the C-Corp's bank account and be available to use to establish the new business.

Sounds like a good idea, right! But wait . . . not so fast.

The biggest issue with using retirement money to fund a new business is an economic concern. Many new businesses fail or do not make a profit which would then jeopardize your retirement savings and income.

Also, what's the purchase price of the stock of this newly formed Corporation? Since the purchase price for the stock should be based on fair market value, it would be difficult to assign a value to a newly formed corporation. Overpaying for the stock could be viewed by the IRS as a prohibited transaction.

The IRS may also consider this to be an act of self-dealing which is also prohibited. If you decide to use your retirement money to start up your new business, you will be the sole owner of the stock, CEO/ President of the company, trustee of the qualified plan, sponsor of the qualified plan, participant of the plan, etc. This may be viewed as a prohibited transaction.

Lastly, the plan and the corporate bylaws have to be drafted or amended to allow for the plan to invest in Qualifying Employer Securities (stock). The plan, along with full disclosure of the intended investment, is then submitted to the IRS for an individualized favorable determination letter. This process can take a long time and is sure to raise questions with the IRS. This is an area of tax law that one would be well advised to tread carefully. You do not want to give the IRS a reason to question the plan.

Retirement Planning

Although this type of transaction may be technically feasible if properly set up, we strongly suggest that you steer away from this sort of venture. There are too many details that could go wrong. Betting your retirement savings in a very risky investment should be a concern unless you have significant resources outside of your retirement savings.

To explore other methods of financing your startup company, please consult with your Guardian financial representative, as well as your tax and legal advisor.

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

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Guardian Financial Representatives may call the Business Resource Center for Advanced Markets, at 1.800.871.7780, Option 3, Option 1, for additional information.

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